Max Financial Services Limited
Q1 FY20 Earnings Conference Call Transcript
August 06, 2019

Moderator: Ladies and gentlemen, good day and welcome to the Max Financial Services Limited Q1 FY20 Earnings Conference Call. I now like to hand the over the floor to Mr. Jatin Khanna – CFO from Max Financial Services Limited. Thank you and over to you, sir.

Jatin Khanna: Thank you. Good evening, ladies and gentlemen. Thank you for being part of Max Financial Service's earnings call. My name is Jatin Khanna, and I am the CFO of Max Financial Services. Before proceeding with the performance highlights, I would like to introduce my other colleagues who are with me on this call. I have with me Prashant Tripathy – MD and CEO of Max Life; and Amrit Singh – Head of Strategy for Max Life. I will first talk about the key highlights for Q1 FY20 and then briefly recap the strategic priorities outlined in the last few calls.

So, pleased to share that MFS Board has approved earlier today a preferential allotment to MSI, which is our JV partner in our life insurance business, Mitsui Sumitomo, against acquisition of substantial stake held by MSI in Max Life. MSI will be issued 21.45% stake in MFS at Rs. 421.67. In exchange, MFS will acquire 19.98% stake in Max Life from MSI at Rs. 80.89 per share. MFS also has a call option and MSI has a corresponding put to acquire residual 5.24% stake in Max Life at the same price. The transaction closure is subject to shareholders and regulatory approval. The main approvals which are required are from IRDA, Departure of Economic Affairs and CCI, if required, we are still examining it.

Now moving on to the quarterly results: Max Financial had a robust growth of about 11% in revenues to about Rs. 3,949 crore. Their consolidated PAT has grown 65% to Rs. 54 crore.

Moving on to Max Life: Max Life MCEV post dividend has grown by 22% to Rs. 9,314 crore. The operating MCEV has grown by about 15% which is in line with Q1 FY19. Due to sales seasonality and investments made in proprietary channels, the impact of cost overrun is higher for Q1. So, ROEV tends to be modest relative to full year. Our full year ROEV is expected to be in line with the historical trends.

Value of new business post overrun has grown by about 33% over Rs. 134 crore. And structural NBM pre-cost overruns have expanded by about 150 bps to 25%. And the post cost overrun NBM were also expanded 150 bps to 20% relative to same quarter last year. Max Life individual APE has grown at a strong 23% to Rs. 685 crore, with increased contribution from non-Participating products. Max Life has performed in line with industry growth of new sales by growing 23% in line with private insurance growth and it's maintained its market share at about 8.5%.

Our Bancassurance business has grown over 26%, predominantly with Axis Bank delivering 16% growth and YES Bank about 75% growth. We opened 18 new offices in Q1 FY20, our total offices have increased to about 345. Our proprietary channels have grown by about 16% YoY. You will see some slowdown here relative to our overall growth of 23%. But that's due to transient impact, caused by agency restructuring, driven by New York Life recommendation. So, really if we factor in July performance, because the first quarter was wherein, we were transitioning or making these changes, we were to factor a July performance. Year to date July proprietary channel has been pretty much growing in line with the overall growth of the company. And therefore, they have made up for whatever lost share in the first quarter within the month of July. So, there is no red flag on our trajectory of proprietary channel growing in line or faster than the rest of the business. So, we are on course the increase our proprietary channel share to about 35% which currently stands at about 33%.

Max Life agency channel in one of the few agency channels that delivered positive margin. And the profitability of proprietary channel is now better than non-proprietary channel, which is encouraging as to grow this channel sharply. Continue with a strong focus on digital, the e-commerce channel has also grown 49%. The individual protection phase has grown by about 23% year-on-year in line with the overall growth. However, group protection growth has been a modest at about 8%, which as you know, is not a core focus area any which ways.

GWP grew a strong 14% to Rs. 2,361 crore because of 12% growth in renewals to about Rs. 1,740 crore which essentially was led by a conservation ratio of 89%. Our 13 months persistency has improved by about 231 bps to over 86%, and our claims paid ratio again 96.8% in Q1 is pretty much at the market leading levels. The solvency surplus is at about Rs. 1,600 crore with a solvency ratio of about 225%. Our AUM as at June end stood at about Rs. 64,000 crore, growing at 18% year-on-year. Max Life is now the fourth largest asset manager of life insurance AUMs, and 8th largest brand including mutual fund retail AUMs. With participating AUM at about Rs. 34,000 crore, Max Life has highest participating AUM in the private industry. Max Life improved its ranking by eight places to 35th among Great Places to Work and was among top-20 BFSI places to work. Only life insurance company in top100 as per Great Place to Work Institute and Economic Times Study. So, we are very pleased to sort of report that our people focus remains razor sharp.

So, really to sum up on that count:

Max Financial Services continues on its trajectory of driving strong shareholder outcome whilst new strategic plan, with significant investments in proprietary channel, sustained efforts to deepen our bancassurance relationships, razor sharp focus on cost and improvement in product mix, we are progressing our aspiration over 25, 25, 25 target on EV, VNB and VNB margins over a next year in terms of the growth.

On that note, we will hand over to the moderator to open the floor for Q&A.

Moderator: The first question is from the line of Manoj Bahety from Carnelian Asset Management.

Manoj Bahety: I just wanted to understand the rationale behind this transaction, because MSI overall economic stake in the life insurance remains same. So, I just wanted to understand whether like we are simplifying the holdco and life insurance, two entities into one entity because now if I consider this, potential 5.24% remaining shareholding with MSI, the other shareholder which is outsider will be only Axis. So, if you can explain the rationale for this transaction in detail please.

Jatin Khanna: MSI invested in Max Life when a Max India which was the holding company used to be a multi-business conglomerate. Now today MFS's only business is Max Life. As you rightly said that there is a requirement for simplifying the structure and things like that, but that is for much later. But for now, MSI shares swap is essentially predicated on the fact that, because MFS is a sole business, so they get access to a listed company as opposed to being a unlisted company. So, that's their sort of critical thing which they achieved from this share swap.

