



INDIA RESEARCH

Max India

Rs170.3

OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs37.8bn; US\$945mn

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Result: Q1FY09

Comment: Strong premium growth; significant increase in economic interest

Revision: Price target upgraded by 16%

Last report: 25 January 2008 (Price Rs237; Recommendation: Outperformer)

Key financials

Year to 31 Mar (Rs m)	Net Sales	% change yoy	Net profit	EPS (Rs)	% change yoy	PER(x)
FY07	1558	24.4	142	0.8	134.5	212.9
FY08	2843	82.5	619	2.9	262.5	58.7

Max India has reported a strong set of numbers with 90% increase in revenues and over 3.5-fold increase in net profits. All the business segments have delivered strong growth. In a defining event, Max India increased economic stake in life insurance JV to 74% (from 50%) which has pushed up the total insurance value by 36% for FY10. The life insurance business has demonstrated growth rates of 75% yoy (above our full year estimate), which has prompted us to upgrade APE numbers by 6.6%. However, we have lowered margins by 3% for FY09 and 6% for FY10 to price in an increasingly competitive scenario. MNYL has adopted an aggressive posture on its distribution, by significantly ramping up its reach and expediting the distribution roll-out. Also, the healthcare business has reported robust numbers, with Max Healthcare (MHC) revenues at Rs995mn (operating margins of 5.1%) for the quarter. EBITDA of Max specialty products (MSP) has grown 104% yoy on the back of optimum capacity utilization. With its formidable presence in two of the fastest growing industry segments of insurance and healthcare (and stand-alone health insurance business in the offing), Max India is one of our preferred plays on the Indian economic growth story. We are lowering the life insurance target multiple by 11% to factor in higher cost of capital of 75bps, but more importantly the change in economic interest has led to an increase in total insurance value by 36% for FY10. Reiterate Outperformer, with a SOTP price of Rs366 per share (upgraded by 16%), offering a 115% potential upside from current levels.

KEY RESULT HIGHLIGHTS

□ Max New York Life (MNYL) – set for traction

... Growth remains robust

- MNYL has reported APE of Rs5.4bn for the quarter ended June'08, yoy growth of 75%, as against our expectation of ~31% growth for FY09. Unit Linked products contribute around 88% to the sales in Q1FY09. During the quarter, individual APE grew by 73% yoy to Rs4.25bn.
- Conservation ratio for the quarter ended June'08 improved to 89% against 79% for the quarter ended June'07.

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- While MNYL's market share slipped to 2.1% in Mar '08, the growth demonstrated over Apr-June '08 is likely to result in an improving trend.
- MNYL contributes 80% of Max India's consolidated revenues

MNYL APE growth rates and movement in market share

	June '07	Sept '07	Dec '07	Mar '08
YTD APE growth – MNYL	62	65	64	98%
MNYL's market share (total industry)	2.97	1.96	2.96	2.12

Source: IRDA, IDFC-SSKI Research

Distribution reach – gaining traction

- MNYL is aggressively strengthening its distribution franchise, with plans to open 250 offices every year and ramp-up agency force to 300,000 by FY12.
- Agency force as at June'08 stood at 47,000 agents- a 69% yoy increase. In addition, productivity of MNYL agents remains amongst the highest in the industry. Non-agency channels contributed 34% of sales in FY08.
- Geographic coverage of the business continues to increase, up 311 offices across 196 locations as of June '08 from 233 offices across 155 locations in Dec'07. The company added 69 offices in the current quarter.

Distribution franchise

	FY05	FY06	FY07	FY08	Q1FY09	FY12E
Agents	9,017	15,285	25,048	36,896	46,851	300,000
Sales offices	65	105	165	242	311	900

Source: Company

Business Strategy – the road ahead

Capital infused – one-third done!!!

- During June '08, Rs2bn has been infused in MNYL, taking the total paid-up capital to Rs12.3bn.
- The JV partners have agreed for peak equity commitment of Rs36bn, out of which 1/3rd has already been invested.

