Bank of America Merrill Lynch

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India Insurance

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Refer to important disclosures on page 40-42.

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India: Prognosis 2014

Worst over, no sign of recovery

- Growth: 4.6% FY14, 5.5% FY15
- Inflation: 6-6.5% levels on energy price hikes, INR
- RBI rates: 8.75% MSF rate by Dec; 7.75% repo rate Mar
- 10y: 8% on RBI OMO; 8.5% now
- Lending rates: On hold till March 2014
- Fiscal deficit: 5.2% of GDP FY14 (30bp risk due to INR)
- Current account deficit peaking off: 4% of GDP FY14
- INR: INR expectations at Rs60-65/$ for now

Swing factors

- Fed tapering
- Downgrades: Unlikely till 2014 elections
- Oil: US$10/bbl swings US$8bn on trade deficit

US closure

- 2 weeks, Jan tapering: RBI to raise addl FX
- Early resolution: No impact
- Debt default: 80bp risk to FY14 4.6% growth

Why US recovery +ve?

- Greater risk appetite, FII equity inflows (INR does well when US does well)
- Fed tightening to stabilize oil prices
- RBI has greater capacity to cut

Source: BofA Merrill Lynch Global Research

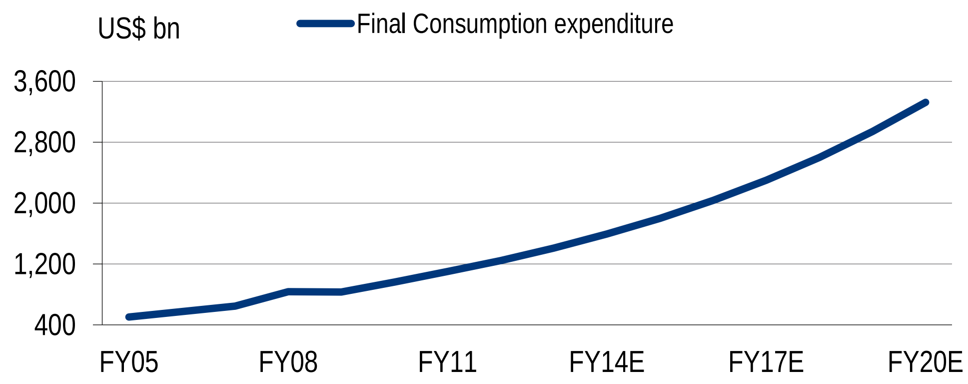
India-2014/15

Variable	FY12	FY13	FY14E	FY15E
Real GDP	6.2	5.0	4.6	5.5
Agriculture	3.6	1.9	4.0	2.8
Industry	2.7	2.1	1.4	3.3
Services	7.9	6.6	5.5	6.7
M3	13.0	13.6	15.0	17.0
Commercial credit	17.0	14.1	15.0	18.0
WPI inflation (eop)	7.7	6.0	6.2	6.5
Fiscal deficit (% of GDP)	-8.4	-7.3	-7.3	-7.1
Current account balance (% of GDP)	-4.2	-4.8	-3.2	-3.6
Forex reserves (US$bn)	294.4	292.6	305.6	326.6
RBI's LAF reverse repo rate	7.50	6.50	6.75	6.00
RBI's LAF repo rate	8.50	7.50	7.75	7.00
Cash reserve ratio (% of bank book)	4.75	4.00	4.00	3.50
10-year GoI yields	8.25	8.00	8.0	7.50
PLR	14.25	13.50	13.25	12.75
US$/INR	50.9	54.3	68.0	

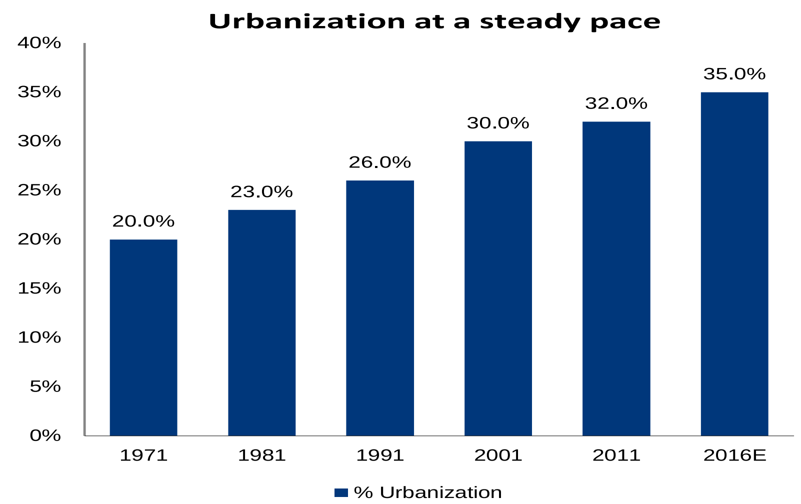
Source: BofA Merrill Lynch Global Research

India: Macro

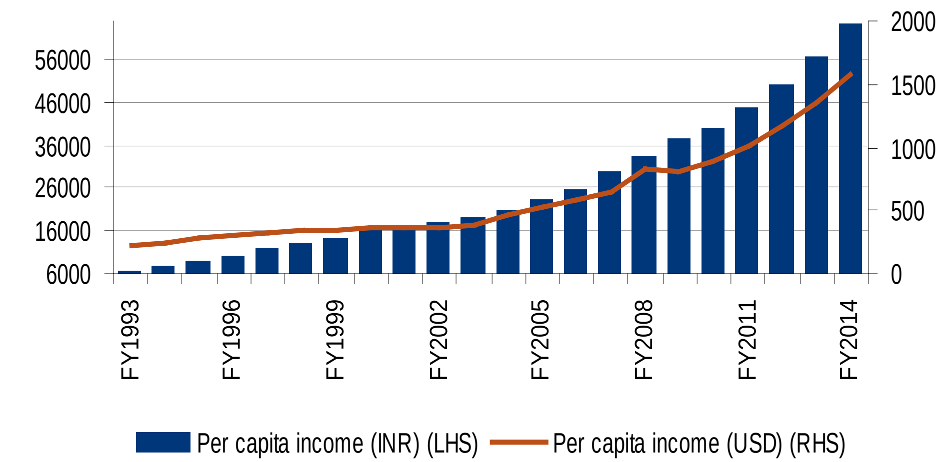
Consumption accounts for >50% of GDP



Increasing urbanization to drive consumption

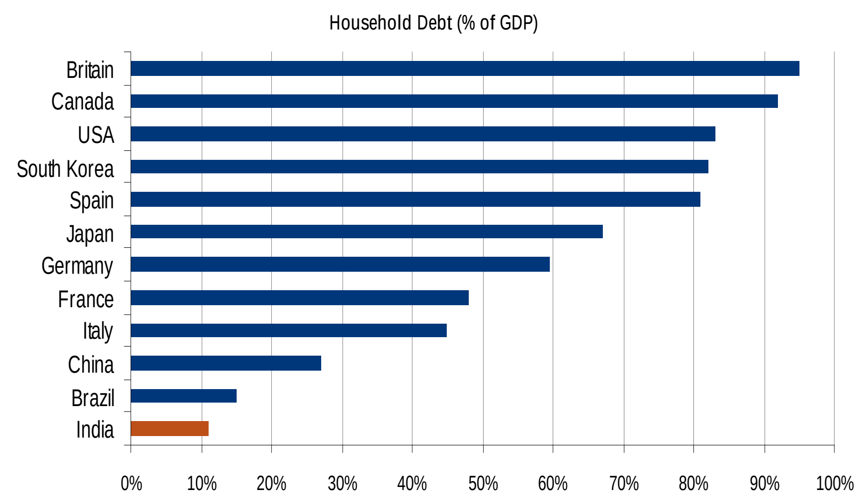


India's per capita income will hit US$1500...



Source: BofA Merrill Lynch Global Research

Indian households still unlevered…



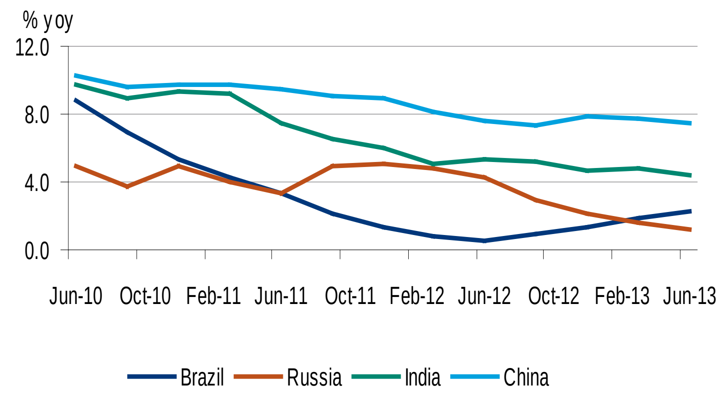
Source: BofA Merrill Lynch Global Research

Growth bottoming out… slowly

Growth bottoming out

	FY03	FY13E	FY14E	FY15E
Real GDP	4.0	5.0	4.6	5.5
Global growth	2.9	3.1	3.2	3.9
Inflation	3.4	6.0	6.1	6.5
Lending rate	12.25	13.25	13.25	12.75
Gross fiscal deficit	9.3	7.3	7.3	7.1
Current account balance	1.2	-5.0	-4.0	-3.7
USD/INR	47.5	54.3	68	--

India still 2nd fastest growing BRIC



5.0% FY13, 4.8% FY14, 5.5% FY15

Item (%)	Weight	FY12	FY13	FY14E	FY15E
Agriculture and allied activities	**16.8**	**3.6**	**1.9**	**4**	**2.8**
Industry	**20.3**	**2.7**	**1.2**	**1.4**	**3.3**
Mining and quarrying		-0.6	-0.6	1.0	3.0
Manufacturing		2.7	1.0	1.0	3.0
Electricity, gas and water supply		6.5	4.2	5	5.5
Services	**62.8**	**7.9**	**6.8**	**5.5**	**6.7**
Construction		5.6	4.3	3	5.0
Trade, hotels, transport, storage and communication		7.0	6.4	4.2	6.5
Financing, insurance, real estate and business services		11.7	8.6	8	8.0
Community, social and personal services		6.0	6.6	7	6.0
Real GDP at Factor Cost	**100**	**6.2**	**5.0**	**4.6**	**5.5**

