IDFC SSKI
INDIA RESEARCH

Max India

Rs190
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs44.1bn; US$911mn

Analyst: Pathik Gandotra (91-22-6638 3304; pathik@idfcsski.com)
Nitin Agarwal, (91-22-6638 3395; nitinagarwal@idfcsski.com)
Neha Agrawal (91-22-6638 3237; neha@idfcsski.com)

Result: Q1FY10

Comment: On track!

Key metrics

Year to 31 Mar (Rs m)	Revenue	% change yoy	Net Profit/Loss	Insurance AUM	% change yoy	Embedded Value
FY08	36,110	81.0	(600)	35,750	95.0	6,700
FY09	48,910	35.0	(3,330)	54,050	51.0	13,160

Highlights of Q1FY10 Results

Max India ('Max') reported consolidated loss of Rs770mn for Q1FY10 as against Rs430mn in Q1FY09. Out of the total losses, Rs800Mn pertains to the life insurance business, a function of continued investments in building the distribution muscle and first year strain.

❑ Life Insurance – Max New York Life ('MNYL')

- Growth mired by volatile capital markets but gains market share: MNYL has reported Gross Premium of Rs11.2bn for the quarter ended June'09 (yoy growth of 29%). During Q1FY10, MNYL has posted a ~9% yoy de-growth in APE, a function of capital markets. However, MNYL's APE market share improved to 7.2% (% of private) from 5.2% a year ago. Expansion in distribution network, business from ULIP products (77% of new sales in Q1FY10) and metro cities continued to drive growth. Amidst volatile markets, company has seen some traction in sales of traditional products; expects 65% of total premium from ULIPs over the medium-term. (Exhibit 5)
- Conservation ratio is high relative to peers: MNYL's conservation ratio continues to be well above its average over the last few years. Albeit amidst market volatility, conservation ratio has declined by ~400bp yoy to 85% for Q1FY10 (at ~82% for FY09). Gross Premium in Q1FY10 continued to be driven by renewal premium, whilst First Year premium declined by ~8% yoy. (Exhibit 5)
- Some expansion in distribution network: Agency force as at June'09 stood at 94,600 agents- ~102% yoy and 13% qoq increase. MNYL intends to focus on better utilization of the existing branch network, with ~340 branches coming on stream during FY09 (6 added in Q1FY10). Non-agency channels contributed 35-40% of sales as of June'09. (Exhibit 6)
- No Capital infusion in Q1: During FY09, Rs7.5bn of more capital has been infused in MNYL, taking the total paid-up capital to Rs17.8bn. In Q1FY10 the company did not invest any additional capital due to lower growth posture. In FY10, company expects to require Rs6-7bn of incremental capital. The peak equity commitment currently stands at Rs36bn, which is a derivative of MNYL's growth trajectory.

❑ MHC – healthy performance

- Max Healthcare (MHC) has reported healthy revenue growth of revenues 18% yoy to Rs1.1bn. EBITDA margins have expanded by 30bp yoy to 5.4%. Absolute EBITDA at Rs640m is 25% higher yoy.

- During the quarter, the occupancy rates have remained increased significantly to 69.4% (as against 69.4% in Q1Fy09 and 65% in Q4FY09). Average revenue per bed per day has remained steady at Rs19,873.
- Max has maintained that they will be adding an oncology facility in H2FY09. Total physicians on rolls have increased to 600 during the quarter (from 500 earlier).
- We assume Max India's shareholding in MHC to be 75.57% (assuming exercise of 53.5m outstanding warrants on par by Max India). This translates into an equity value of Rs4.1bn, or Rs19 per share, for Max India

Exhibit 1: Healthcare businesses

(Rs m)	Q1FY10	Q1FY09	% yoy growth
Revenues	1117	995	18
EBITDA	640	510	25
EBITDA %	5.4	5.1	NA

Source: Company

❑ Max specialty products (MSP) – pricing pressure

- MSP has reported Q1FY10 revenues of Rs798m (18% decline yoy). While volumes have increased by 3% yoy, pricing has come off significantly.
- EBITDA margins have declined by 80bp yoy to 10.7%.
- All the BOPP lines are running at 100% capacity utilization. Max plans to add another 20,000 TPA capacity, taking total capacity to 49,000 TPA, operational by end of 2010.
- We maintain our estimates and value Max India's MSP business stake at Rs14/share

Exhibit 2: Max specialty products

(Rs m)	Q1FY10	Q1FY09	% yoy growth
Speciality business			
Revenue	798	978	(18)
EBITDA	107	139	(23)

Source: Company

❑ Other Businesses

- Max India's other 2 nascent businesses of clinical research and healthcare staffing continue to scale.
- Total revenues for the clinical research business stands at Rs36m for Q1FY10 and net earnings for Rs20m for Q1FY10.
- Clinical research business has shown a strong order book of ~Rs370m despite a weak CRAMS outlook. Max has expanded its database of principal investigators to over 950.