Manoj Bahety: They will need liquidity only if they are planning an exit, or the other reason maybe like, because earlier the deal which was about to happen with HDFC Life it could not get through because of this complicated structure where a life insurance company cannot be merged with a non-life insurance company. So, out of these two things what is the main reason for this transaction?

Jatin Khanna: They are fully committed to this business. They are not looking at an exit. What this swap does is that they get swapped into a listed company. There is part of their shareholding which we will eventually acquire, we have about 12 months or so to make that acquisition. But essentially you are right that it simplifies the structure because then we have pretty much the entire shareholding with us other than, of course, for Axis Bank which has a 3% ownership. So, it does simplify the structure to that extent.

Manoj Bahety: Lastly, in fact, whether this current structure, like if I take the earlier thing which has stopped our transaction with HDFC Life, now if we own 100% of this life insurance, does this make things simpler? Like if that kind of transaction if it has to happen today, with this kind of transaction, with this kind of a structure, whether it will be more simple?

Jatin Khanna: So, I would say, yes or no. Yes, because the structure gets simplified. No, because there is no transaction currently with HDFC or any other life insurer for that matter.

Moderator: The next question is from the line of Prashant Pawar from Newbury Capital.

Prashant Pawar: Sir, just wanted an update with the arrangement with Axis Bank, just routine update, anything happening on that front for the Bancassurance tie-up or anything?

Jatin Khanna: So, our relationship currently secured till September 2021. So, this continues. If and when there is a conversation around extension of the relationship, of something crystallizes on that front, we will be more than happy to come and share. But at this stage, suffice to say, the partnership is till September 2021 and it continues strong, and it's firing well, as I spoke about in my initial comments.

Prashant Pawar: Okay, just a follow-up to the previous question. So, you were saying that there is no intention of any exit by MSI?

Jatin Khanna: No intention of any exit.

Moderator: The next question that is in the line of Dhaval Gada from DSP mutual fund.

Dhaval Gada: Just a couple of things. First is on the transaction that we are doing with Mitsui Sumitomo. So, just if you could explain the cash flow implications that will happen? And also, how are you going to fund the balance as takeaway for Max Life, given that we have obligation of acquiring Axis Bank's stake as well each year? And second is, you mentioned about a call option for MSI. So, what is the call and the duration of the call and put, if you could clarify that part?

Jatin Khanna: So, let me take the second question, because that in some sense will result into the answer to the first question. So, the put and call arrangement is almost a 12-month arrangement, wherein we have to acquire this ownership within the next 12 months. And by which time, and now I am getting into your second question, by which time we had few options we are working on, we could potentially have liquidity to take care of sort of acquisition of that stake. At this stage I can only say as much and not more, because, obviously, none of those options have been crystallized or finalized. As some of those get finalized, we will be happy to share more details.

Dhaval Gada: Okay, and sort of just one more aspect around this. So, what is the reason for doing a 20% stake and not more? I can understand beyond 25% it could trigger an open offer, but what was the reason of doing just 21.45% stake?

Jatin Khanna: See, this was also an opportunity for us to, in some sense, consolidate our ownership in the business and limit the dilution for shareholder. And after doing a lot of work, we thought its most optimal that we just swap to 20% to 21.5%. And the balance 5% we can acquire, for which we can manage through our own resources.

Dhaval Gada: Okay. Understood. And any thoughts around how we want to sort of remunerate Axis going forward, in terms of when the contract comes for renewal in 2021? Does this in any way positively or negatively impact our there is basically no implication per se to that? I mean, does it anyway help or doesn't help in any sense?

Jatin Khanna: It is a little bit sort of a speculative question, because the renewal is due in September 2021. So, I don't know if I can answer that question for you today, that how will this thing impact our Axis arrangements or not. So, let something happen there and then we will be happy to share more details.

Dhaval Gada: Okay. And Just one more question on the margins and VNB growth. So, the growth has been pretty strong. And so just some comments around how for the rest of the year the margin trajectory is likely to sort of move? And some comments around, metrics around the agency channel and direct channel in terms of kind of potential that they are sort of building over the next 12 to 24 months in terms of their share in the overall distribution and how that could help on the margins?

Prashant Tripathy: I think the overall traction on margin is on the predictable trajectory, the guidance that we had given. And I expect that when we finish the year on a net of overrun basis, we should come closer to 21-22%, that's where we should land up. In terms of overall agency performance, we are very pleased with the progress that we are making in agency earlier, it was communicated that we were going to work with New York Life, three of the top retired agency folks to come and work with us. In the first quarter we rolled out most of the recommendations which were given, predominantly around building an agency which is sustainable, enlarging the pool of high productive or highly productive agents, looking at our entire training and skilling methodology, and looking at the overall sales processes. So, we have taken those initiatives in quarter one. And very happy to report that four months, which is including July, agency is growing quite well. It is upwards of about 20% growth that we have seen. As a result, our own proprietary channels are closer to 30% growth. These numbers are a bit higher than the first three months because we have started to see a turnaround in agency or higher growth in agency.

And as we finish the first four months, as a result of that our growth appears quite robust. We are close to about 30% growth as against 23%, which was for the first three months. So, the business is doing well, it is on the predictable trajectory that the way we had described. And the margin seems to be holding on. This is the first year of full investment in agency. As you may remember, through last year we were making investments, we were opening offices in starting quarter two. So, in a sense, this is the first year of full investment or near full investment that we had made in agency. And as a result of this, we will start to see the benefit of this going forward as we progress from this year to the next year.

Moderator: The next question is from the line of Madhukar Ladha from HDFC Securities.

Madhukar Ladha: Any update on the promoter pledges? I don't think there has been any reduction on that, and is this deal being done also to kind of provide an exit to the promoters or some partial exit to promoters?

Jatin Khanna: Well, not really. Because, frankly, like one of your friends asked the question that MSI is at 21.5%, they could have been at 25%. So, there is hardly headroom for MSI there, frankly, to help our promoters at any level in terms of monetization or not. So, therefore, clearly this has no linkage with the promoters, I must say so. Secondly, on your question around the pledges, I think we had spoken about sort of multiple steps through which the pledge will get addressed. The first step of that, which is the transaction around Max Healthcare wherein there was some advance which has come, it has reduced the pledge about 500 bps from the levels it used to be. And there are sort of more monetization events which are planned over the course of next, I would say, 9 to 12 months, which will further help him sort of bring down the pledge levels. So, they are working on a plan, and their plan is being implemented one after the other. There is something more which is happening on the monetization front I think in the current quarter itself. So, one after the other I think slowly and gradually the plan is to bring down the pledge levels over the next 12 months.