…stagflation comparable with BRIC levels

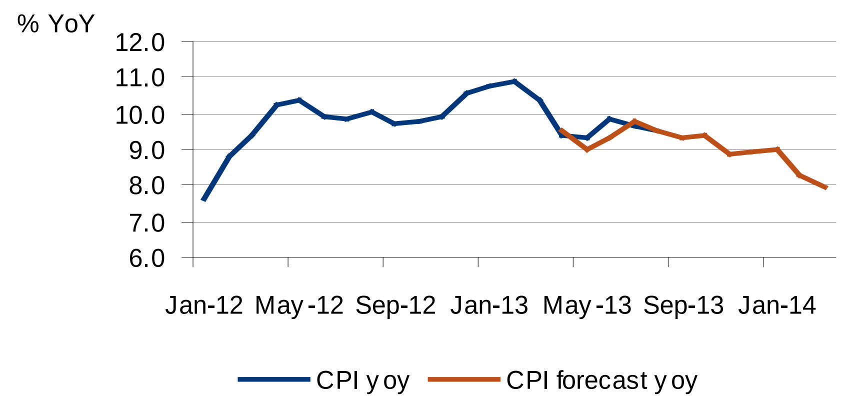
	Growth			Inflation		
	Pre-crisis	Crisis	Current	Pre-crisis	Crisis	Current
BRICs						
Brazil	6.1	-0.3	2	3.6	4.9	6.2
Russia	8.1	-7.9	2.5	9	11.7	6.4
India	9.3	6.7	4.6	4.7	3.9	6.2
China	14.2	9.2	7.6	4.8	3.9	2.5
TIMs						
Turkey	4.7	-4.7	3.2	8.8	6.3	7.5
Indonesia	6.3	4.6	5.8	8.8	4.9	7.2
Mexico	3.3	-6	1.5	4	5.1	3.8

Source: BofA Merrill Lynch Global Research

Source: BofA Merrill Lynch Global Research

CPI inflation: Peak off at high levels

CPI inflation: 7.6% in March 2014…



…because of higher food weight than WPI

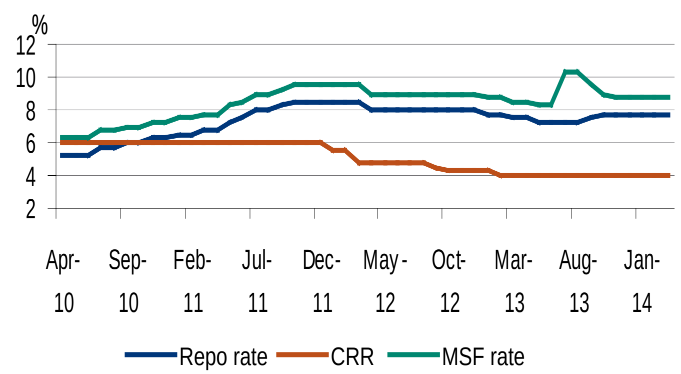
Major group / Item	Weight	Impact of a 5% change (bp)	FY12	FY13	Current (Aug'13)	FY14E
Consumer Price Index (CPI)	100		9.4	10.4	9.5	8.4
Food, Beverages & Tobacco	50	250	8.3	12.3	11.0	9.1
Cereals & Products	15	70	2.6	17.6	14.1	10.0
Milk & Milk Product	8	40	15.0	7.7	7.9	8.0
Vegetables	5	30	9.5	12.2	26.5	11.0
Fuel & Light	9	50	11.8	8.3	7.6	9.5
Clothing, Bedding & Footwear	5	30	12.4	10.6	9.0	5.0
Housing	10	50	14.4	10.5	10.5	10.0
Miscellaneous	26	130	8.6	7.4	7.1	6.7
Medical Care	6	30	6.9	6.2	6.3	5.0
Transport & Communication	8	40	8.2	8.1	8.0	10.0

CPI supplements WPI in RBI policy

	Current	FY13 average	FY07-12 average
Headline WPI	6	7.4	7
Core WPI	4.3	5.6	4.6
CPI - new	10.4	10.2	
CPI -core	8.9	9.2	
CPI -urban	10.4	10.4	
CPI - rural	10.3	10.1	
CPI -IW	12.1	10.3	9.3
CPI-UNME			9.7
CPI-RL	12.6	10.2	9.9
CPI-AL	12.8	10.0	10.0

Source: BofA Merrill Lynch Global Research

RBI to roll back MSF rate



Source: BofA Merrill Lynch Global Research

Recent measures to raise FX by US$22bn

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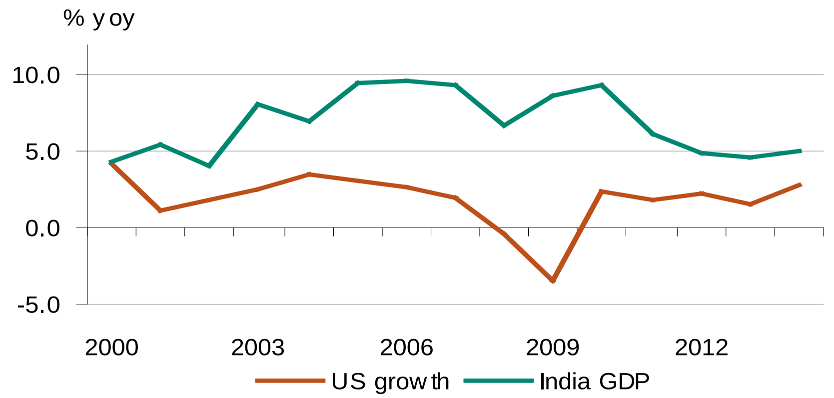
Measures	Inflows (USD bn)	Measures	Outflows (USD bn)
Curbs on gold import	20	Lower remittances on NRI deposit rate hike	7.5
Oil imports from Iran	2	Lower FII inflows on RBI tightening	17
Lower outward remittances by residents	0.5	Lower short term credit by oil companies	3
Lower outward direct investment	2	RBI's FX sales	12
Quasi-sovereign bond - IIFCL, PFC, IRFC	4	RBI's FX forward maturity	10
ECB by oil companies	4		
NRE/FCNRB deposits inflow after rate hike	29		
ECB liberalization	10		
Oilco swaps	16	Oilco swaps	16
Total inflow	87.5	**Total outflow**	65.5

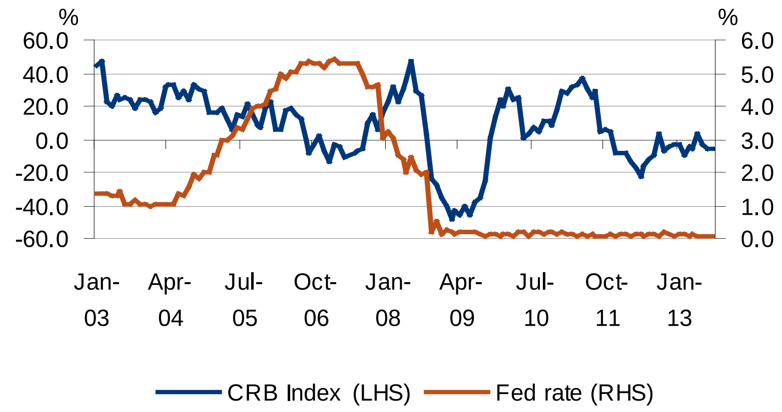
Source: BofA Merrill Lynch Global Research

US recovery positive for India

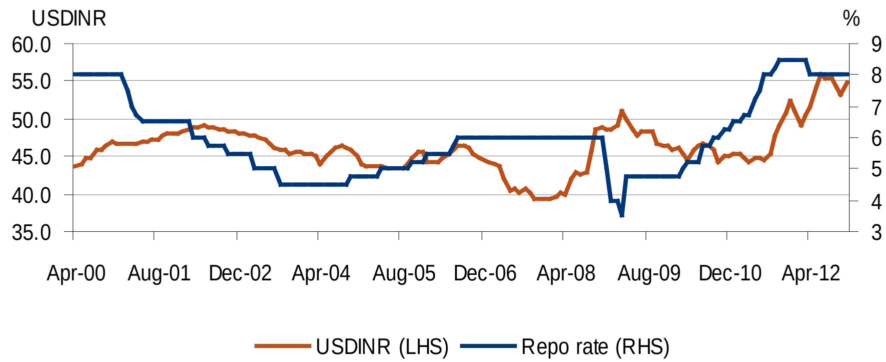
A rising tide lifts all boats



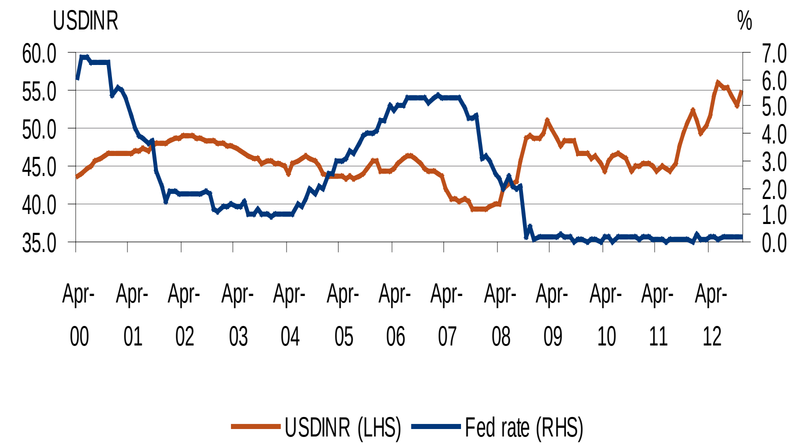
Fed easing inflationary



Rupee performs better during RBI easing…



…and when the Fed tightens



Source: RBI, BofA Merrill Lynch Global Research estimates.

