Max Financial Services Limited
Q4 & FY18 Earnings Conference Call
May 28, 2018

Moderator: Ladies and gentlemen, good day and welcome to the Max Financial Services Limited Q4 & FY18 Earning Conference Call. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Mohit Talwar – Managing Director, Max Financial Services. Thank you and over to you, Mr. Talwar.

Mohit Talwar: Thank you. Welcome everybody on the Earnings Call. I would like to introduce you to Prashant Tripathy who is the CFO for Max Life, and Mr. Jatin Khanna who handles the Investor Relations for Max Financial Services.

So, let me start with the Key Highlights and then we can move on to some of the Strategic Priorities for the Group and then thereafter we would welcome questions from you all.

We have had a pretty solid year, the revenue growth has been 15%, achieving Rs.14,967 crore; our consolidated PBT however was lower than last year Rs. 538 crore but then last year was an unusual year for us when we were in the midst of merger with HDFC which you all are familiar.

Moving on to some of the Key highlights of Max Life specifically:

You will recollect that a few quarters back we had shared aspiration to get to "20-20-20 Performance" on embedded value, sales and margins and this was to be achieved by 2020. I am delighted to share that we have achieved this during the year itself. MCEV has grown by 21% on an operating basis and so the EV is at Rs.7,509 crore, this is after dividends. Value of new business has grown by 31% to Rs.656 crore with our margins at 20%, improvement by 140 basis points over last year. Our individual adjusted sales has grown 22% to Rs.3,215 crore with an undiluted focus on traditional and protection products. We have experienced a strong growth across all our channels and we are very encouraged by this performance.

We continue to focus strongly on Digital and direct online sales has grown 112%. Online ULIP has been launched to gain further market share in the online market. Protection sales including individual and group, has grown 35% YoY resulting in an improvement in protection mix from 7% in FY17 to 8% in FY18, we want to take this to about 11% or so by FY21. Gross written premium has grown 16% to Rs.12,501 crore. There is 15% growth in renewal premiums at Rs.8,152 crore and this has been led by record improvement in the conservation ratio to 90% which is one of the highest in the industry. The trend lines in the expense ratios, conservation, persistency, all continue to show a healthy YoY improvement. Claim settlement ratio at 98.3% is probably best-in-class. Solvency surplus is at Rs.2,028 crore with the solvency ratio registering 275%. Assets under management has for the first time crossed Rs.50,000 crore milestone and now it is at Rs.52,237 crore growing 18% YoY.

Some softer aspects of the business and these are awards and accolades. Max Life has won the Life Insurer of the Year at the "Outlook Money Awards for 2018" and we also won Gold at the" ASQ World Conference for Quality and Improvement for the year 2018."

Now, briefly about the Performance Highlights for Q4 of 2018: Again, strong performance with 23% growth in GWP which is at Rs.4,648 crore. 28% individual adjusted FYP growth to Rs.1,339 crore and the shareholder profit pretax has increased 3% to Rs.225 crore.

I would like to now talk about some of these Strategic Priorities for Max Life during the period what we are envisaging for FY19 all the way to FY21 and we just concluded our Business and Strategic Review. So some highlights on that; we will continue our efforts to deeply integrate with our partners and build capabilities across products, marketing and technology. We will accelerate investment in proprietary channels to build a robust multi-distribution architecture. We will aspire to grow these channels by around 35% CAGR over the next three years to get to a more balanced channel mix and get as close to about 35%-40% contribution from these channels, bring down Axis share to about 40%-45% and the others 15%-20%. Max Life Agency channel is one of the few channels in the country that is delivering positive margins. We will continue to build on our market leadership in online sales because of consistent pricing advantage, powered by strong underwriting capabilities.

I would like to now just touch upon the Bancassurance Strategy:

There is a sharp focus to retain and grow our existing partners. There is also a lot of curiosity in terms of the Axis Bank partnership. So here I would just like to say three things…and we have a kind of socialized script between Axis and ourselves and I have said this on some of my investor meetings as well – First , our arrangement which is till 2021, is strong, solid and sacrosanct, so that is not changing.