Madhukar Ladha: Can you comment on where the promoters have invested and whether they are being able to service those debts adequately right now?

Jatin Khanna: So, there were broadly I think two areas wherein they invested. The first investment was around consolidating their shareholding from about 30% to about 40% of which only 10% in MFS has been monetized, but the rest of it in Max India and Max Venture continues. So, that was one predominant reason. The second reason was that they made certain investments in the hospitality space internationally, that was the second big reason why these pledges were created. And what I can confirm to you is that at this stage there is no default on any of their borrowing. So, to that extent interest servicing or whatever, repayments, as and when they fall due, are all being made on time. As per the last information which I have, of course, we don't run these things for promoter, so one wouldn't know.

Madhukar Ladha: Got it. And my final question more on the business side. So, you are seeing a good increase in non-PAR savings products. Can you talk a little bit about which are these products and are these the deferred annuity and deferred pension products that some of your competitors are selling, one of your competitors mainly selling?

Prashant Tripathy: So, yes, we have seen increase in proportion of non-PAR savings design, and these are not deferred annuity designs, these are short-term interest rate guarantee designs, 5 pay, or 10 years contract period. We actually prefer that because the duration is small. It is a tactical play for us like we have always said that we would like to be in the range of about 15% odd, and overall non-PAR mix including protection could go up to 25%. That's the zone that we will operate in. Overall, it was an attempt to optimize the margin with the growth. But would like to clarify one or two things, We prefer non-PAR savings only if it is hedged, so we are not taking positions which are unhedged. There is going to be limitation in terms of how much we like to sell. Historically, we have always been in and around between 10% and 20% and we would like to maintain that share. So, your observation is correct. However, I would like to clarify that this is not going to be the major driver of our growth in our three-year strategy.

Madhukar Ladha: Understood. And, any change in thought process on group protection, other companies are growing extremely rapidly on that side. But that doesn't seem to be the case for us.

Prashant Tripathy: Yes, like I have always mentioned, we are an individual player, our credit life portfolio is more tactical. And while we are growing, I must highlight that some of our partners have seen real struggle because of NBFC crisis which is going on. On a more steady state basis I would like to see a growth of about 20--25%. So, that's our stated philosophy and I think we will adhere to that. When we talk about 25% growth or 25% margin etc., you should take predominantly individual business being the main driver of it.

Moderator: The next question is in the line of Ajox Frederick from B&K Securities.

Ajox Frederick: Sir, my question is with respect to the protection growth again. On the retail side also we haven't grown as much as the competition for the quarter. Is there any specific reason to it or we seeing a structural growth at these levels, 14% odd levels on the individual APE protection?

Amrit Singh: Actually protection, we have shared in our disclosures earlier, the large part of protection selling happens to the proprietary channel. And Prashant did mention about the structural weakness that we kind of witnessed there. So, there was a bit of a slowdown there. But there is a new product which has got launched and in the month of July, the uptake is positive. We continue to see significant volumes on number of policies being sold, but there was a case size stress which kind of led to a muted growth this quarter. But as we, kind of look forward in the quarter ahead, we do see the trend reversal happening again here. And our July performance has been strong, the numbers again in protection are also strong.

Prashant Tripathy: So, basically there was a movement from regular premium to limited to a pay-product design. And unfortunately for the first two months of the quarter we didn't have a limited pay product which we launched somewhere at the end of May. So, we just had one month of limited pay. As limited pay becomes larger proportion of our kitty, you will start to see increase and we are hoping that we will be aligned to market kind of growth rate or even better.

Ajox Frederick: Okay. And my next question is with respect to the changes on CRNHR. So, we have always had a higher ratio, so what is the rationale for bringing it down, and even now we are not as low as the competition. So, what is that adjustment happening there?

Prashant Tripathy: So, basically it was on the basis of review, we had to align to two things. One, on the economic capital what kind of discount rate do you apply, and we kind of look at the equity returns over the risk-free rate and to us that was in the range of 3.5% to 5% is what the range is. So, 5% is indeed on the high end. Also, we noticed that most of our competition is in the range of about 3% to 4%. So, we just thought it will make sense to true up to two realities, one, the access over risk free on equity basis, and more aligned to where the market consistent practices are and that's why we reduced from 5% to 4%.

Ajox Frederick: And does this CRNHR depend on the mix by any way or this is more like alignment?

Prashant Tripathy: Yes, unfortunately, there is no straight science to it and there are no guidelines or recommendations around it. One could debate however there is another line where you have to put the cost of guarantees etc. So, between the two we like to cover. This is not like hugely scientific where you could arrive at a number. This is on the basis of the judgment that one applies. And we find that the 4% is reasonably conservative from our perspective.

AjoxFrederick: Sir, and on the expense ratio there was a slight uptick to this. And this time our margins expanded primarily because of this realignment to CRNHR. So, what was the impact of margins due to the expense ratio burn out?

Prashant Tripathy: Yes. So, let me clarify, the expense ratios have gone up and rightfully so, that's as expected. We have opened in last year close to about 135 new offices because we believe that we would like to expand our own channels and that's been a part of the strategy. Now, first quarter last year we had hardly made any investment, the investment actually happened through second quarter until now. So, this indeed is the first quarter where the entire base has been upgraded in terms of total expenses of new channels coming on Board. And that is why on quarter-on-quarter you will see an increase, and that is as per the budget that we had planned. Now, as our own channels start to fire and they are growing as per the expectation, we will start to see the scale advantage and some of these ratios will get settled. My sense is that, somewhere around the next year we will find the ratios to be tapering down significantly.

Moderator: The next question is from the line of Neeraj Toshniwal from Emkay Global.