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India Banks: Investment Overview

Asset quality to remain a key challenge

- Gross NPL's at 6% in FY15 vs. 3.4% now
- Stressed stock at 12.7%; up 70% in 2 years

Rate cycle likely peaking

Loan growth to moderate to ~14% in FY14

- Mortgage showing traction;
- Retail loans to grow by 16-17%
- Corporate loan growth <10% on delayed recovery

Regulatory Challenges to fore

- PSL norms; Dynamic provisioning, Restructuring
- New banking licenses
- Basel 3: Capital cliff for govt. banks from FY16-18

Govt. banks most impacted

Key Sector Ratio

Particulars	FY11	FY12	FY13E	FY14E	FY15E
Loan growth	20.8%	17.5%	16.7%	13.8%	14.2%
Deposits growth	15.8%	17.4%	13.5%	13.5%	13.5%
NIMs	3.1%	3.1%	3.0%	2.9%	2.8%
CI Ratio *	44.1%	43.4%	43.9%	44.8%	45.3%
Gross NPLs	2.3%	2.9%	3.4%	4.5%	5.3%
Net NPLs	1.0%	1.2%	1.7%	1.9%	1.8%
Slippages	2.0%	2.6%	2.8%	3.3%	3.3%
Restructured Loans	3.3%	4.7%	6.1%	6.3%	6.0%
Tier 1 *	9.7%	10.2%	10.1%	9.5%	8.9%

Loan Trends / Mix

Growth yoy	Mar-11	Mar-12	Mar-13	YTD	Mar-14
Agri	**18%**	**15%**	**9%**	**12%**	**12.8%**
Retail (incl HFC)s	**24%**	**12.6%**	**13.2%**	**18.6%**	**15.6%**
Total Mortgage (incl. HFC)	19%	15%	17%	20%	19.4%
Auto	14%	22%	25%	23%	12.0%
Transport Operators (CV)	42%	6%	4%	4%	4.0%
Other Retail	22%	11%	8%	18%	16.4%
Corporate Credit	**20%**	**20%**	**20%**	**18%**	**13.3%**
Infra	38%	20%	16%	20%	13.0%
Iron & Steel	32%	22%	20%	21%	14.0%
Other industries	14%	19%	13%	15%	12.0%
NBFCs	62%	24%	13%	18%	13.0%
CmRE	6%	16%	12%	17%	12.0%
Other Services	11%	20%	31%	18%	15.0%
Total	**20.8%**	**17.5%**	**16.7%**	**17.3%**	**13.8%**

Source: BofA Merrill Lynch Global Research Estimates., * For covered banks only

Earnings Sensitivity to Loan growth, Yield, Rates: Govt. banks more impacted

Earnings Sensitivity Analysis	SBI	PNB	BOB	BOI	Canara	UBI	OBC	Corp	IDBI	ICICI	HDFC BK	Axis	Fed BK	Kotak	Yes	IndusInd
Loan growth Sensitivity (100bps)	-1.9%	-2.4%	-2.3%	-3.0%	-3.0%	-3.5%	-3.7%	-3.0%	-3.3%	-0.9%	-1.1%	-1.1%	-1.7%	-1.3%	-1.3%	-1.7%
Yield Sensitivity (10bps)	-0.7%	-1.2%	-0.6%	-0.3%	-3.0%	-1.0%	-1.0%	-2.6%	-0.2%	-0.1%	-0.2%	-0.2%	-0.6%	-0.4%	0.0%	-0.3%
Lending / Deposits rate sensitivity (50bps)	-10.2%	-7.5%	-6.5%	-9.0%	-7.1%	-9.2%	-4.5%	-9.9%	-8.6%	-1.2%	-0.8%	-2.3%	-7.0%	-2.3%	-1.6%	-1.7%

Source: BofA Merrill Lynch Global Research Estimates

INDIA INSURANCE

Favorable Demographics

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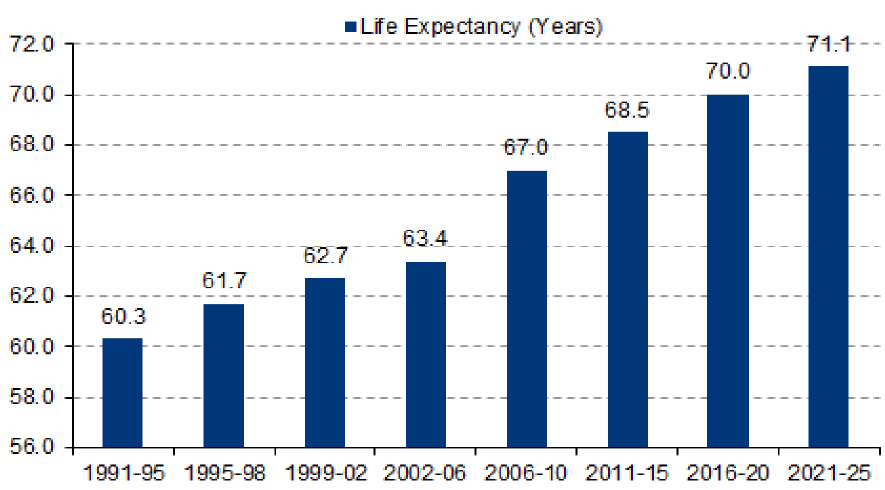
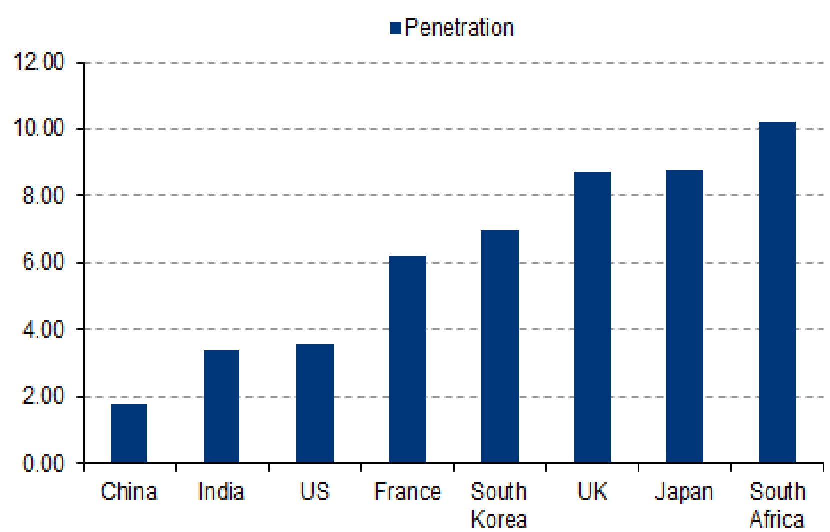
- Increase in average life expectancy would fuel need for pension and health products
- Emergence of nuclear families has resulted in reduction in average household size and would increase need for protection products
- Sufficient headroom exists to sell insurance as penetration remains lower than advanced economies

Life Expectancy



Source: BofA Merrill Lynch Global Research estimates.

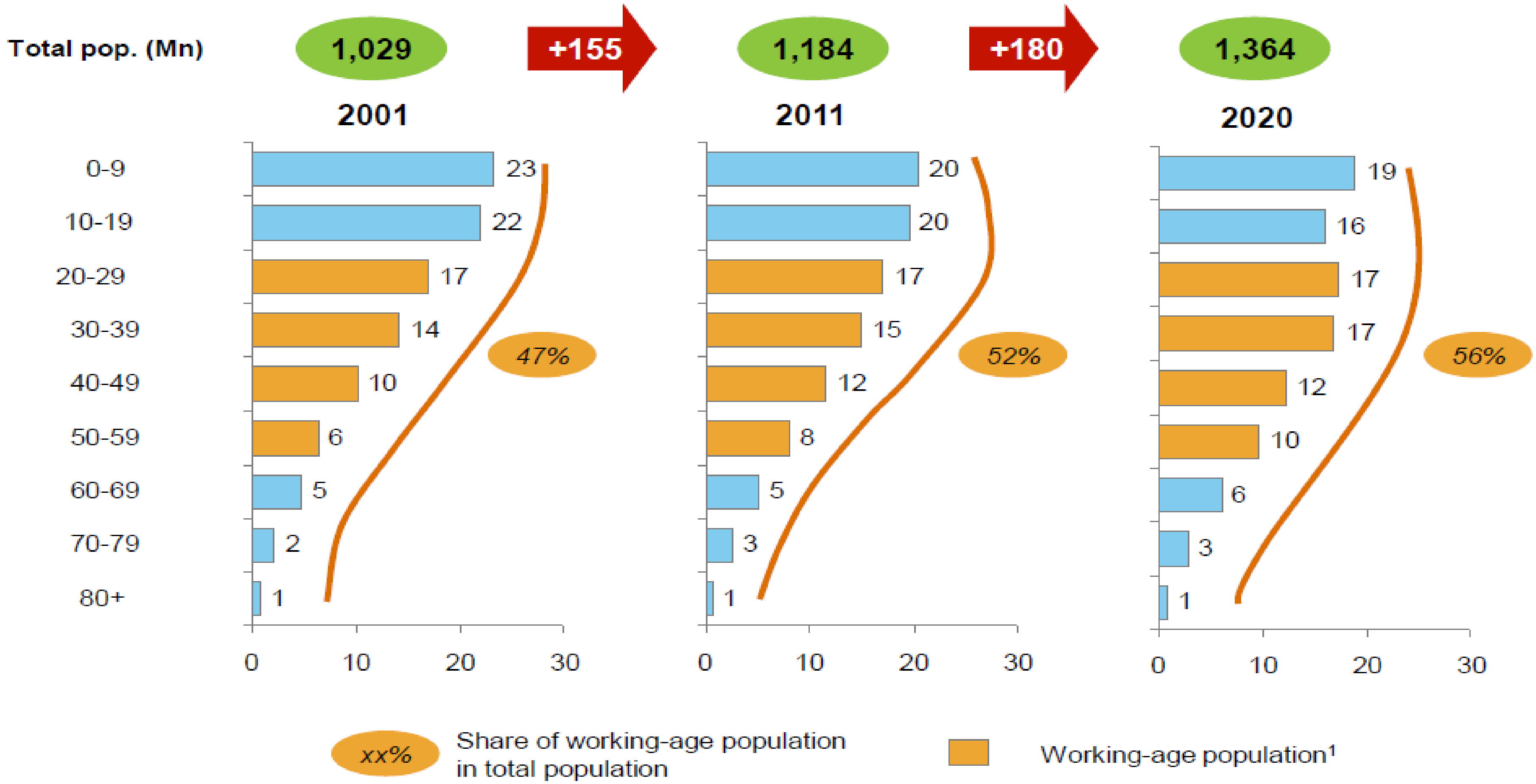
Penetration (Insurance premium / GDP)



Source: BofA Merrill Lynch Global Research estimates.

