

ICICI Prudential Life Insurance

BSE Sensex: 9,885 S&P CNX: 2,890 16 June 2006

Not Rated

We attended the first ever Analyst Meet hosted by ICICI Prudential Life Insurance Limited (I-Pru Life), ICICI Bank's life insurance venture. The meeting highlighted the strong growth potential that the life insurance business offers in India and how I-Pru Life is tapping this opportunity. The management also discussed how it calculates new business achieved profits (NBAP). We present below our key takeaways.

Life insurance business offers strong growth potential

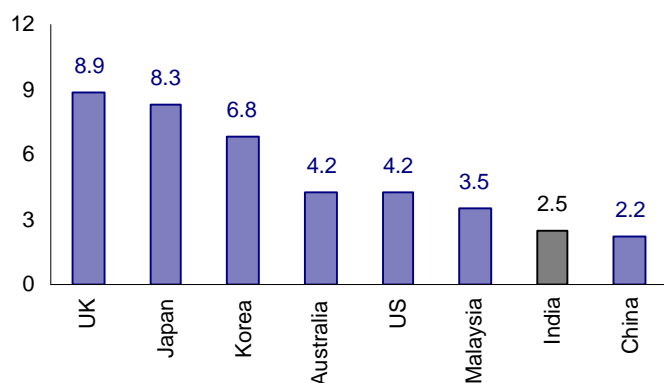
Life insurance premiums constituted just about 2.5% of India's GDP in FY04 and are likely to constitute about 3% of GDP in FY06. Under-penetration of life insurance in India should result in strong growth in life insurance premiums in India over the next few years. The management expects growth of 20% CAGR over the next five years for the industry.

LIFE INSURANCE: A GROSSLY UNDER-PENETRATED MARKET IN INDIA

| | FY00 | FY05 | FY06 |
|------------------------------------|------|------|------|
| No of Players | 1 | 14 | 15 |
| Life Insurance Premiums (Rs b) | 270 | 786 | 960 |
| LIPs as a % of GDP | ~1.2 | ~2.6 | ~3 |
| Per Capital Insurance Premium (Rs) | 280 | 700 | 875 |

Source: Company

LIFE INSURANCE AS A % OF GDP (2004)



Source: Company

I-Pru Life has been gaining market share consistently

On the back of its expanding sales and distribution network, I-Pru Life has been consistently gaining market share over the last four years. It has emerged as the second largest life insurance player in India, with an overall market share of 10% and the largest amongst the private insurers. In group insurance, I-Pru Life's market share has risen from 17% in FY05 to 27% in FY06 amongst the private insurers.

I-PRU LIFE: CONSISTENTLY GAINING MARKET SHARE (%)

| | FY03 | FY04 | FY05 | FY06 |
|--------------------------------|------------|------------|------------|------------|
| ICICI Pru Life | 2 | 5 | 9 | 10 |
| Other Private Life Ins Players | 4 | 9 | 17 | 24 |
| LIC | 94 | 86 | 74 | 66 |
| Total | 100 | 100 | 100 | 100 |

Source: Company

Focusing on strong sales and distribution

I-Pru Life has focused on building a multi-channel distribution network. It has built up a sales force of 72,000 trained financial advisors and has a presence in 132 locations. During FY06, I-Pru Life sold 2m policies, up from 0.8m policies in FY05. The management highlighted that the focus would be on aggressively increasing its reach to Tier II and Tier III cities, which also offer huge potential. I-Pru Life intends to double its reach over the next 2-3 years.

I-PRU LIFE: GROWING DISTRIBUTION NETWORK

| | FY03 | FY04 | FY05 | FY06 |
|----------------------|------|------|------|------|
| Locations | 25 | 54 | 74 | 132 |
| Branches | 29 | 70 | 107 | 177 |
| Advisors ('000) | 18 | 32 | 57 | 72 |
| Non Agency Share (%) | 27 | 28 | 30 | 37 |

Source: Company

Strong growth in NBAP, with steady margins

Life Insurance in India yields profits on statutory accounting only after 6-8 years, as all the expenses relating to

commissions are front ended. Thus, profits accrue only after few years of the policy initiation. As a result, life insurance companies report losses in initial period and requires capital to support the strong growth. Hence, New Business Achieved Profits (NBAP) is one of the key performance indicators for insurance companies. NBAP is the present value of all future profits likely to be achieved on policies written in a particular year, based on some key assumptions.