Branding – a key monitorable

- While convinced about MNYL's growth prospects, we had factored in conservative growth rates in our valuations and assigned a lower NBAP multiple as MNYL's business prospects in Tier-II and III cities remained to be seen, primarily on the back of a relatively weaker brand resonance when compared to well-entrenched financial players such as SBI and ICICI.
- On a positive note, MNYL is due to launch a micro insurance product, called Max Vijay', which would enable them to strengthen franchise in the semi-urban and rural areas (sum assured of Rs100,00, with top-up features catering to the irregular income and savings patterns). In addition, the company has increased its advertising spend.

Forays into stand-alone health insurance

- Max India recently announced a JV with UK's BUPA group to form a stand-alone health insurance. The business is due for roll-out by Q4FY09.
- The business is currently capitalized with Rs1bn, with peak commitment of Rs4 - 4.2bn.

Valuation

Change in economic interest - Max India now at 74%...

- Max India has hiked economic interest from 50% to 74% in their life insurance JV with New York Life (US)
- The 24% stake has been acquired in lieu of refund of Rs1.74bn deposit to New York Life
- Earlier based on agreement entered dated 2003, the JV partners had agreed to make equity investments as follows:

Erstwhile options agreement

JV partners	% of equity contribution
New York Life	26%
Max India	50%
Advance paid by New York Life to MNYL	24%

Source: Company

...life insurance value pushed up by ~36%

- Adjusting our valuations for change in economic interest, valuations of life insurance business increase by ~50%
- However, we are lowering our NBAP multiple to 16 from 18 to factor in:
 - Higher cost of capital in the system of 75bps and;
 - Agreement with NYL to buy-back the additional 24% stake (over the next 8 years) at 10% discount to fair market value.
- Also, we have re-aligned our NBAP margins to reflect the increased competitive scenario.
- We expect MNYL's NBAP to show a 35% CAGR over FY08-10 to reach Rs5.05bn by FY10. We have valued MNYL at 16x FY10E NBAP and added Embedded Value, to arrive at a value of Rs313 per share of Max India.

Max New York Life- Valuation

Rs mn	Revised		Earlier		upgrade (%)	
	2009	2010	2009	2010	2009	2010
APE	18,963	26,548	17,787	24,901	6.6	6.6
NBAP	3,699	5,047	3,587	5,022	3.1	0.5
Multiple	16	16	18	18	(11.1)	(11.1)
Structural Value	59,187	80,760	64,569	90,396	(8.3)	(10.7)
Total Value (includes embedded value)	75,128	104,044	80,192	113,296	(6.3)	(8.2)
Value of Max India Stake (74%)	55,595	76,993	40,096	56,648	38.7	35.9
Less: 10% Holding company discount	5,559	7,699	4,010	5,665		
Value of Max India Stake (74%)	50,035	69,293	36,086	50,983		
Value per share of Max India	226	313	163	230		

Source: IDFC-SSKI Research

Embedded Value & NBAP reported

- Ahead of peers, MNYL disclosed the embedded value of Rs13.16bn as of Mar '08, assuming break-even in FY11. Also, the company disclosed NBAP margin of 20.4%. These are largely in line with our estimates.

□ MHC – Health on track

Max Healthcare (MHC) has kept up the growth momentum and reported total revenues at Rs995m (21% growth yoy) for Q1FY09 and EBITDA margins of 5.1% for the quarter.

	Q1FY09	Q1FY08	Yoy growth (%)
Revenues (Rs m)	995	821	21
EBITDA	51	28	82
EBITDA margin	5.1%	3.4	

- This is well in line with our FY09 estimates of Rs4.5bn revenues and 8% EBITDA margins.
- Other key highlights of the quarter include consistently high occupancy rates at 62% for the MHC network and 12% yoy growth in average revenue per bed to Rs19930 per day.
- Max has added an institute of internal medicine during the quarter and will also adding an oncology facility in H2FY09.