Favorable Demographics (Cont.)

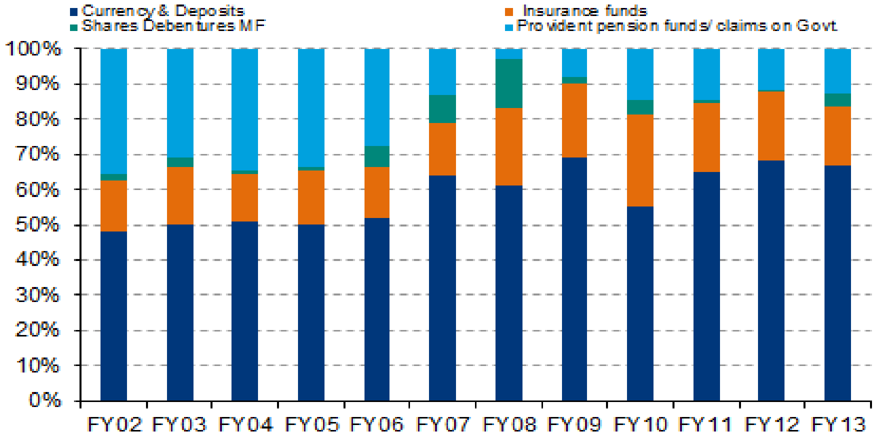
Increase in the working age population would ensure demand for long term savings and protection plans offered by life insurance



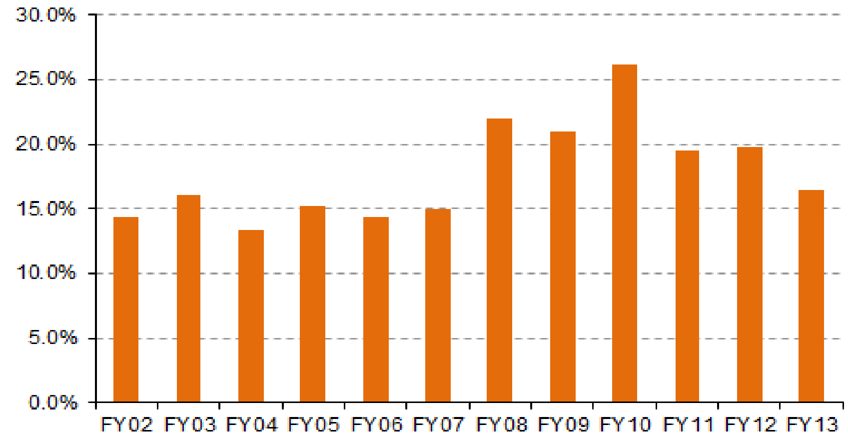
Source: BofA Merrill Lynch Global Research estimates.

Insurance share and Savings rate

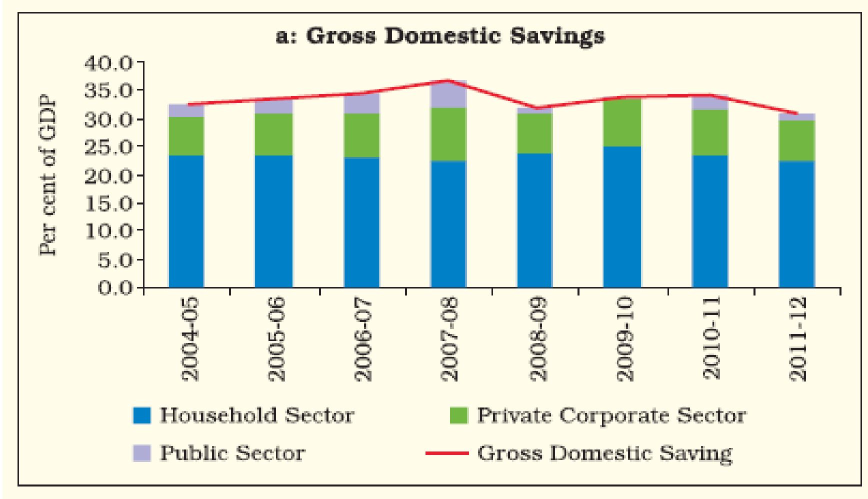
Break up of Household savings



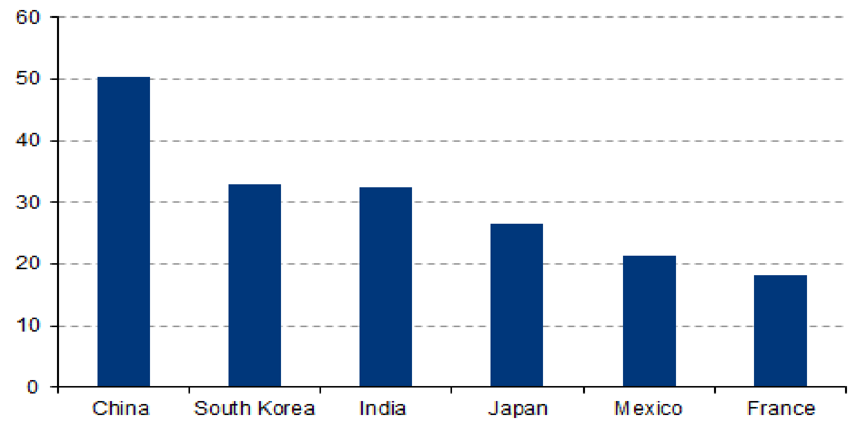
Share of Insurance in Household savings



Savings rate in India



Savings rate comparison



Source: BofA Merrill Lynch Global Research estimates.

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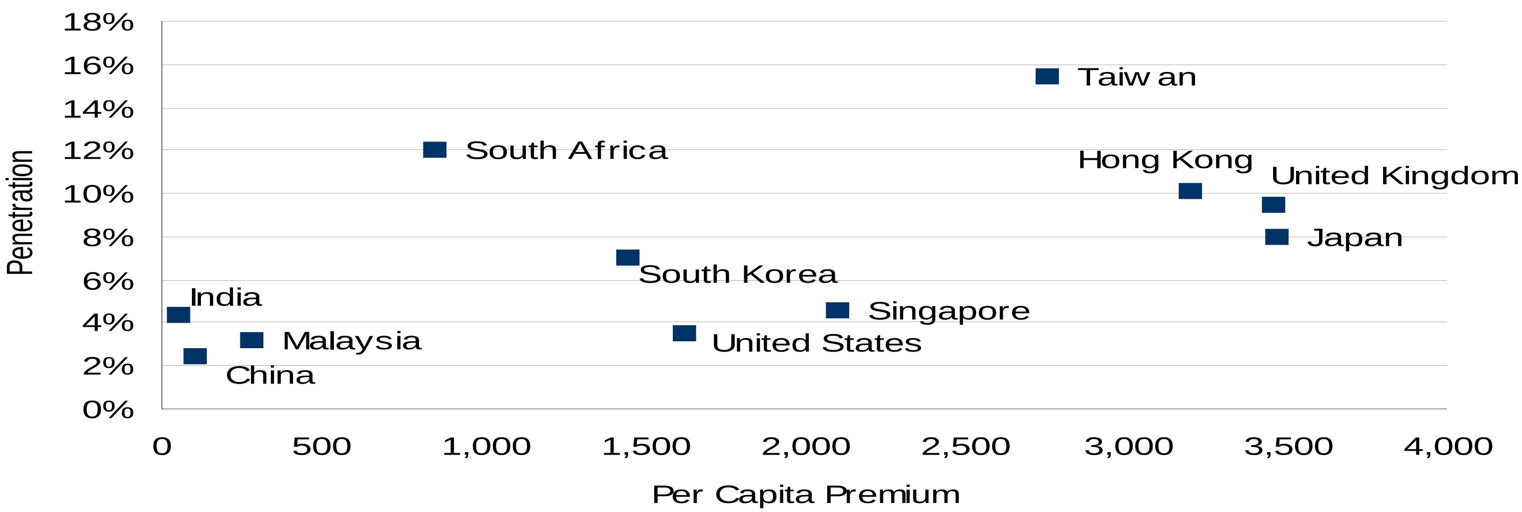
Underinsured not underpenetrated

- Life insurance penetration (Premium / GDP) at 4.4% of the GDP
- Ratio of prevalence (measure of underinsurance: sum assured/GDP) stands at 44%
- Higher sum assured to help increase profitability

Countries	Ratio of Prevalence	Penetration
Japan	330%	8.0%
Hong Kong	240%	10.1%
Taiwan	316%	15.4%
Singapore	220%	4.6%
India	44%	4.4%



Source: BofA Merrill Lynch Global Research estimates.