VALUATIONS & VIEW

We continue to be convinced of long-term growth prospects of the life insurance industry, and expect a change in the FDI regulation as and when it happens to act as a trigger. Also recovering capital markets would bolster premium growth and thereby earnings. On the back of improving growth prospects, high conservation ratio relative to peers – despite the challenging macro-economic environment – and factoring in falling cost of capital, we are assigning a 14 times NBAP multiple to MNYL. Reiterate Outperformer, with a SOTP price target of Rs283.

Exhibit 3: Sum of parts valuation

Business	Valuation Method	FY10 (Rs/ share)
Life insurance	Appraisal Value (EV + 14 times NBAP)	250
Max Healthcare (MHC)	DCF	19
Max Speciality Products (MSP)	DCF	14
Total SOTP Value		**283**

Source:IDFC- SSKI Research

Exhibit 4: Life insurance valuation

(Rs m)	2009	2010E	2011E
APE	16,189	19,419	24,274
yoy growth (%)	*19.6*	*20.0*	*25.0*
NBAP Margins (%)	19.6	18.5	17.5
NBAP	3173	3593	4248
Embedded Value: {A}	**22,840**	**32,751**	**44,794**
Structural Value			
NBAP		3,593	4,248
Multiple		14	14
Total Structural Value: {B}		**50,296**	**59,472**
Appraisal Value: {A} +{B}		**83,047**	**104,265**
Value of Max India's Stake (74%)		61,455	77,156
Less: 10% Holding company discount		6,146	7,716
Value of Max India's Stake (74%)		**55,310**	**69,441**
Value per share of Max India		**250**	**314**

Source: IDFC-SSKI Research, Company

- In line with improved macro-economic environment, we believe the APE growth would recover in FY10, whilst it may be rear-ended. Consequently we are factoring in a 20% APE CAGR over FY09-11 (revised from our conservative 10% yoy growth for FY10 earlier). Whilst management expects to grow at 10-15% higher than private insurers, we prefer to be conservative.
- We have built in a compression in margins of 100bp yoy decline for FY10 and FY11, to factor in increased competitive pressures.
- We expect MNYL's NBAP to show a ~16% CAGR over FY09-11 to reach Rs4.25bn by FY11.

Exhibit 5: Growth rates

Gross Premium (Rs mn)	June '08	yoy growth (%)	Mar '09	yoy growth (%)	June '09	yoy growth (%)
First Year Premium	4,240	76.7	4,180	(12.7)	3,890	(8.3)
Renewal Premium	3,690	113.3	6,800	74.4	6,770	83.5
Single Premium	720	53.2	550	(33.7)	520	(27.8)
Total Gross Premium	**8,650**	**88.0**	**1,153**	**21.1**	**1,118**	**29.2**
APE (FYP+ 10% of SP)	4,312	76.2	4,235	(13.1)	3,942	(8.6)
Conservation Ratio	**89.4**		**78.3**		**85.4**	

- Single premium was down by ~28% yoy in Q1F1Y0 as a result of management's conscious strategy
- The company has reported Annualized First Year Premium at Rs4.41bn for FY09, a yoy de-growth of ~18%
- Decline in Conservation ratio is indicated to be lower than peers due to lower proportion of limited pay products, and robust sales process

Exhibit 6: Distribution Network

	FY07	FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	FY12E- revised
Agents	25,048	36,896	46,851	58,500	72,000	84,000	94,594	200,000
Sales offices	165	242	311	443	555	581*	711	100 every year

** Re-stated to 705 after including rural offices*

- Optically, the increase in branch network looks strong at 130 over Mar '09 reported levels. However, including rural offices opened on IOC premises (further to the companies' bi-lateral agreement), MNYL has added 6 branches during the year
- Upto Dec '09, MNYL is focused on increasing operating efficiencies. Net addition to agents stood at ~10,000 during Q1FY10
- MNYL intends open 100 offices every fiscal year and ramp-up agency force to 200,000 by FY12
- Productivity of MNYL agents remains amongst the highest, whilst case rate and amount per agent declined due to downturn in markets