Second, any of these long-term strategic initiatives like Greenfield, Brownfield we were told, it is not a priority for the bank at this point in time.

The third thing is that if and when Bank will decide to do something which is strategic in nature, we would be front-runners, and this is because of the fact that we have a long standing mutually rewarding relationship.

So on our side, we are very optimistic that we are a preferred partner and I would like to believe that the arrangement which they have with us is far superior to any other option that they may want to explore in the future. In our judgment, the value creation from us is in multiples of any other option.

We will continue to maintain an aggressive posture towards inorganic growth for acquiring bank-based life insurers and acquiring new banca relationships. To this effect, Max Financial board has approved a significant capital raise too.

There will be a focus to pursue more balanced product portfolio with the bias towards preferred segments which you are all familiar with. Given our increased focus on the affluent customer segment, you will see proportion of PAR will reduce to around 40%, contribution from ULIP increasing to above 40% and protection focus contribution increasing to about 11% from the current 8% and balance in NPAR savings ~10%

Having achieved the "20-20-20 target over three years" within one year, we have now set aspirations to 25-25-25 target over the next three years. The key drivers will be growth acceleration, increase protection focus and sustain improvement in cost ratios.

To sum up, Max Financial Services is delivering strong performance for shareholders via Max Life which will further improve, and Max Life delivers on its new strategic plan. There is a three-pronged strategy in play for addressing the channel concentration risk that have been playing in the mind of investor – Aggressively grow our proprietary channels, retain and grow existing partners and pursue inorganic opportunities to balance out the channel mix in a shorter time.

On that note, I would like to hand you back to the moderator and open it up for Questions-and-Answers. Thank you.

Moderator: Thank you very much. The first question is from the line of Prakhar Agarwal from Edelweiss. Please go ahead.

Prakhar Agarwal: A couple of questions; first, when I look at your unwind rate, which has come up to 9.73% vis-à-vis 9.5%, whereas when we look for other players they have been declined. Anything to read into it why we have seen rise in your unwind in discount rate?

Prashant Tripathy: No specific reason, these are minor movements. You may also like to see that our non-hedgeable risk which typically is higher than the market, we do it at 5% whereas I have seen that the market players are 3.5%-4%. So when it unwinds, it unwinds at a higher rate. So you should expect us to have our unwind rate higher than the market players because of that reason.

Prakhar Agarwal: That probably will continue in future?

Prashant Tripathy: Yes, that is correct.

Prakhar Agarwal: Second is more from overall perspective, how do you see the overall size of protection market in Indian context, any ballpark numbers?

Prashant Tripathy: I will give the answer broken into two parts – One is the group market which to a great extent is protection only if you exclude the funds business, so if you were to look at the group business, almost all of it is protection and it has been growing close to about 15% Y-o-Y, so that should continue to build. On individual side, I think the current mix will be in the range of 2%-3% if you include the entire market including LIC and I am reasonably sure that in a few years from now that should go closer to 10% and that by far will be one of the highest margin drivers if company demonstrates very strong underwriting capabilities, then it will be a strong margin driver. So we are definitely quite bullish on the protection market and that is reflected in the strategy that Mohit just outlined.

Prakhar Agarwal: How many banks have we tied-up with in terms of Credit Protect plans? A question related to, there has been commentary from various other players that Credit Protect business has possibly seen higher level of competition and thus some pricing pressure, do you also see the same or probably it is too early to comment?

Prashant Tripathy: We have Credit Protect business with people who we work closely but as you may know, Credit Protect business not only comes from bank but also comes from NBFCs or other financial service providers and loan providers. The largest relationship is with Axis Bank but other than that we have relationship with three, four other NBFCs and we are in the process of building it. However, large part of this growth from our current 8% to 11%-12%, is predicated on individual, so we will be quite aggressive in the individual business which is more sustainable, and we believe that it will continue to provide good source of margin as we continue to work through. On your second part of pricing pressure, could flow through, that is really B2B business, in B2B business it is logical that the margin generally get sucked out as more people jump in the fray and exactly for the same reason as I described to you, we are going to be more aggressive in the individual business rather than in the Credit Protect business.