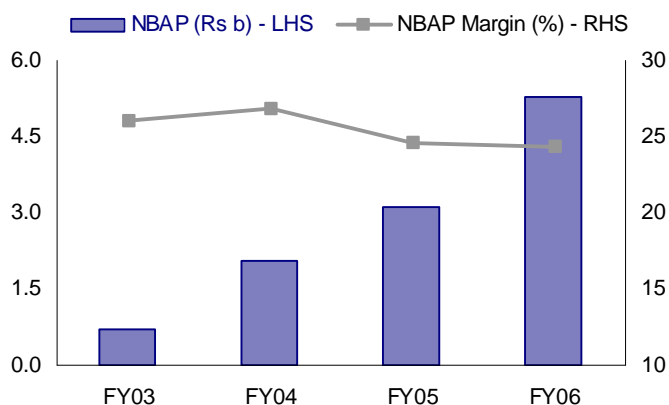
KEY ASSUMPTIONS USED BY I-PRU LIFE FOR NBAP MARGINS

| | FY05 | FY06 |
|---------------------------|------|------|
| Return Assumptions | | |
| G-Sec | 6.5 | 7.45 |
| Equities | 13.0 | 13.0 |
| G-Sec Long Term | 7.15 | 7.75 |
| Cash | 4.75 | 6.25 |
| Other Assumptions | | |
| Inflation | 5.0 | 5.0 |
| Tax | 14.0 | 14.0 |
| Risk Discount Rate | 13.0 | 13.0 |

Source: Company

While on a reported basis, I-Pru Life is reporting losses, its NBAP has been consistently increasing over the years. It has witnessed a 65% CAGR in NBAP during FY03-06 period. NBAP margins have declined from ~27% in FY04 to 24.4% in FY06. The management expects the margins to gradually decline, given high competition, and growth would be volume driven. While valuing I-Pru Life, we have assumed 20% NBAP margins in the initial years, gradually declining to terminal margins of 10%.

I-PRU LIFE: RISING NBAP

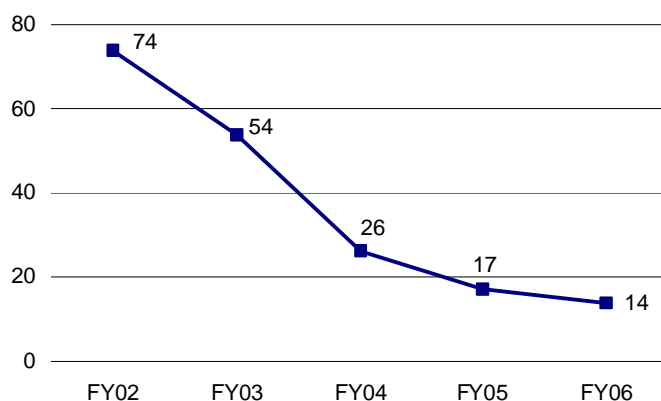


Source: Company

Other key issues

Falling expense ratio: As the size of operations is increasing, the expense ratio has been declining consistently. As of FY06, the expense ratio is 14%, down from 26% in FY04. The management mentioned that they intend to bring down to expense ratio to single digits over the next 3-5 years.

I-PRU LIFE: DECLINING EXPENSE RATIO



Source: Company

Growing funds under management: On the back of robust capital markets over the last couple of fiscals, I-Pru Life's funds under management have been increasing in favor of equities, which now contribute more than 50% of the total funds under management. A higher proportion of equity funds would result in higher asset management fees and better profitability for the life insurance company.

I-PRU LIFE: FUNDS UNDER MANAGEMENT TILTING IN FAVOR OF EQUITIES

| | FY03 | FY04 | FY05 | FY06 |
|--------------------------------------|------|------|------|------|
| Funds Under Management (Rs b) | | | | |
| Debt | 6.1 | 13.3 | 27.8 | 42.5 |
| Equity | 0.6 | 3.3 | 10.5 | 45.2 |

Source: Company

Renewal premiums expanding: I-Pru Life's renewal premiums as a proportion as total premiums have increased from 13% in FY03 to 39% in FY06, indicating long-term value creation.

I-PRU LIFE: RISING PROPORTION OF RENEWAL PREMIUMS

| | FY03 | FY04 | FY05 | FY06 |
|--|------|------|------|------|
| Proportion of Renewal Premium (%) | | | | |
| Individual | 50 | 64 | 62 | 54 |
| Single | 37 | 12 | 6 | 7 |
| Renewal | 13 | 24 | 33 | 39 |

Source: Company

Future strategy

The management highlighted the future strategy to further scale up its operations. The key focus would be on network expansion, wherein the strategy would be to double the reach within 2-3 years. On the distribution front, it intends to improve sales force productivity and strengthen relationship in partnership distribution. New product offerings would be for pensions and health over the next year. The key challenge would be to maintain human resources wherein they are issues on higher churning at the lower level.

I-Pru Life – big value generation for ICICI Bank

ICICI Bank holds 74% of I-Pru Life. The management has reiterated that whenever norms for FDI are revised, it will have to sell an additional 23% to the foreign partner. However, the sale would be at a value prevailing at that time and not at a pre-determined price. We value I-Pru Life at Rs140b (20x FY07E NBAP). For its 74% holding, the value per share for ICICI Bank works out to Rs116.

We have valued I-Pru Life on a DCF basis. We estimate that its new business (non-single premium) will grow at 50% in FY07 and 30% in FY08. Beyond that, we have assumed a slower growth rate because of high base. We have assumed a 20% margin on regular premium payment policies and 5% margin on single premium policies. We have built in a gradual decline in margins and a terminal growth of 5% and terminal margins of 10%.



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| Disclosure of Interest Statement | ICICI Prudential Life Insurance |
|---|--|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
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