Industry: New Business premium trends

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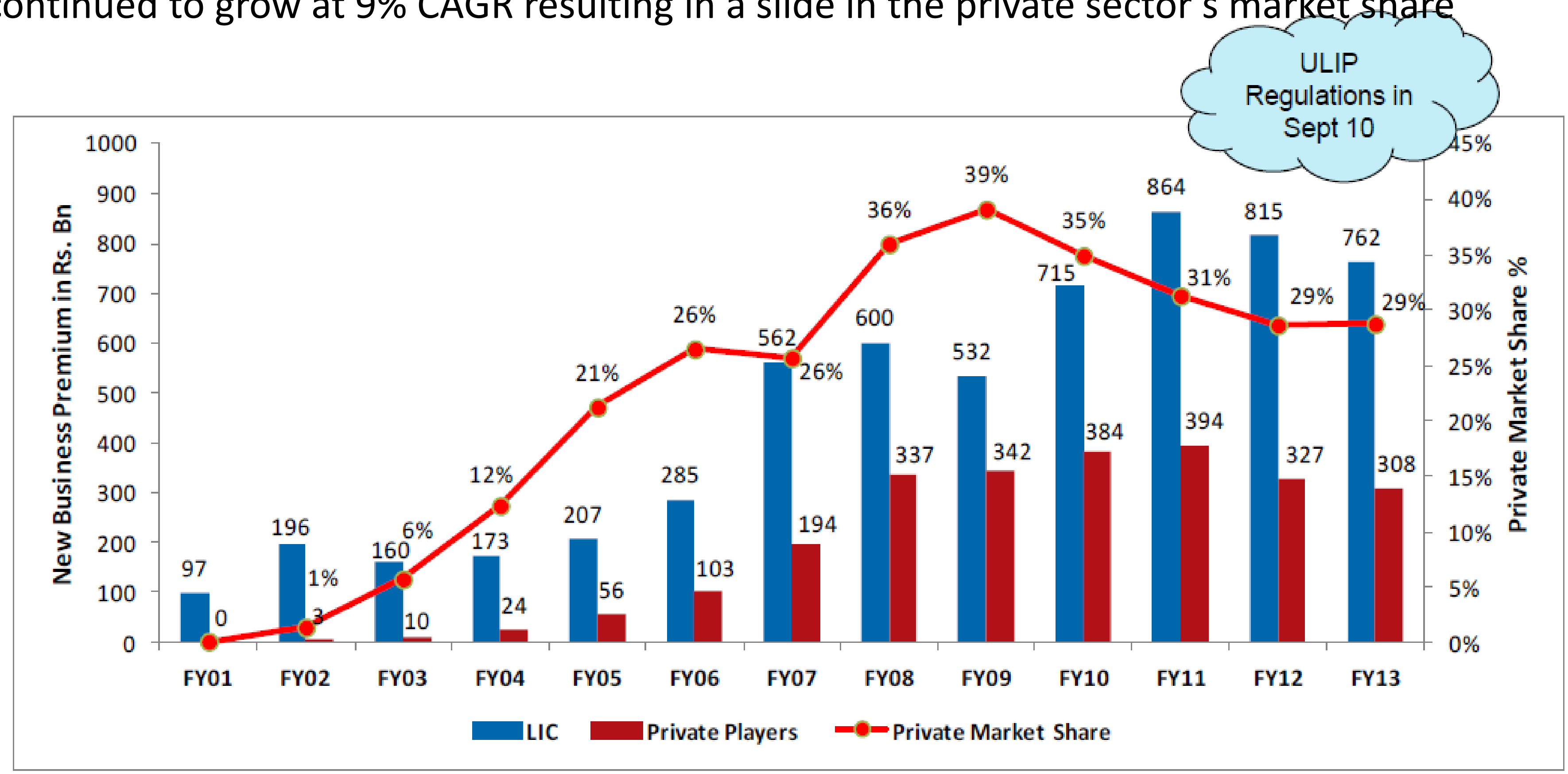
- Insurance industry was opened to private sector in 2000 and was able to garner 39% market share in new business premium by FY09
- Between FY09 and FY13, private sector slowed down with de-growth of 3%, while LIC continued to grow at 9% CAGR resulting in a slide in the private sector's market share



Note: New Business Premium numbers are based on first year premium including single premium

Source: BofA Merrill Lynch Global Research estimates.

Insurance: Growth & Outlook

Growth at 12-15% CAGR for FY13-18

- Post 3% growth in FY13, industry to grow still modest at 5-7% in FY14 on new regulatory regime
- But for long term, we est. a CAGR of 12–15% over the next five years.
- Growth to accelerate as insurers’ extract benefits from new strategies / products

Underlying potential remain strong on

- Favorable demographics
- Expanding of distribution network to tier 2 and tier 3 cities by new players
- Higher penetration / density

Margins to stabilize

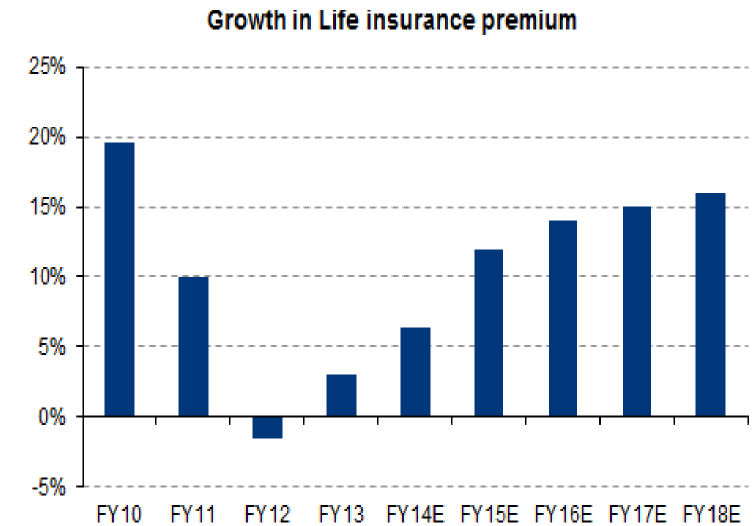
- Expect margins to take a hit on new regulations but still at 13-16% levels.
- Lower persistency and higher expense assumptions could provide upside to margins

Industry growth (historical)

Rs bn	FY10	FY11	FY12E	FY13E
Sector Total Premium	2,652	2,916	2,871	2,956
- FYP	607	640	622	520
- Renewal Premium	1,553	1,652	1,731	1,886
- Single Premium	492	625	517	551
APE- New Business	656	702	674	575
yoy growth in new business - APE	22%	7%	-4%	-15%
Total Premia (US$bn)	48.2	53.0	52.2	53.8

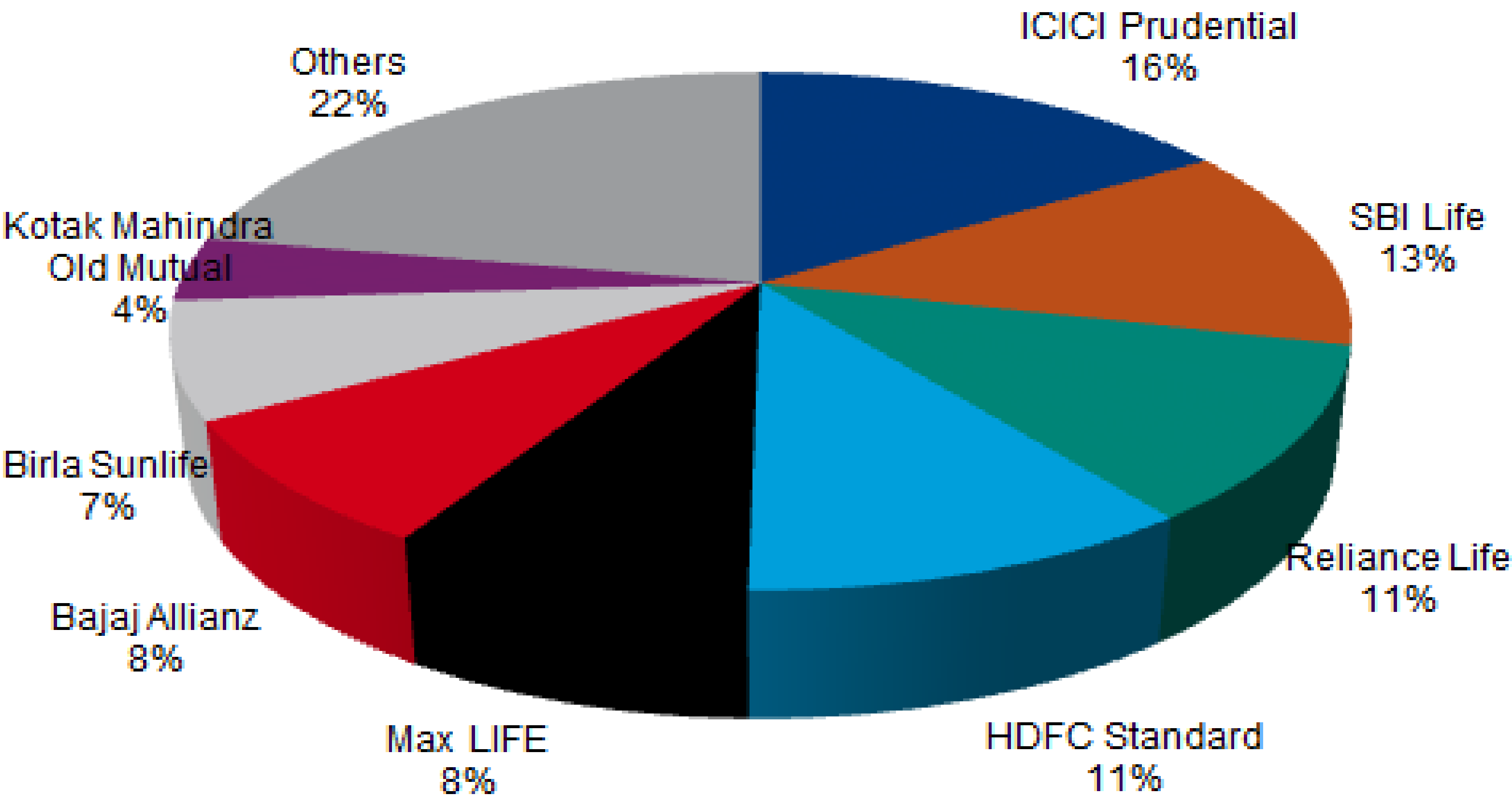
Sector	FY10	FY11	FY12E	FY13E
Total Premium	20%	10%	-2%	3.0%
- FYP	22%	5%	-3%	-17%
- Renewal Premium	16%	6%	5%	9%
- Single Premium	29%	27%	-17%	6%
APE- New Business	22%	7%	-4%	-15%

Industry growth (Estimate)



Source: BofA Merrill Lynch Global Research estimates.