Neeraj Toshniwal: Just wanted some color on this deal, if you can just explain more on that. I mean, I think there is no real money coming in but there is dilution on the table. So, what is it exactly we are looking at and how we are structuring it, I mean probably over the next 12 months what is the plan?

Jatin Khanna: Firstly, there is no dilution because as opposed to owning directly in Max Life so now what will happen, at the end of this transaction the ownership of Max Financial in Max Life will go to 91.77% once the swap is done. So, therefore, to that extent there is no dilution per se. If at all, this gives us an opportunity to over the next 12 months acquire whatever residual 5.24% ownership of MSI at the price which is getting frozen today at Rs. 80.89 per share of Max life, which is essentially a price which is broadly linked to the Max Financial share price.

Neeraj Toshniwal: Sorry to cut you down, but the dilution I think is more in Max Financials side, because I think you have mentioned from the fresh issue of shares you will be doing that.

Jatin Khanna: Our ownership in Max Life will increase from 71.79% to 91.77%. So, to that extent we are also… our ownership of Max Life is going up by 20% also. So, our shareholders are not getting diluted at all, it's just a swap.

Neeraj Toshniwal: But on the base of Max Financial definitely we will have a dilution, right?

Jatin Khanna: But it doesn't matter, because Max Financial and Max Life are not different. The only business which Max Financial owns is Max Life.

Neeraj Toshniwal: So, are we looking at dissolving this structure by anytime soon? I mean, because we are doing this and probably, we will have a larger control on Max Life. So, are you looking at dissolving the structure and probably list Max Life individually?

Jatin Khanna: See, at some stage we have been on record to say we have to ultimately sort of simplify this structure. We are not ready at this stage. I cannot commit to any timeline also. But, what I can tell you is that at some stage we will simplify this structure.

Neeraj Toshniwal: Okay. On the business side, the VNB margin walkdown, of you can explain. So, you have mentioned that the positive impact came from the change in the cost of capital in CRNHRs and from the effective tax rate. But there is some gap, I think this is due to leakage coming from the operating expenses if you can just give the walkdown in terms of what is supporting and how much is coming from the change in product mix, movement of margin of 150 basis points?

Prashant Tripathy: So, 19.6% we have to adjust for the non-hedgeable risk part that will be aligned to what we achieved last year actually. And your observation is correct, there is a bit of tax but that tax is actually real, we got the ruling last year in our favor after which we had done the math. So, if you were to really adjust for that, the number will be somewhere between 17-18%, it is a tad lower. But like we had mentioned last year also, our business is quite seasonal, and hence the first quarter margins are not representative of the full year margin. My anticipation, like I have mentioned to you, when we finish the full year we should land up somewhere between 21% and 22%.

Neeraj Toshniwal: So, the impact of interest rate coming to sensitivity in terms of, because we are a lot more traditional heavy and with the fall in the yield how we are factoring any change in sensitivity of that? Because largely we restricted ULIP at 40-45%, so any impact coming from that in terms of margins?

Prashant Tripathy: So, there might be a bit of margin upside, but that margin also as per plan is getting absorbed by the additional expenses that we are incurring by opening so many new offices.

Neeraj Toshniwal: I am asking about in terms of interest rates

Prashant Tripathy: So, the interest rate sensitivity is not very high, like I mentioned to you. And the interest rate sensitivity table actually demonstrates the sensitivity of the book. But we have always mentioned that we prefer the non-PAR savings book which is fully hedged. So, as we speak we are perhaps the only players in the industry who have a very active interest rate swaps program, and just about everything is hedged. And about 90% of what we have written is short duration 5 pay 10-year contract. And with the help of interest rate swaps, we are very effectively able to hedge a book for 10 years. So, overall, hence the sensitivity goes down, though there is a cost of hedge which is already baked into the margins that we declare and it is already priced for.

Neeraj Toshniwal: Okay. And on the last question, I think the surrenders also increased a lot. You have mentioned 6% coming from ULIP discontinuance, what does that, I mean any particular reason?

Prashant Tripathy: Yes. There are two kinds of surrenders, customer-initiated surrender and company initiated surrenders. So, customer-initiated surrender in terms of number of policies being surrendered is exactly the same. So, let me explain then why this ratio goes up. There is company-initiated surrender, as per law, people when they stop making payments in the first five years of the ULIP, you are not meant to refund that money, you actually park it into a discontinuous fund and you actually return it only after five years. So, we started writing the new book which is as per this regulation about six, seven years ago, so that book has become a bit larger of people who decided not to pay and it was parked in discontinuance fund, we returned that money. So, that is a very significant part. The other trend that we saw, and hopefully that should subside is, people who are surrendering their overall fund size was a bit higher than how it was last year. Because of which the surrender appears a bit lower, both of them are not out of expectation, it's a business reality and a part of the commercial progress that the business is meant to be.

Neeraj Toshniwal: Okay. So, it will probably come down in the future you are saying, I mean, from the current level?

Prashant Tripathy: It depends on the aging of the book and what is parked in discontinuance fund.

Neeraj Toshniwal: Any guidance? I mean, any number you are looking at?

Prashant Tripathy: Similar numbers perhaps.

Jatin Khanna: Prashant, correct me if I am wrong. But directionally because or persistency moving up towards the 61st month, then this as a percentage has to come down over a period of time.

Prashant Tripathy: Yes, the discontinuance fund is not counted as a part of persistency. So, whatever has gone in discontinuance fund has already lapsed as per our record. Why don't I come back to you, if you could send me an email, because I will have to go and kind of read on the book, I can come by with a forecast. But my sense is in the range of 30%- on the base of Q1.

Neeraj Toshniwal: Okay. And this investment write-off on DHFL or anything, YES Bank we have done anything in this quarter or anything we have cleaned off the book?

Prashant Tripathy: On DHFL we have taken the impairment of about 40%, by July we have taken about 40% in the books and that is gone and it was all in ULIP. On the investment that we have on YES Bank, it will just continue as it is because I think in the ULIP book where we have the investment, we have done mark-to-market with the revision in the credit rating. But the other part of the portfolio we will hold to maturity and we are just continuing with it.

Neeraj Toshniwal: So, on DHFL you said 40% by July and 25% by Q1, is it right?