Moderator: Thank you. We will take the next question from the line of Utsav Gogirwar from Investec Capital. Please go ahead.

Utsav Gogirwar: Sir, just a couple of questions from my side. If I look at the AUM growth for this year it has declined compared to our historical run rate, it is now around 18%. Is it because of a decline in markets or higher surrenders, any specific reasons?

Prashant Tripathy: None of that actually, some bit because of market being more stable, typically our growth rate will range between 18%-22% going forward and it completely depends on how you have written the business some bit, no specific reason.

Utsav Gogirwar: The second question is just want to understand the distribution from Axis Bank perspective like LIC is doing good business with them. So just wanted to understand how the things will pan out over the next couple of years from Axis Bank distribution channel, how are we looking at that piece?

Prashant Tripathy: What I would like to inform you is perhaps the segments where we operate the two of us is quite different. So while LIC operates more in the segment of lower ticket size or single premium, as you know, we do not operate in those two segments. There are mutually exclusive markets that we are targeting. If you were to look at percentage of total sales that is going to LIC at this point in time it is less than 5% and we hope that it will continue to remain sub-10%. So really from our perspective, we are quite comfortable with how things are and it is not different from how we had anticipated it to be.

Moderator: Thank you. We will take the next question from the line of Madhukar Ladha from HDFC Securities. Please go ahead

Madhukar Ladha: My question is on the margin improvement. Can you name the sources and quantify the different sources of margin improvement?

Prashant Tripathy: Basically, two big sources – one source is higher protection that should be close to about one-third of margin enhancement and the balance two-third is on account of a couple of things; a) hardening of interest rate which generally gives a better profile on margins on Non-PAR and also improved design that we came up with, within Non-PAR itself. So those are a couple of reasons that should constitute two-third. So that is really the full margin enhancement.

Moderator: Thank you. We will take the next question from the line of Shailendra Mundra from Veba Financial. Please go ahead.

Shailendra Mundra: There have been some press reports that you have been bidding for the IDBI Federal Life Insurance, etc., So could you please throw some light on what kind of financial arrangements you have made in order to acquire any company if it comes your way because it is seen heavily on the share prices and investor sentiment, so like to have some clarification please?

Mohit Talwar: I can only comment on the fact that we are one of the bidders who have reached the final round for this particular transaction. You will appreciate that since it is a bid process, there is no way that I can talk numbers here. At this point in time we are to meet with IDBI Federal shareholders for final round. We are in the process of working through documentation. As far as the funding arrangements are concerned, we have tied up the funding, we have managed to get underwritten offers from several banks, but I am afraid I would not be able to add more color in terms of quantums or what those arrangements are because of the fact that we are in a very-very sensitive stage as far as the bidding is concerned and you will appreciate that.

Shailendra Mundra: At least, will it be a mix of debt and equity? Only debt? Or only equity, any light on that?

Mohit Talwar: All of the above, including Max Life, MSI, all of these options are going to be evaluated at the appropriate time.

Shailendra Mundra: One last question on the same thing, if you manage to acquire the company, IDBI Federal Bank, does it give you any advantage in terms of bancassurance channel with those two partners - IDBI and Federal is it part of the deal or what?

Mohit Talwar: That is the only reason we bid for the distribution, although they have a clean book, it is about maybe one-fourth our size, but it is a good book, nothing major came out during due dilligence, the whole idea is to enhance the distribution and it comes with two big banks and that is why I think most insurance companies bid for it to start with 16, down to 8, down to 5 and now down to a couple maybe.

Shailendra Mundra: When would we know that it is closed?

Mohit Talwar: Closed it will be only after statutory approval, but if you are asking when is the decision going to be made, we are hoping that will happen sometime in June.

Moderator: Thank you. We will take the next question from the line of Bhavesh Jain from Envision Capital. Please go ahead.

Bhavesh Jain: Our claims and other benefit payout growth rate seems to be high versus the overall revenue. So how do we see this line item going forward?