Industry: Market Share (Cumulative APE* basis) 1HFY14



Source: IRDA.
* APE is sum of Non Single premium plus 10% of Single Premium

Industry: Product and Channel Mix

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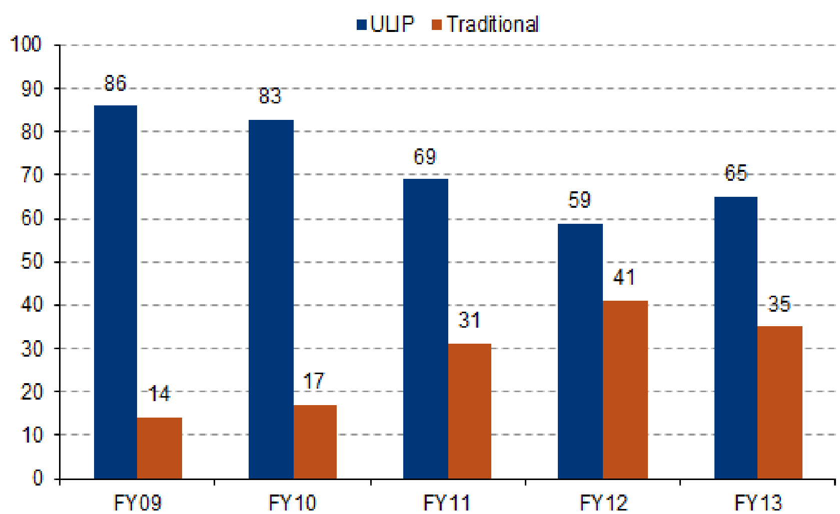
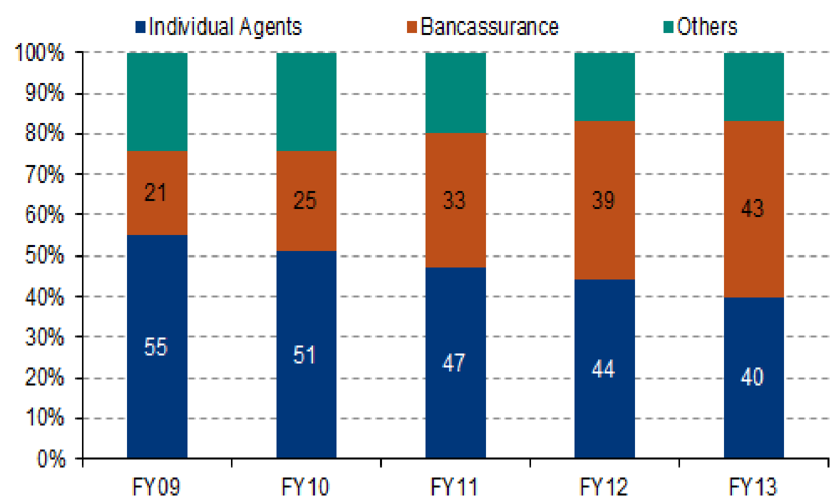
- Share of Traditional (Conventional) product up till FY12 but declined thereafter in FY13
- Bancassurance increasingly gaining market share. Likely to increase further as banking system still not penetrated as far as insurance sale is concerned.
- Top private life insurers (ICICI, HDFC, SBI) have banking partners within their group entity

Product Mix: Private players



Source: BofA Merrill Lynch Global Research estimates.

Channel Mix: Private players



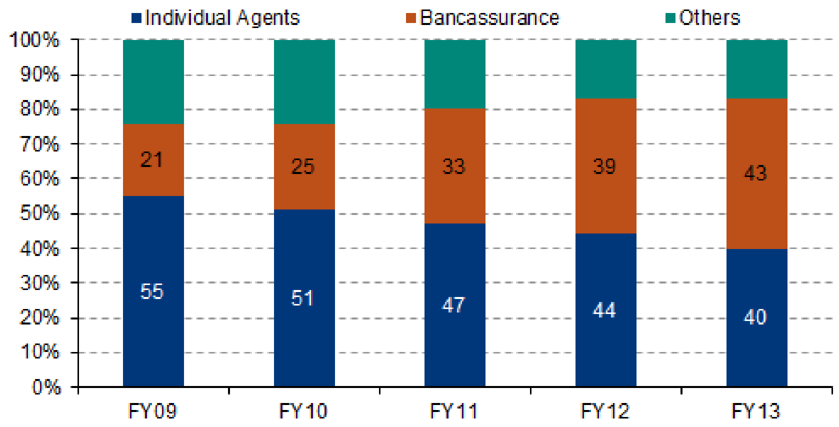
Source: BofA Merrill Lynch Global Research estimates.

Distribution channels, persistency Key

Distribution channels, cost efficiency, persistency key

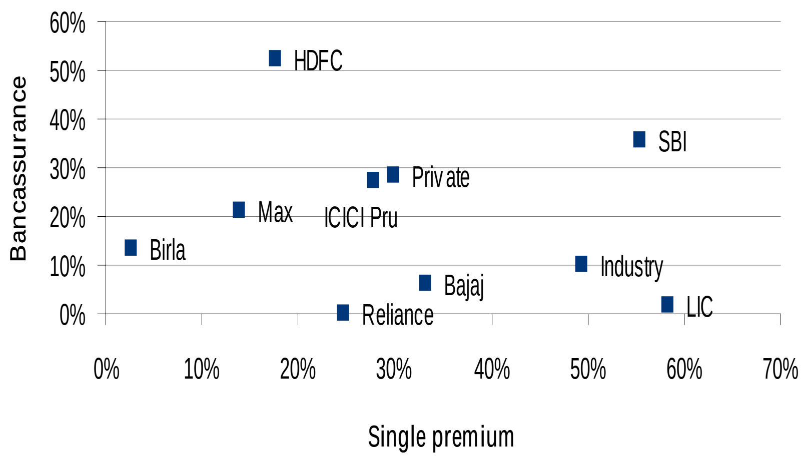
- Bancassurance provide access to existing customer base, reduces fixed cost and is cost- efficient
- Bancassurance emerging as the biggest distribution channel
- Agency: most efficient channel but also most expensive, mostly protection product and regular premium product

Channel Mix



Source: BofA Merrill Lynch Global Research estimates.

Bancassurance in Single premium



Source: BofA Merrill Lynch Global Research estimates.

Product guidelines

Traditional Products	New guidelines	Impact
Commissions	Commission on all policies is defined as per the premium paying term	Need to sell longer tenure products
Surrender value	Policy attains minimum guaranteed surrender value (GSV) after payment of 2 years (policy <10 years premium paying term) and 3 years (policy >= 10 years premium paying term) against earlier lock-in of 3 years	Positive for persistency but negative for demand in short term
Minimum term of policy	This is specified as 5 years; earlier there was no such stipulation	Need to sell longer tenure products
Premium paying term	Minimum premium paying term of five years; earlier there was no such stipulation	Need to sell longer tenure products
Minimum death benefit	Explicitly mentions minimum death benefits for traditional products; there was no clearly defined rule earlier	Traditional products without minimum death benefit clause impacted
Index-linked nonparticipating products	Index-linked non-participating products are brought at par with ULIPs in terms of cost structure	Index-linked nonparticipating products impacted
ULIPs	**New guidelines**	**Impact**
Reduction in yield (RIY) requirement in ULIPs	Prescribed Reduction in Yield (RIY) has to be complied for all gross investment returns to the customer from 5th policy year onwards and addition to the unit funds (wherever applicable) is to be done through non negative claw back additions	Increased operational complexity
Cap on guarantee charge	Guarantee charge capped at 50 bps	
Highest Net Asset Value - NAV guaranteed products	Products with highest NAV guaranteed shall not be allowed and any guaranteed benefit under a linked product shall be at product level	

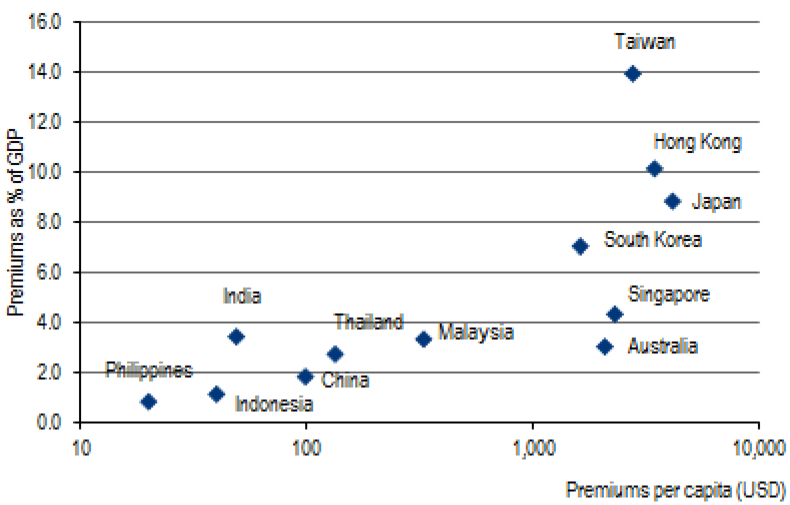
Insurance : Regional Overview

- Insurance premium growth tends to take off when GDP per capita hits US$1,000 per annum insurance premium growth begins to take off.
- However, when GDP per capital hits US$10,000 per annum, insurance premium growth would start to slow