Prashant Tripathy: Yes.

Neeraj Toshniwal: Okay. And any impact on change of norms from IRDA, mean, the increase in surrender rate because we are PAR heavy book, so any impact on margin?

Prashant Tripathy: No, negligible really. Actually, we already had a month's significant surrender scale compared to all the competition, maybe 20 bps or something like that, which we will figure out a way of covering. So, while there is a lot of administrative work that we are doing, but in terms of impact to overall financial because of new product guidelines is negligible on us.

Moderator: The next question is from the line of Pradik Poddar from Reliance Nippon Asset Management.

Pradik Poddar: Sir, you talked about in the 12 months even buying out the remaining stake of MSI, that's the correct understanding?

Jatin Khanna: Yes, we have a call optional and we have a put option, of course, 12 months can be advanced or pushed out on a mutual agreement.

Pradik Poddar: And sir once this happens, it's fair to say that the structure will then be collapsed? Because there is no rational, right, for keeping this once Sumitomo is directly in the listed company. That's one question. And second is, what did the Board deliberate on? Why was this right now taken and what is the rationale for Sumitomo wanting a stake in the listed company and no longer in the life insurance company? I was not a bit clear on that. What was deliberated in the Board meeting, could you just talk a bit about that and why was this approved? Thanks.

Jatin Khanna: So, let me first answer your first question, which is the eventual collapse of the structure, I think I have addressed that question saying that that is eventually the sort of thought process. The timeline of that I cannot comment on at this stage. So, therefore, I will sort of park that question till such time we are finalized on the timelines and things like that. Now on the structure of the Mitsui Sumitomo, sort of swap, I think two things there, firstly obviously from their perspective they get into a listed company. So, that was obviously motivation from their side. The motivation from our side is that we have the opportunity today to consolidate more ownership in the sense that to acquire this 5% stake over the next 12 months with a price frozen today, therefore, really the opportunity for us is to be able to enhance that overall ownership of Max Life, for which we will have option through which we will be able to generate adequate funds. And like I said earlier, leave this with us for a while, we will come back to you with what those options are once they are in some shape. But clearly the incentive for us is that it helps us consolidate part of our ownership in Max Life. So, it works both ways. And therefore, Board has approved this transaction.

Pradik Poddar: And sir, just one operational question. When you talk about the guidance on VNB margins of 21%, 22%, that is assuming assumption changes and effective tax rate, right?

Prashant Tripathy: Yes. That's correct. I mean, sitting today we are just done with Q1 and how things look like. You may notice that our structural margins are closer to 25%. The objective of the business will be to minimize overruns as much as possible. So, conservatively speaking, we should be in the range of 21%, 22%.

Moderator: The question is from the line of Sanketh Godha from Spark Capital.

Sanketh Godha: Just wanted to understand, when we buy back the 1% stake every year from Axis Bank, I believe Mitsui Sumitomo buying back 0.26 percentage and 0.74 percentage Max Financial Services. So, with the current deal, how that structure, means, that contact still remaining intact or there are changes with respect to the structure also?

Jatin Khanna: Now that Mitsui Sumitomo practically exits Max Life and becomes a Max Financial shareholder, therefore, their share in the obligation with Max Financial had to buy back from Axis and Max Financial, in turn, shared the obligation which MSI has to buy back from Axis. So, in some sense, all those obligations then move into Max Financial.

Sanketh Godha: So, basically, it's Max Financial ultimately buying an entire 1% stake whenever Axis comes and sells it to you back?

Jatin Khanna: Correct.

Sanketh Godha: Yes. Okay. And just one more thing. Just for my understanding, if it's right. If I don't take that assumption, changes of 250 basis points, then the margins for the current quarter would have been lower than what we have reported in the last quarter, right?

Prashant Tripathy: Yes. Adjusted for those two changes. However, I am must highlight that it is only internal comparison. When you make the comparison with respect to other players, it is apple-to-apple.

Amrit singh: And also I think there is a bit of assumption in the market where people take a view of cost on a full year basis, whereas we actually report the actual cost of quarter one and the ratio kinds of starts improving as the year builds up, because the sales in this quarter is less than 20%. And as the year progresses, that kind of changes.

Prashant Tripathy: When, historically, for last many years, Sanketh, on a full year basis the delta between our structural margins and our net overrun margin ranges less than 100 basis points. However, in quarter one you would find that the structural margin was closer to 25%, and we are reporting a 19.6%. Which is only states that we didn't do any smoothening in terms of giving a forecast on margins. However, as the year progresses, quarter one being the smallest quarter where total sales is actually is less than 20% of the full year sales, as the business starts to see the seasonality and grows the overall overrun as a percentage of total actually falls drastically, and hence on a conservative basis I am saying, we should land up between 21% and 22%.

Sanketh Godha: Yes. The reason why I am asking this question is because the contribution of non-PAR savings, which is pursued to be having margins better than overall margins has increased and even protection has remained the way it was in the Q1 of last year. Sir, so net despite assumption changes, I mean, if I have not incorporated assumption changes the margin should ideally would have expanded. So, basically, the prop channel has not grown to the extent because of the transient nature. Is it the major reason why the margins have not expanded? Because of this product...

Prashant Tripathy: Yes. Your observation is absolutely correct. For example, end of July, and like I mentioned to you, for the month of July the prop channels are growing upwards of around 59%. If I were to add that, all the numbers would start to look good. But your observation is correct, in quarter one the prop channels were undergoing the changes because of which there were bigger drag on overruns. So, that will settle down as we go along. So, on a completely apple-to-apple internal comparison basis, our margins are a tad lower than how they were last year. It is aligned to the budgeting exercise that we do internally, because that has an implication of all the investment that the business has done. And hence, the long-term forecast as well as the forecast for the year remains intact.

Sanketh Godha: Okay. And just on EV. The EV growth is around 22%, but ROEV is around 15%. So, when the operating ROEV which we report 15%, does it include the assumption changes what we have made with respect to tax and also the capital charge on CRNHR, right?

Prashant Tripathy: Absolutely.