- MHC has also recently announced the acquisition of land for setting up a new 300 bed tertiary care hospital in North West Delhi. This hospital is expected to be operational by 2011 and will take MHC's network to more than 1500.
- Maintain estimates for MHC. 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 Rs6.8bn, or Rs31 per share, for Max India

□ Max specialty products (MSP)

MSP has reported Q1FY09 revenues of Rs.978m (85% growth yoy) with EBITDA margins of 14.2% for the quarter.

	Q1FY09	Q1FY08	Yoy growth
Revenues (Rs m)	978	529	85%
EBITDA	139	68	104%
EBITDA margin	14.2	12.9	

- All the BOPP lines are running at 100% capacity utilization and the ROCE on the business has also grown to 18%.
- MSP has signed a non binding MoU with a US based player for the manufacture and distribution of thermal films. First of these lines will be commissioned by Oct 2008 and the second by Aug 2009
- We are maintaining estimates and we value Max India's MSP business stake at Rs22/share

□ Other Businesses

Max India's other 2 nascent businesses of clinical research and healthcare staffing continue to scale up strongly. Clinical research business is witnessing a steady increase in the order book and has also made a successful entry into Europe this quarter. We have not valued these businesses this quarter.

□ Valuations and view

Max India has continued to deliver robust performance across all business segments and this quarter's performance has reinforced our confidence in Max's ability to succeed in the high potential life insurance and healthcare spaces. Max India is one of our preferred plays on the Indian economic growth story. We are lowering the life insurance target multiple by 11% to factor in higher cost of capital of 75bps, but more importantly the change in Max India's economic stake to 74% (from 50%) has pushed up the total insurance value by 36% for FY09. Reiterate Outperformer, with a SOTP price of Rs366/ share (upgraded by 16%), offering a 115% potential upside from current levels.

SOTP Valuation

	Value per Max India share (Rs)
Max New York Life	313
Max Healthcare	31
Max specialty products	22
Total Value	366

Quarterly results

	Q1FY07	Q2FY07	Q3FY07	Q4FY07	FY07	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09
Net Sales	317.3	398.2	402.5	435.4	1553.4	482.6	721.2	774.9	864.3	915.2
Total expenditure	330.5	419.3	413.3	482.9	1646.0	521.6	728.5	769.3	851.0	971.2
COGS	202.5	276.8	273.6	293.1	1046.0	323.1	478.4	516.3	548.5	652
Staff cost	37.8	53.4	54.5	86.3	232.0	67.1	88.2	76.7	46.0	144.9
Other Expenditure	90.2	89.1	85.2	103.5	368.0	131.4	161.9	176.3	231.7	244.1
EBITDA	(13.2)	(21.1)	(10.8)	(47.5)	(92.6)	(38.95)	(7.3)	5.6	13.3	(55.9)
EBITDA	(4.2)	(5.3)	(2.7)	(45.9)	(6.0)	(8.1)	(1.0)	0.7	1.5	(6.1)
Other Income	147.5	88.3	81.7	86.2	403.7	133.5	255.7	271.5	250.0	273.4
Interest	14.7	11.3	11.1	12.1	49.2	33.2	36.6	35.2	41.0	39.9
Depreciation	14.7	13.7	12	17.3	57.7	27.3	28.5	28.5	29.6	29.9
PBT	104.9	42.2	47.8	9.3	204.2	34.05	183.3	213.4	222.3	147.7
Tax	4.9	0.2	9.3	47.5	61.9	(4)	14.1	3.9	20.1	11.5
PAT	100	42	38.5	(38.2)	142.3	38.05	169.2	209.5	202.2	136.2
yoy change (%)										
Net Sales						52.1	81.1	92.5	98.5	89.6
EBITDA										
PAT						-61.9	302.9	444.2	-629.3	258.0

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