Per Capita GDP

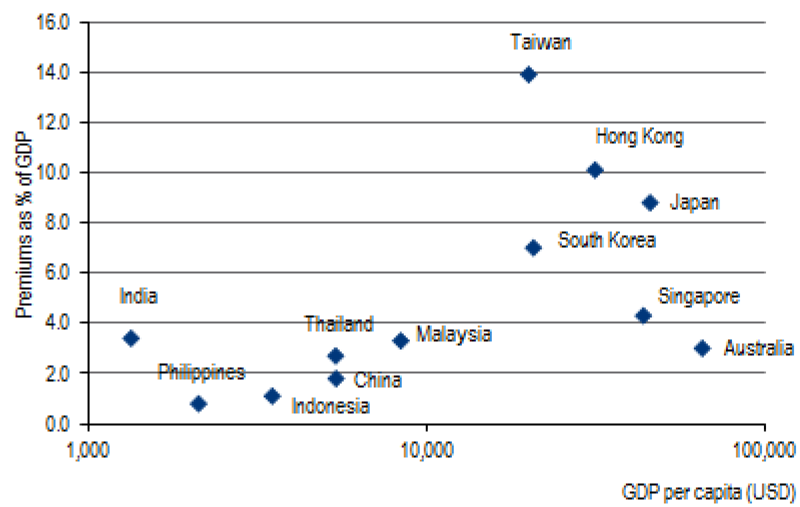
India	Philippines	Thailand	China	Malaysia	Taiwan	South Korea	Hong Kong	Singapore	Japan	Australia
1,342	2,123	5,394	5,414	8,418	20,101	20,765	31,575	43,865	45,920	65,477

Asia: Insurance Penetration vs. Density



Source: BofA Merrill Lynch Global Research estimates.

Asia: Insurance Penetration vs. GDP per capita



Source: BofA Merrill Lynch Global Research estimates.

Trends in Asia

Developed markets: Taiwan, Korea, Hong Kong, Singapore

- Insurers would still want to focus on protection products
- But, growth will remain low
- Volatile growth in investment related products
- Scale does matter, and M&A is the way to grow
- Margins likely to trend lower
  - Economies of scale
  - Shifting into investment related and bancassurance

Developing markets: China, India, ASEAN countries

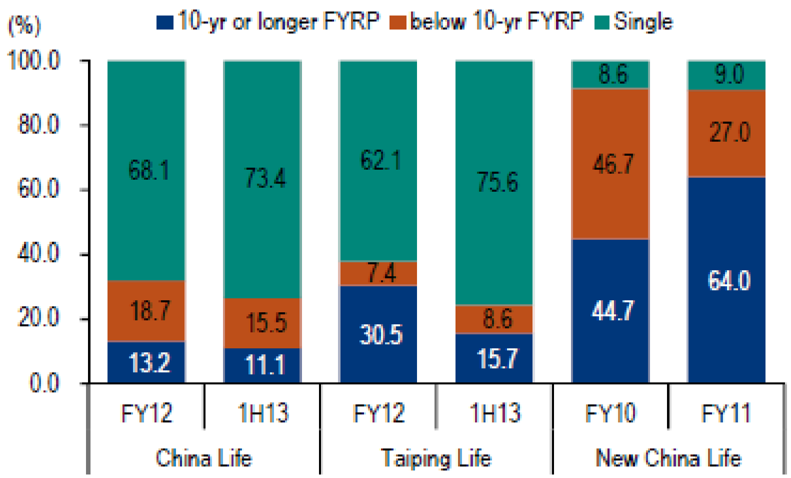
- Growth is relatively high
- Operations not reach economies of scale –expense overrun –margins to improve
- Greenfield projects –better growth
- High regulated, locals tend to have better advantage
- Margins unlikely to reach levels of developed markets, as expanding into bancasurance already

Regional Overview: China

We are overweight on China insurers on

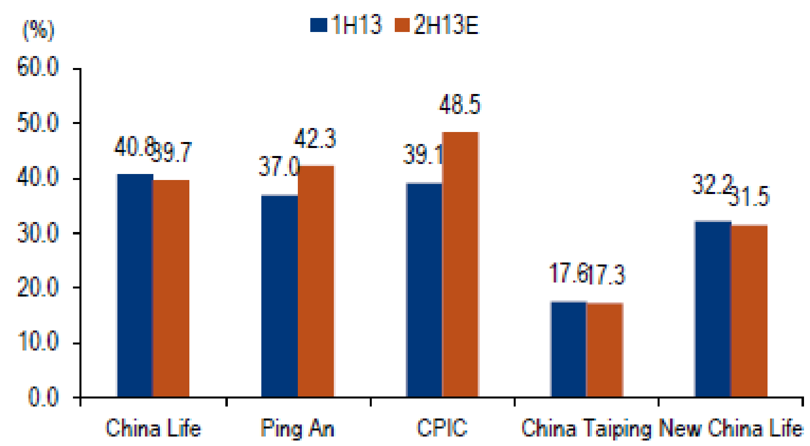
- **Growth may pick up on low base effect:** The peak of maturities and surrenders seems behind us, reducing pressure on insurers to achieve top-line growth.
- **The gap between returns of insurance and Wealth Management products is narrowing,** so sale of life products should be less difficult than before
- **Operating environment should improve** as there are less regulatory headwinds
- **Attractive valuation** as the sector is now trading at 0.9x-1.3x P/EV (Price/Group EV) and (3.5x-7.4x NBM (new business multiple), implying the market has minimal expectations

Longer tenure products would lead better margins



Source: BofA Merrill Lynch Global Research estimates.

New business margins picked up on better product focus



Source: BofA Merrill Lynch Global Research estimates.

Regional Overview: China

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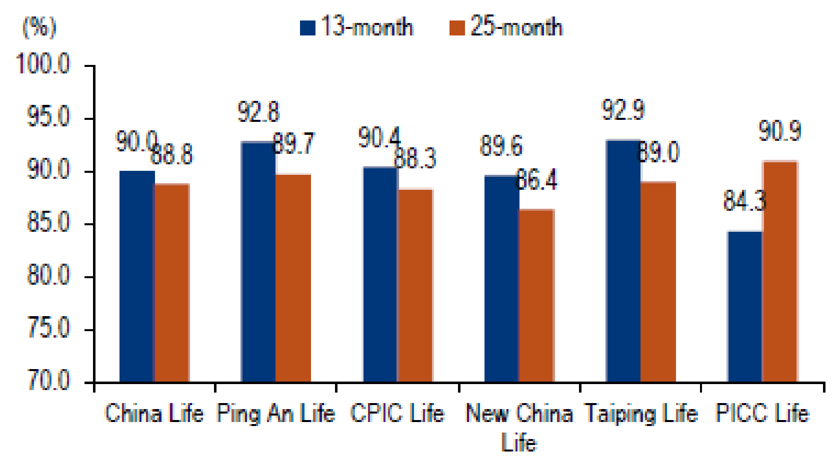
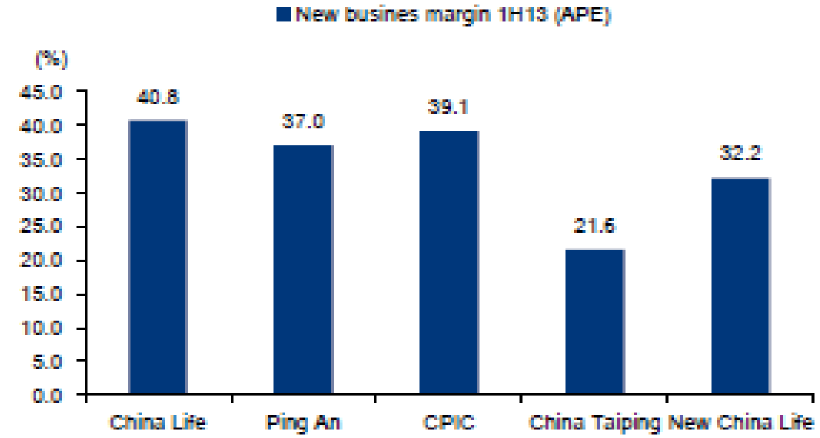
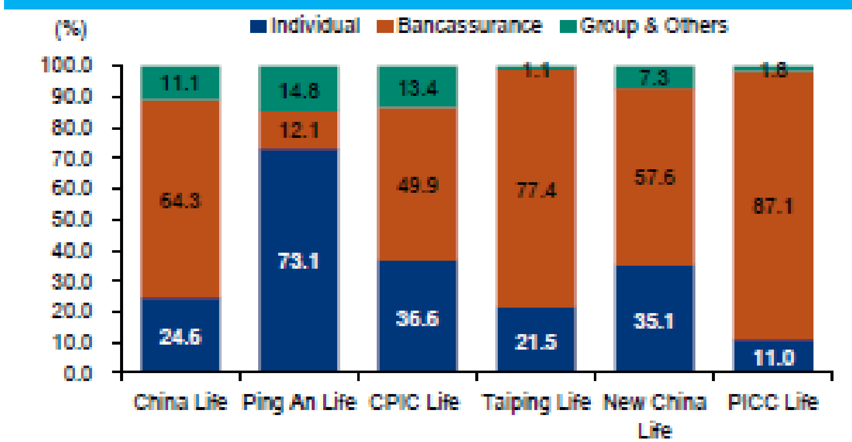
Chinese insurers: Persistency



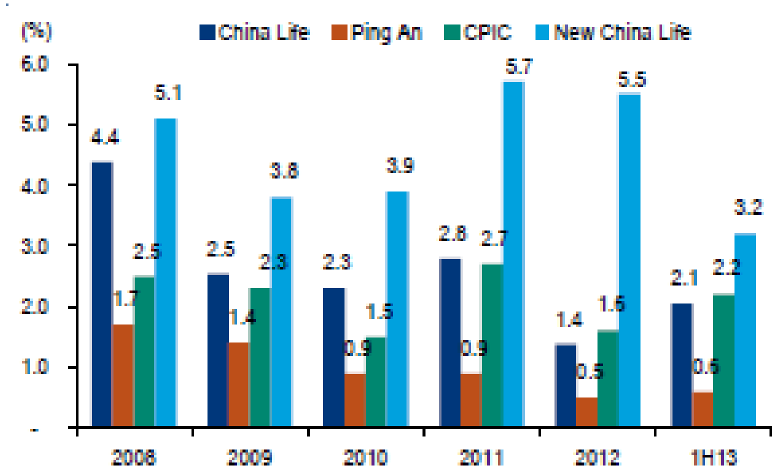
Chinese insurers: New business margin (APE) 1H13



Chinese insurers: FYP by distribution 1H13



Chinese insurers: Surrender rate



Source: BofA Merrill Lynch Global Research estimates.