Prashant Tripathy: It is because of the maturity of ULIP and PAR book as we are maturing. That is the reason.

Bhavesh Jain: Sir, you said in FY'17 there was some one-off in PBT line item. Is it possible to quantify that?

Prashant Tripathy: The largest item was an item which happens because of fall in interest rate. So we realize all the gains on the shareholder account and that was close to about Rs.150 crore.

Bhavesh Jain: Sir, how do we see this other banks channel going forward in terms of the growth rate in that particular channel?

Prashant Tripathy: We will expect it to be higher than the company growth rate because some of these channels are growing quite rapidly. If you look at for example this year the other category you would have noticed has grown faster than the average company growth rate.

Moderator: Thank you. We will take the next question from the line of Neeraj Toshniwal from Emkay Global. Please go ahead.

Neeraj Toshniwal: I just wanted to understand on the margin improvement which you talked about sometime back. How much of it is sustainable in terms of the two-third portion because the Protection mix okay you are improving and you will be improving more but out of the rest two-third, I wanted to understand how much it will be repeat business and how do you see that?

Prashant Tripathy: We see that as quite sustainable. You heard Mohit just talked about our strategy on going to 25-25-25 which means our outlook is that in next three to four years our margin should reach close to 25% from the current level of 20%, and that will happen on the back of increased penetration of protection as well as growth which will start to churn economies of scale and better leverage. So those two factors put together should take our margin up from current level of 20% to 25%.

Neeraj Toshniwal: But my question is actually this two-third. If you can talk about more on that and how much of that is repeat, hardening of interest rate again can change, where do you see that?

Prashant Tripathy: We will be able to protect that margin because on a Non-PAR interest rate guarantee design is that if the interest rates fall, then there is an impact on the margins but then now with a flexibility to go ahead and re-file the product. In a way it will be easy for us to protect the margin irrespective of how the interest rates are moving and hence I am quite comfortable that the margins on Non-PAR will be where they are.

Neeraj Toshniwal: Possibly no impact from change of interest rate or what assumptions you are taking in, for the interest rate in VNB margin?

Prashant Tripathy: We use the FIMMDA curve like I have shared in the deck.

Neeraj Toshniwal: On IDBI Federal, what is the EV book they are in FY'18?

Jatin Khanna: We are bound by confidentiality agreement, so we cannot be sharing too much information on the asset at this stage.

Neeraj Toshniwal: There was a change in your presentation for the group and individual for the Protection biz. So last year was something like 5% which has now become 7%. So …?

Prashant Tripathy: Basically, this is just to bring it in consistent with how other people are reporting. We were earlier reporting only on individual basis but what I found was most of the people are reporting total protection. So we just made sure that we report at a total level. However, we have also given visibility to individual and group separately. So you will notice that it gives you a more comprehensive picture of our current protection mix.

Neeraj Toshniwal: In terms of your ticket size in Protection, are we seeing ticket size improving especially the individual segment after riders and a lot of things are happening and people are bringing in different kinds of products as well?

Prashant Tripathy: It is that generally an attempt that we work towards; however, it is not the biggest driver of margin and it is quite range-bound typically on average our numbers will vary between Rs.13,000-Rs.15,000 per ticket size.

Neeraj Toshniwal: Last question would be your cost ratios which has improved this year lot in terms of policyholder 20% of GWP which you mentioned. Where do we see after investments to be made in the agency channel over the next few years to be consistent or higher?

Prashant Tripathy: We absolutely expect it to get better and just to give you some sense of the agency investment, we are making investments to ensure that our current channel start to get fillip, but equally the decisions that we are making around expansion or not hugely fixed cost oriented, so there will be better control on cost, we are also attempting to leverage the current infrastructure as much as possible, so that we could sweat our assets better and hence in about three years' time we will definitely expect it to be more closer to 10% from the current level of 13%.

Neeraj Toshniwal: 10% basically reducing the cost. Basically, you are saying reduce the cost structure by…?