Sanketh Godha: Okay. Perfect. And just one small question to Jatin. I mean, when we started the year, you said that the holding company expenses probably will fall to Rs. 50 to Rs. 60 crore for the full year. But if I look at the quarter, the net holding company cost is still around Rs. 20 crore. So, if I annualize it, it is closer to Rs. 80 crore. So, do we see a trajectory moving to around Rs. 60 crore for the full year or we would be running with Rs. 80 crore to Rs. 100 crore kind of it was for the full year of FY20?

Jatin Khanna: So, your question is right. I think there is also a severance payout in this quarter because of the cost rationalization initiative, which has pretty much resulted in this quarter's expenses being a little higher. And so on a normalized basis you will find it on a Rs. 55 crore, I know we had discussed Rs. 55 crore, but that Rs. 55 crore plus/minus Rs. 5 crore range on an annualized basis.

Sanketh Godha: Okay. So, basically, we would end up at around Rs. 60-odd crore for the full year, right?

Jatin Khanna: Well, Rs. 55 crore is where my sense is, but it could be plus/minus Rs. 5 crore. So, it could be a bit lower or higher.

Sanketh Godha: Okay. And just last one question, on the hedging strategy, whether we are basically hedging it with partial paid debenture or it's more through swaps? And if it's swaps, then after hedging cost whether the structural VNB margins on non-PAR savings products would be closer to our structural VNB margins or lower than our structural VNB margins? Just the indication.

Prashant Tripathy: So, the interest rate swap is what we use. We don't use partial paid debentures because what comes along with that is also come to the credit risk. Considering the current circumstance, we want to use such mechanisms only as ancillary or peripheral mechanisms to hedge. Our core strategy so far has been interest rate swaps. We were also quite keen to do FRA, but RBI has not allowed it. So, in the industry, I think we will be the only players, or one of the very few players who is using interest rate swaps quite successfully ever since we started to sell non-PAR savings designs. The cost of doing the hedging is already built in the structural margin as well as net margin. So, we look at margin only, net of expenses on swaps.

Sanketh Godha: Yes. I understand that point, but just wanted to understand whether after the cost of hedging the margins of non-PAR savings is overall margin accretive for the company or it remains flat?

Prashant Tripathy: Absolutely margin accretive, otherwise why will we be writing this product. The other thing that I would like to highlight is and considering that there's a lot being discussed now in market regarding the non-PAR design, our stance is very conservative with respect to the guarantees that we offer. We always validate the returns not just from MCEV perspective but also with respect to the traditional margin computation perspective as well as IRR. And these numbers are quite sensitive with respect to where the earned interest rate is and what is the level of guarantee, we are generally quite conservative about it. So, that it is accretive not just on an MCEV basis, but also on top-down embedded value methodology as well as IRR perspective.

Sanketh Godha: Can you just tell us what are the typical IRRs offered on five pay 10-year payout?

Prashant Tripathy: To the customers?

Sanketh Godha: Yes. To the customer, I mean to say.

Prashant Tripathy: That is anywhere between 5% to 5.5%.

Amrit Singh: Those are just a month old. The revenues have been coming down, these numbers is falling down.

Prashant Tripathy: Yes. They are always revised upwards or downwards depending on what is interest rate.

Sanketh Godha: So, have you revised it after we have introduced it any time in near future, near history I mean to say?

Prashant Tripathy: Ever since the interest rates have fallen drastically, we are just looking at making the changes, because that's about a month-old phenomenon.

Moderator: The next question is from the line of Nidesh Jain from Investec.

Nidesh Jain: So, firstly on the change in shareholding. Will there be change in Board composition at Max Life and Max Financial Services level also? And just wanted to know, just a curiosity, who initiated this initiative of change in shareholding? Was it from a Max Financial Services perspective or Mitsui Sumitomo was more keen to get a stake in the listed entity?

Jatin Khanna: So, your first question on the Board side, as Mitsui Sumitomo comes on the Max Financial Board, therefore, they will have a Board seat at a Max Financial level. As always till such time they have ownership at Max Life level, they will have a Board seat at Max Life level also. So, therefore, to that extent… but obviously, from a governance standpoint, the governance will mostly largely move to a Max Financial level and will become lighter at the Max Life level. The second is that I think just to me who initiated this conversation is less important, but I think what's more important is to say that we had a mutual win-win in this, because it allows us to, like I said, consolidate our shareholding. And it also helps them to be as a listed company. So, it works well for both.

Nidesh Jain: Yes. And you are saying that definitely Mitsui Sumitomo is not exiting their investment at Max Financial Services?

Jatin Khanna: No, their existence in the company continues, absolutely.

Nidesh Jain: Sure. And secondly on the Max Life performance, did you mention in the opening remarks that the profitability of proprietary channel has become more profitable than Bancassurance channel on margin basis or was there a comment on that?

Prashant Tripathy: Yes. I mean, if I were to look at the overall margin for last years, the proprietary channel consolidated margin net overall is comparable or slightly better than banca channels. And as we move along, one of the best that we have is, we start to grow our own channels, a bit faster than how the third-party channels are growing, and all the scale advantage or economy advantage will accrue to our proprietary channels because of which I am hoping that in three years' time the margins of proprietary channels will be significantly better than third-party channels. And that is one of the key drivers of our 25-25-25 strategy.

Nidesh Jain: Sure, sir. And then just one clarification, when we are saying margins, we are saying net of cost overrun or...?

Prashant Tripathy: In all cases, net overrun.

Moderator: The next question is from the line of Harshit Toshniwal from Jefferies Group.

Harshit Toshniwal: Sir, a couple of questions. First, on the CRNHR assumption change. So, largely I want to understand that, is there any way of ensuring consistency in standards for these kind of rates within players or do we need to get this vouched or audited at intervals? Because as you rightly said that you maintain a buffer of 4% versus 5% earlier, and even currently industry maintains that buffer of 2.5%, 3%. So, what is the rationale for changes in CRNHR at this offering?