Source: BofA Merrill Lynch Global Research estimates.

From an investors' perspective…

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- Insurers – earnings are not relevant
  - Revenue and earnings mismatch; Claims operate in cycles
  - Long term business, So current earnings is not reflective of the underlying real value
- Equity market movement has small impact on insurers
  - While equity and bonds are marked to market, impact on EV is not as big as market perceives
  - Impact on EV is minimal (10 change leads to 2% change in EV) and no change in VNB
- Insurers are interest rate hike proxies
- Premium growth is important in determining the growth of company
- Valuing Insurers
  - Traditional methods don't work
  - What drives insurance valuations
  - Comparisons difficult across markets

Earnings important?

Insurers – earnings are not relevant

- Highly volatile and fluctuate owing to equity market
- Revenue and earnings mismatch;
- Claims operate in cycles
- Earnings can be massaged by reserves fluctuation
- New company usually make losses in the first few years –fiscal year profit not indicative
- Long term business, So current earnings is not reflective of the underlying real value

Earnings gain relevance as Insurers mature

- Less meaningful for developing insurers, as a lot of the expenses are still front end loaded, and operations have not reached economies of scale
- For developed insurers, ability to generate earnings is important
- Operating profit –Underwriting profit + recurrent return –could be a proper benchmark
- Profit is more important for mature insurers –as new business strain is no longer an issue

So…Earnings should not matter… But…

When earnings disappoint and when insurers misses earnings, market will still react negatively

Equity market meaningful?

Equity market movement should have small impact on insurers

But

- Insurers is an indirect way to play with the equity market
- Insurers have very low ROA, therefore any movement in investment returncan lead to huge movements in earnings and book value
- Investors are willing to pay for a higher new business multiplier in a bull market and lower new business multiplier in a bear market
- In India, at the early stage when ULIP dominated, equity markets impact was more than required for a traditional insurer

Life insurers FV are benchmarked on

- Fair Value = Embedded Value + Value of New Biz * New Biz Multiplier
- For example: bear market – 10x NBM for China, bull market 40x?
- bear market – negative NBM for Taiwan, bull market 10+x?

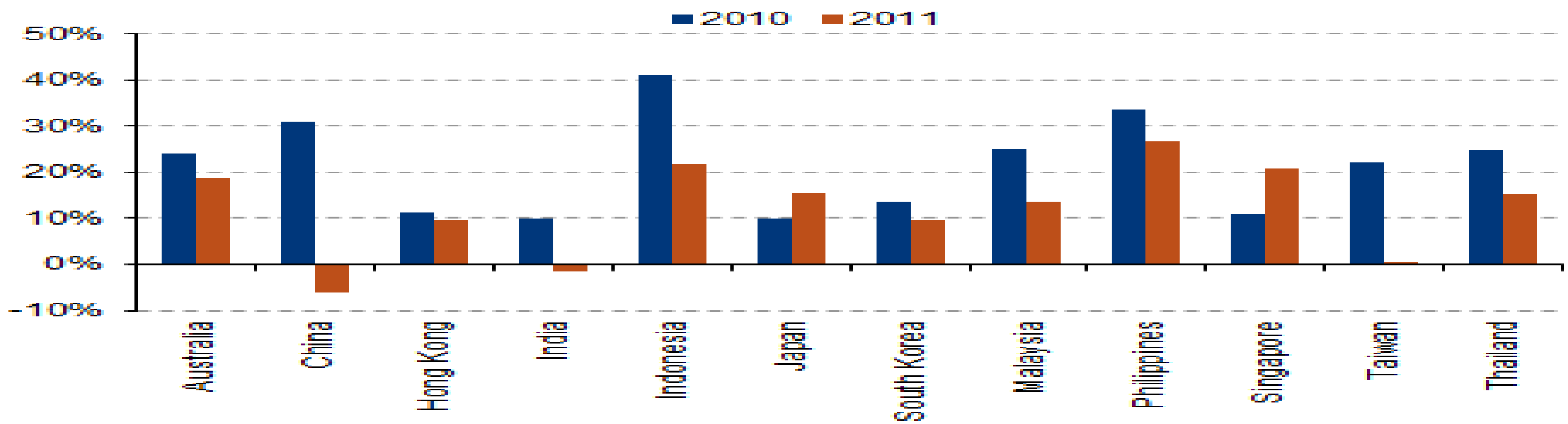
Premium growth is important?

Premium growth is important in determining the growth of company

But

- Quality matters more than quantity
  - Low premium growth may not mean low value of new business growth
  - High premium growth may not mean high value of new business growth
- In developed markets, investors are willing to pay for growth…any type of growth
- Monthly premium figures –trend setting but can be misleading

Asia Insurance : Premium growth for 2010 & 2011



Source: BofA Merrill Lynch Global Research estimates.

Interest rate hike proxies?

Insurers are the one of the best interest rate hike proxies in the market

- More positive for insurers with negative spread problems
  - Taiwan
  - Korea
  - Japan

- LONG TERM THEME
  - Reinvestment
  - New money

- Immediate impact on P&L and EV is minimal

- Insurers are late cycle interest rate hike plays
- Less meaningful for insurers focusing on investment related products
- Watch out for MTM losses on bonds on EV and book value

What Analysts look for in insurers' P&L / BS?

Profit & Loss A/c

- Premium growth, persistency rates
- Claims + reserves as % of net premium (to see if insurers are using reserves to massage its earnings)
- Expense as % of net premium
- Deferred Acquisition Cost (DAC) as % of net premium
- Investment return : recurrent investment return and total investment return
- Operating profit growth and Return on operating profit for developed insurers

Balance Sheet

- Investment portfolio growth
- Investment mix changes
- Return on equity
- Shareholder's equity / net premium
- Total reserves / net premium

- Watch out:
  - Are reserves being MTM on liability side?
  - What happens if account standard changes?
- Negative spread can still happen when guaranteed rates are higher than market rates

How to value insurers?

- Embedded value / appraisal value concept
  - Current book + MTM gains + discounted profit from existing business + growth prospect
  - P/EV

- RoEV derived embedded value
  - Gordon Growth Model

- Mature insurers
  - PER
  - BV

- Long term and stability is more important than current year earnings

- Insurers typically use different subsidiaries to run their life and non-life business

- Consistency is the key –fluctuations in investment return or investment style is NOT healthy

- Flow with the market trend and not against –insurance is a commoditized business, and therefore, any swing from the norm is not deemed as healthy

Valuation Approach: India

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- We use approximation to appraisal value (AV) for valuing life insurers.
- Appraisal value is embedded value (EV) plus NBAP.
- Globally, insurance companies are valued on a multiple to their EV; the multiple factoring in two key factors
  - Growth trajectory (the expected profits on new business):
  - Market estimates of the insurer's variance over normal actual assumptions on
    - Underwriting ability,
    - Investment management capability
    - Ability to control costs.
- Hence, for a similar EV a company that is expected to generate higher investment returns or have a better mortality experience would trade at a higher multiple than the other one.
- The Indian experience so far, we think, is not able to capture the full impact of these variables as all the private insurers are in the early stages of life.
- Although the majority of private insurers have been in existence for 10 years, EV is likely to be minimal owing to the very small value of in-force business as they went through a rough patch due to the new regulations.

Valuation Approach: India

- A dominant portion of the total actuarial value for a private life insurance company in India would come from the “new Business component” or the AV.

- Hence, the valuation of these companies would largely be a function of their AV and they could potentially trade at close to or even at a premium to their AV depending upon the ability to achieve the projected growth rates and the underlying actuarial values.

- Embedded value is EV is adjusted net worth plus the value of in-force book. We believe this methodology is prudent enough as the discount rate takes into consideration the economic as well as actuarial assumptions. However,
    - Currently, not all companies disclose EV.
    - Also, there is no standardization of EV disclosures.

- Estimating the NBAP margin for different regular premium products becomes impossible due to the lack of disclosure, so we use an overall NBAP margin based on
    - Distribution model
    - % Mix of traditional / ULIP
    - Persistency trends
    - Expected savings on mortality,
    - Gains due to of economies of scale

Embedded value

Quality of EV matters

- EV is full of assumptions, therefore change in assumptions can have a huge impact on EV
- It is important to see what drives the embedded value growth
- Operational embedded value : Unwinding of existing business + new business value

Key variables

- Discount rate
- Investment return assumption
- FYP growth assumption
- New business margins assumption

Market does not trust embedded value when

- Liabilities are not marked to market
- Assumptions are way too aggressive
- Visibility is low

P/EV not very comparable across markets

- P/EV hard to compare on regional basis –as insurers have different EV characteristics
- Developed markets P/EV : 0.8-1.6x (not focus on new business multiplier)
- Developing market P/EV : wild card!!

Embedded value

Mature company:

- Larger adjusted net worth
- Bigger back book (more in force policies, accumulated more wealth historically)
- Value of in force should be sizable, but can be affected by negative spread (resulting into a negative value of in force)
- Embedded value growth will be generated more by Asset accumulation
- Unwinding of existing business thru discount rate
- VNB as % of EV would be small

Exception : 1) low capital 2) book has been written down

Young company

- Value of new business as % of EV and VIF is huge
- Book value dragged by Initial losses from underwriting business
- Shorter period of asset accumulation
- Embedded value growth will be generated primarily by VNB growth
- RoEV tends to be higher for these insurers
- Insurers tend to trade at higher multiple to EV and VNB

THANK YOU

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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

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