Prashant Tripathy: No, you hold the cost at lower level and you expand. So it happens more out of expansion overtaking the increase in cost and my sense is that numbers will be between 11% and 12% from the current level 13% if you outlook three more years from here on.

Moderator: Thank you. We will take the next question from the line of Sumeet Kariwala from Morgan Stanley. Please go ahead.

Sumeet Kariwala: Hi Prashant. Just two questions from my side; one is on the Group Protection business, have you shared any breakup between Credit Life and Term?

Jatin Khanna: Sumit, it is in the presentation.

Sumeet Kariwala: The other one is if you can share the distribution mix for individual protection as well?

Prashant Tripathy: Basically, if you look at the Credit Protect, it is close to about 1%, the individual is close to about 4.2%, so between the two Credit Protect and individual, we will come close to between 5.1 to 5.2, that is where we will land up, the balance is GTL business.

Sumeet Kariwala: The other question was with respect to distribution mix of the Individual Protection business. So how much is…?

Prashant Tripathy: Large part actually of the 5.2% that you see, needless to say the share from our own channels is reasonably high, will be in the range of about 5-6% of their sales being protection, for the bank channels it ranges between 2-3%, so the weighted average comes to about 5.1%, 5.2% at a total level, Group Credit Life large part actually comes from Axis Bank.

Sumeet Kariwala: How much of individual protection will be third-party or web aggregators?

Prashant Tripathy: It will be close to around 1%. I mentioned to you on individual basis; we are close to about 4.1%, 4.2%, of that I think internet channel is anywhere between 1.5% to 2% and of that about 50-60% comes out of web aggregators.

Moderator: Thank you. We will take the next question from the line of Prakhar Sharma from CLSA. Please go ahead.

Prakhar Sharma: I just wanted to get a sense on the product strategy between ULIPs and PAR. This year ULIPs have seen a very strong growth whereas PAR is flattish. Margin profiles of these products generally are not very different. So one, can you discuss it on the concept of is there a thought process around changing the mix towards ULIPs? What would be the difference in terms of margins on these products?

Prashant Tripathy: Basically, we do not declare the margins at product levels but margin profiles on PAR are slightly better than margin profiles on ULIP's, when I say slightly which means about 200-300 basis points more. We did maintain, and we have been telling that we want to reach higher level of balance in our product mix and from that objective even in the last call we described that when we look at long-term product mix we would like to be between 35% to 40% PAR, little over 40% on ULIP and the balance on Non-PAR with the higher orientation towards Protection business and what we did last year was an attempt to align it to our long-term strategy. So, we are happy with the current level of product mix. Suffice it to say at this point of time that we do not intend to become a player where ULIP will be 60% or 70% of our product mix, but we want to remain at in the range of where we are between 40-45% of sales.

Moderator: Thank you. We will take the next question from the line of Avinash Singh from SBI Cap Securities. Please go ahead.

Avinash Singh: One question on persistency. We have seen the longer tenor persistency continuously improve but in 13-months we are sort of sustainable at 80%. Now realistically where do you see the persistency evolving and how much the persistency improvement you expect to contribute towards your ambition of 25% margin, what sort of improvement that realistically this persistency improvement can bring into your margins?

Prashant Tripathy: The 80%, 81% number that you see for 13-month should go past 85%. So I am quite hopeful that when we finish this year we will be in the range of about 82%-83% and we will continue to make progress. So suffice it to say that in three years' time we should attempt to be north of 85%.

Avinash Singh: Similar sort of improvement, of course not that same level, but the improvement directionally should we assume over the tenor like 25^{th} or 37^{th} and so on?

Prashant Tripathy: Every passing year it just flows and transfer to the next tranche.

Moderator: Thank you. We will take the next question from the line of Piyush Sharma from Edelweiss. Please go ahead.

Piyush Sharma: I wanted to ask that since you maintain that you will keep your ULIP targets at 40% distribution mix. So what products do you see as contributing to your growth in future other than the Protection business?