Prashant Tripathy: The rationale, like I mentioned to you, there are two data points that we continue to review, which is the equity delta that you will expect. I mentioned to you the reason of 3.5% up to 5%. Now these are risks that you take with respect to business, and we are sure of our assumptions. So, I won't go to the higher end of 5%, it has to be perhaps towards the lower end, and we have chosen a number of 4%. And we think, because these are implications, analysts like you compare our numbers, and we believe that the 4% is as dependable as 5% was we had chosen to be at 4%, I think there's no guidance around it. These are calls that actuarial folks make looking at the business and the dynamics, and the kind of sensitivities do exist with respect to different assumptions. And with the robust assumption methodology and positive variances that we see with respect to our operating assumptions, the appointed actuary was quite comfortable to go with 4%. That's really the rationale. Broadly speaking, these are two reasons, one, to align it with broader set, come closer; and looking at the risk profile and adjusting equity delta.

Harshit Toshniwal: Okay. And one more thing, it's more about curiosity on this transaction which we have done. So, we have done 20%, I understand this is a transaction beneficial to both you and MSI. What was the reason to hold back on the 5% shareholding?

Jatin Khanna: Like I said, from our perspective we had an opportunity to consolidate, we did not want a situation wherein we don't make most out of the opportunity wherein they are swapping as part of the shareholding at the Max Financial level. So, we have locked-in this 5% at our current share price to be acquired over a 12-month period. We have option sort of to fund that acquisitions, which are currently being worked upon. As some of those get finalized, we will share those options with you. So, that's the summary of what I said earlier.

Moderator: The next question is from the line of Adarsh Parasrampuria. from Nomura.

Adarsh Parasrampuria : Jatin, the question is again on the structure. Just wanted to understand, once you have done this, versus doing any deal, for example, either be it a merger or selling or getting in a partner at whatever level like a company or a holding company. What are the pro and cons of what you have done in terms of the structure, right? Earlier what was not possible, is it possible now, anything like this is step one and there could be step two or three? So, I just wanted to understand with the changes done, does that any consequences materially change on either a merger possibility or a partner coming in? Does that materially change, what you can structure now?

Jatin Khanna: Well I think I sort of addressed this question previously wherein I said that the simplification of structure will open up more options than relative to the current structure. So, therefore, really the attempt is to see if we can obviously simplify in this whole process of simplification, consolidate part of our shareholding, so that we get benefited eventually. So, that's the whole theme off this transaction.

Adarsh Parasrampuria: And any time line of like collapsing the structure? Like I know 12 months is the period you have to buy out, but any time period that you would collapse the holding company and the life company?

Jatin Khanna: Adarsh, apologies, I can't answer that question at this stage because we don't have a time line at this stage, I mean, to be very honest. But the eventual game plan as we have sort of discussed previously also and on this call or previous occasions, eventually the idea is to really simplify the structure and not have a holding company maybe at some stage. But putting a timeline on something like that till such time we have sort of fully worked out plan, will be I think a little premature.

Moderator: The next question is from the line of Amit Jain from Samsung Asset Management.

Amit Jain: Just wanted to understand the sort of structure again. The way I understand this is, 75% of MSI stakes we sort of get to keep and 25% is effectively being acquired by Max Financial Services. Any reason why the ratio was worked out, was this part of an earlier transaction sort of when they came in or was this negotiated this time and they got a chance to flip up? I mean, can you sort of talk through that?

Jatin Khanna: So, it's an 80:20 and not a 75:25 because off the 25%, 20% is being acquired and 5% has been left behind, acquired through the swap essentially.. This was not a part of any preconceived arrangement because at that stage Max India was a consolidated entity, so there was no way that we could have flipped the life insurers' ownership into a conglomerate. So, therefore all of what we have done has been done here and now. Of course, we workshopped over the last few weeks but it's not a here and now story.

Amit Jain: Sure. Understand. And second, maybe I missed this clearly, but in terms of when you talk through the margins and you look at sort of the changes that were made in this particular quarter, why were the margins still down QoQ despite having a better mix, is that your protection being lower or there is something more to it?

Amrit Singh: You are right that the margins actually adjusting for the CRN HR change and the effective tax rate change is lower than what it was last quarter. It's primarily because of the first quarter slowdown of proprietary that we witnessed, which I think in July stands now corrected. So, that, along with the fact that this was a quarter of the full cost kind of coming in through with respect to run rate of the investment of last year has impacted the margins. But as we mentioned, the July numbers are back on track, proprietary channels are now YTD July growing in the range of around 30%.

Jatin khanna: I think it is important here to understand that there was a little bit of a transition we have done in our agency, from the how it used to be run versus some of the recommendations which came out of the New York Life study. So, which is only a temporary effect. And therefore, if you look at our performance not on a YTD June basis, but on a YTD July basis, we are pretty much doing as we have been doing over the last full year, wherein proprietary channels are growing very sharply and the contribution on a YTD July basis is pretty much evened out. But if this pace of growth continues in August, September, etc., then this whole equation of proprietary channels outperforming the non-proprietary channels and their contribution going up in line with our articulated strategy of saying that we want to take that share to about 35% will then play out.

Moderator: The next question is from the line of Sanketh Godha from Spark Capital.

Sanketh Godha: Yes, just one clarification with the transaction. Sir, that 5.24% stake which would be bought back, it will happen again as a swap deal or it could be a cash consideration at that point of time? Because the value comes to around Rs. 813 crore, so that Rs. 813 crore would be funded through swap itself or there would be some other way of doing it?

Jatin Khanna: So, if you look at the announcement carefully, the balance by 5.24% is meant to be a cash transaction, wherein we will acquire that 5.24% for cash.

Sanketh Godha: But at the holding company level, means, the source of income is just the dividend income from Max Life. So, how will you fund this Rs. 813 crore then?

Jatin Khanna: Like I said, there are certain plans being sort of workshopped currently in terms of what's the means of finance for the Rs. 813 crore. So, therefore, once we have something crystallized, we will be happy to share more details. But at this stage all I can say is that there are certain things which are work under process. And as we finalize some of those things, we will be happy to share how we will fund this.

Moderator: The next question is from the line of Amit Saxena from Credit Suisse.