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6638 3300
Pathik Gandotra	Head of Research; Financials, Strategy	pathik@idfcsski.com	91-22-6638 3304
Shirish Rane	Construction, Power, Cement	shirish@idfcsski.com	91-22-6638 3313
Nikhil Vora	FMCG, Media, Retailing, Mid Caps, Education, Exchanges	nikhilvora@idfcsski.com	91-22-6638 3308
Ramnath S	Automobiles, Auto ancillaries, Real Estate, Oil & Gas	ramnaths@idfcsski.com	91-22-6638 3380
Nitin Agarwal	Pharmaceuticals	nitinagarwal@idfcsski.com	91-22-6638 3395
Chirag Shah	Metals & Mining, Pipes, Textiles	chirag@idfcsski.com	91-22-6638 3306
Bhoomika Nair	Logistics, Engineering, Power	bhoomika@idfcsski.com	91-22-6638 3337
Hitesh Shah, CFA	IT Services	hitesh.shah@idfcsski.com	91-22-6638 3358
Bhushan Gajaria	FMCG, Retailing, Media, Mid Caps	bhushangajaria@idfcsski.com	91-22-6638 3367
Ashish Shah	Construction, Power, Cement	ashishshah@idfcsski.com	91-22-6638 3371
Salil Desai	Construction, Power, Cement	salil@idfcsski.com	91-22-6638 3373
Ritesh Shah	Metals & Mining, Pipes, Textiles	riteshshah@idfcsski.com	91-22-6638 3376
Neha Agrawal	Financials	neha@idfcsski.com	91-22-6638 3237
Swati Nangalia	Mid Caps, Media, Exchanges	swati@idfcsski.com	91-22-6638 3260
Sameer Bhise	Strategy, Pharmaceuticals	sameer@idfcsski.com	91-22-6638 3390
Shweta Dewan	Mid Caps, Education, FMCG	shweta.dewan@idfcsski.com	91-22-6638 3290
Nikhil Salvi	Cement, Construction	nikhil.salvi@idfcsski.com	91-22-6638 3239
Rajeev Desai	Real Estate	rajeev@idfcsski.com	91-22-6638 3231
Chinmaya Garg	Financials	chinmaya@idfcsski.com	91-22-6638 3325
Aniket Mhatre	Automobiles, Auto ancillaries	aniket@idfcsski.com	91-22-6638 3311
Probal Sen	Oil & Gas	probal@idfcsski.com	91-22-6638 3238
Rupesh Sonawale	Database Analyst	rupesh@idfcsski.com	91-22-6638 3382
Dharmesh Bhatt	Technical Analyst	dharmesh@idfcsski.com	91-22-6638 3392

Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6638 3300
Naishadh Paleja	MD, CEO	naishadh@idfcsski.com	91-22-6638 3211
Paresh Shah	MD, Dealing	paresh@idfcsski.com	91-22-6638 3341
Vishal Purohit	MD, Sales	vishal@idfcsski.com	91-22-6638 3212
Nikhil Gholani	MD, Sales	nikhil@idfcsski.com	91-22-6638 3363
Sanjay Panicker	Director, Sales	sanjay@idfcsski.com	91-22-6638 3368
V Navin Roy	Director, Sales	navin@idfcsski.com	91-22-6638 3370
Suchit Sehgal	AVP, Sales	suchit@idfcsski.com	91-22-6638 3247
Pawan Sharma	MD, Derivatives	pawan.sharma@idfcsski.com	91-22-6638 3213
Dipesh Shah	Director, Derivatives	dipeshshah@idfcsski.com	91-22-6638 3245
Jignesh Shah	AVP, Derivatives	jignesh@idfcsski.com	91 22 6638 3321
Sunil Pandit	Director, Sales trading	suniil@idfcsski.com	91-22-6638 3299
Mukesh Chaturvedi	SVP, Sales trading	mukesh@idfcsski.com	91-22-6638 3298
Viren Sompura	VP, Sales trading	viren@idfcsski.com	91-22-6638 3277
Rajashekhar Hiremath	VP, Sales trading	rajashekhar@idfcsski.com	91-22-6638 3243

Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

1. IDFC - SSKI and its affiliates may have received compensation from the company covered herein in the past twelve months for Issue Management, Capital Structure, Mergers & Acquisitions, Buyback of shares and Other corporate advisory services.
2. Affiliates of IDFC - SSKI may have mandate from the subject company.
3. IDFC - SSKI and its affiliates may hold paid up capital of the company.
4. IDFC - SSKI and its affiliates, their directors and employees may from time to time have positions in or options in the company and buy or sell the securities of the company(ies) mentioned herein.