Prashant Tripathy: A) Between 40% and 45% is the target, so not just quite 40%, again tactically it may go up or go down depending on how the markets are moving and we will be opportunistic about driving growth. B) while products do play a role in terms of driving the growth, we are anticipating that the growth will be driven also because the investments that we are going to make in our own channels as well as productivity improvement that we see YoY through the bank channel. So large part of bet is on growth is also about expansion of distribution channel.

Piyush Sharma: So in terms of breakup of distribution through banks, as of now what is the distribution mix for different products that you are selling through your banking arms, as you previously mentioned 2-3% are Protection sales?

Prashant Tripathy: Depending on the bank, it ranges again not very different from how you see at a top level. Between 45% to 50% of ULIP, closer to 10% are Non-PAR and then the balance of participating. So they also sell quite a balance product mix like the entire company sells.

Moderator: Thank you. We will take the next question from the line of Saurabh Dhole from Trivantage Capital. Please go ahead.

Saurabh Dhole: I just have two things to talk to you about; one is on the Protection side, now for the last couple of years we have seen a consistent improvement in the proportion of the Protection business. So I just wanted to know, what kind of initiatives have you taken which have led to this consistent improvement? The second would be related to this acquisition that you are looking at. I understand that you are obviously not in a position to give out the financial detail. But were you to say acquire this particular entity and say for instance if there was any other entity, would you have plans to sell your own policies, that is Max policies through the channel of this particular acquisition that you would have and how would you look at cannibalization in that case? Those are my two questions.

Prashant Tripathy: So let us take the first question on Protection. It is correct that we have been focused on Protection business and if you look at our Individual Protection for example we have grown at quite consistently over last few years and the objective is to continue to grow. I have given a slide also on looking at the Protection in terms of number of policies, how we have gone over last three years and all of them are witnessing strong growth. The reason for that growth is two or three-fold; First, our focus on eCommerce as the channel and our prowess on working with the digital companies' aggregators, etc., has been one of the core reasons. The second one is created competitive product offers which have been accepted by the market and we continue to do very well there. Third , is aligning the Protection penetration as a part of key measurement criteria for evaluation of performance. So starting from the top management to the last person who does the sale, everybody is aligned in terms of goals and objectives to drive the Protection up. So those are two or three reasons why you see enhancement in our Protection mix and we continue to do so as Mohit explained. Your question on whether or not we will be selling Max policies through the distribution partners of the acquired entity, the answer to that is yes, that is the design; however, we will try to ensure that there is good phasing and there is good staging which is provided before we start to do that. If we were to acquire this and we succeed in our bidding process and we happen to acquire, then there will be very detail plan that we will lay out to start to put the distribution and usage of distribution as a part of this acquisition strategy. I did not quite get your question on being the sales replacement, etc., It is just that currently the banking partner are selling the products of that particular life insurance company. When that life insurance company merges with our company, then the distribution partners will continue to sell the product just being replaced by maybe a brand, etc., but we anticipate that it will be quite seamless, and we do not anticipate any replacement.

Saurabh Dhole: Just one last question on persistency. Now this is something that is common to almost all life insurance companies. So on the 13-month persistent if we look at, so the best players maybe at around 85%, you are at 80% and you obviously plan to move to 85%. I just want to understand what industry characteristics drive 20 % point drop in the first bucket while the successive buckets have around 7-8% point kind of a drop?

Prashant Tripathy: So basically it is quite unique about India, if you have to look at more evolved geographies, generally the persistency will be upwards of 90%, even our internet channel we are witnessing persistency level of closer to 95%. There are a couple of reasons that drive persistency or lapsation. One of them is the quality of sales and the ticket size. The lower the ticket size, the lower generally is the persistency and the better quality of representation, the better is the persistency, also we have noticed that because of the lock - in which is there for five years in ULIP design and by virtue of ULIP being higher ticket size product, generally the average ticket size on ULIP will be higher than average ticket size on any of the product design, ULIP is witnessing higher persistency for first five years.

Moderator: Thank you. That seems to be the last question. I would now like to hand the floor over to Mr. Mohit Talwar for his closing comments.

Mohit Talwar: Thank you. I would like to thank all the participants for sparing time to be on this call and we will have more such calls in the future as well. Good bye.