Amit Saxena: I think you have given a fair bit of background on the transaction. Just one question on the transaction, you mentioned there are certain call and put arrangements, and these some put arrangements specifically if this is a cash transaction, just wanted to get your view as to what are the key aspects of this put arrangement, is that to understand the obligations on the company per se from a time line perspective, and other side of things?

Jatin Khanna: So, its broadly a 12-month time line, firstly. Secondly, the price is now as it is today, so it's a crystalized price. In some sense there is an advantage of having the price frozen over the next 12 months to do this put/call arrangement. So, I think those are the two details. Other than that, I think, pretty much...

Amit Saxena: You mentioned 12 months, is it any time between 12 months or post 12 months?

Jatin Khanna: It's currently 12 months, which can be advanced or extended mutually.

Amit Saxena: Okay. So, it's a specific kind of close to 12-month kind of a period. My concern was more in terms of the obligations of the cash layout, so that makes sense. And the last bit was on, I think we have been in discussion on the distribution side of the things as multiple partners. Has there been any certain updates on any bank or long-term distribution partner coming on a more holistic basis or is there any thoughts around that, any updates?

Jatin Khanna: Well, I mean, our existing partnerships with our partners are currently going very strong, and performance is for all of you to see. In terms of the new tie-ups, we are always on the lookout and we are aggressively seeking organic opportunities on that front as well as we are always open and keen to do inorganic opportunities to expand our distribution. So, that's our stated strategy, and we are pretty much on course on from that strategy.

Amit Saxena: Yes. Understood Jatin, but from a perspective of this shareholding swap, is this a precursor to any potential transaction at the Max Life level, because again, while I think there have been a couple of questions around rationale for the share swap, it is difficult to understand as to from Mitsui Sumitomo perspective, swapping into a holding company and you consolidating in to life company, is it a precursor to any potential long-term distribution partner coming at the life level or any thoughts you can give for further clarity on that aspect of the business?

Jatin Khanna: I mean, unfortunately, it's not appropriate for us to comment on speculations. And like I said that anything and everything which we do, as some of those things crystalize we will come back and share with you at an appropriate time. Unfortunately, I have nothing which will crystalize in my hand at this stage on whether a distribution arrangement or a different way of funding this transaction. So, you will have to bear with us till such time, we will finalize something and come back and share the details.

Moderator: The next question is from the line of Susmit Patodia from Motilal Oswal Securities.

Susmit Patodia: I just had a couple of questions; will Sumitomo be classified as a promoter at the listed entity?

Jatin Khanna: No.

Susmit Patodia: And would you need a special resolution, 75% of minority or the promoters can vote as well?

Jatin Khanna: Promoters can vote, it's not a majority of minority resolution for sure. I think it is a special resolution there. I will have to check and reconfirm this to you.

Susmit Patodia: And Sumitomo not classified as promoter is confirm?

Jatin Khanna: Sumitomo not classified as promoter is confirmed, absolutely.

Moderator: The next question is from the line of Harshit Toshniwal from Jefferies Group.

Harshit Toshniwal: Sir, a couple of questions. One, when I look at dissolving the 2 Tier structure. So, at the time of HDFC Life - Max merger there was a problem because we had some liability sitting at the NBFC level, which did not allow. So, at this point of time are we mostly clear from the regulatory angle of merging Max Life at Max Financials at whatever point of time?

Jatin Khanna: So, look, I think we have discussed this topic. I think we had options at that stage also to sort of make that work. And the next steps could have been taken if both parties were aligned, but at that stage the priority for HDFC Life was clearly to do an IPO because the other insurers had done an IPO. So, therefore we had to part ways. So, clearly, from a structural standpoint, I think we know how it can be done, what can be done, we knew it then, we know today. Now, obviously one will to test it with the regulator at the right time, make it work and do whatever is required to make it work. I mean frankly it is, again, one of those speculative questions which is difficult to answer at this point in time. I don't know if I will be able to answer it properly.

Moderator: The next question is from the line of Dhaval Gada from DSP Mutual Fund.

Dhaval Gada: Jatin, just had one more thought on this. So, in the past, one of the thoughts that we had was, if and when we need to give equity to our banca partners, both the partners will chip in their respective shareholding structure. How does this sort of play out if we were to give an equity even in the future, given that now they are at the holding company level? So, the entire 90% or 100% basically is now with… so the cost of that is with the holding company. So, just if you could explain that.

Jatin Khanna: Yes. I think you are right, the cost of value at the holding company. But at the same time, I think Mitsui Sumitomo will come in with their share because they are shareholders of MFS now. So, they will participate in what MFS would have given. And MFS shareholders will participate in what Mitsui could have given. So, in some sense, now that the broadly like you said we are 100% owner of Max Life, practically. So, therefore, whatever has to then happen, if at all it happens, has to happen out of Max Financial.

Dhaval Gada: But with a 20% share, instead of 25% earlier?

Jatin Khanna: What's the 20% and 21%?

Dhaval Gada: No. So, I was just saying that they whole 22%, so that is their share versus earlier 26% sort of...

Jatin Khanna: I mean, frankly, the cost of potential dilution in the future, if at all, for any Bancassurance partner or otherwise to do a strategic sort of partnership with anyone, frankly, I mean, the sense is I am sure well understood by the markets, and therefore is factored in our share price today. So, to that extent, we are sort of buying part of their ownership at the current share price. So, I assumed that that ownership already factors in such costs. And therefore, the cost of any potential dilution to any investor is reflected appropriately through the ownership.

Dhaval Gada: Understood. And just a follow-up on what I asked earlier. I mean, broad calculation suggests that we will need about Rs. 1,000 crore of money to sort of buy the Axis stake and also the MSI's stake. And I would never expect about Rs. 600 crore to Rs. 700 crore dividends to come from Max Life. So, the balance bridge we have, so would you take debt or something, I mean, just some color around that? Firstly, is that math correct?

Jatin Khanna: Leave the options for a while. Once we have something crystalized and in hand, we will be happy to give you more details.

Moderator: Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their closing comments.

Jatin Khanna: Thank you so much for being part of the earnings call. We hope we have clarified all your questions to best of our abilities. Should you have any further questions, please feel free to reach out to us. We look forward to more such interaction. Thank you, once again, and goodbye and have a good day.