

# A Quintessential Emerging Markets Investment - HDFC Life

HDFC Life is India’s leading private life insurer with 30% market share in the protection segment. HDFC Life is an excellent example of the type of EM company that we seek. The company represents a strong structural growth opportunity in a large, addressable market, with an attractive industry structure and competitive advantages over its rivals.

*This information has been prepared by Northcape Capital, the underlying investment manager for the Warakirri Global Emerging Markets Fund.*

## HDFC Life – Quintessentially EM

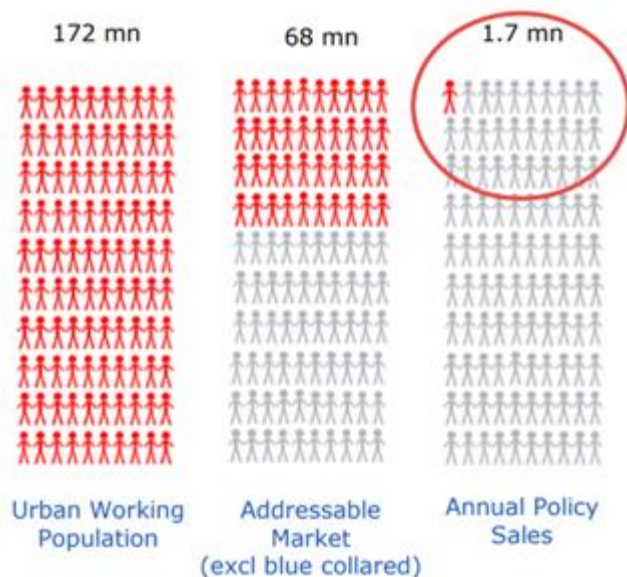
**HDFC Life is India’s leading private life insurer with 30% market share in the protection segment.** HDFC Life is on our Approved List and is 48%-owned by core portfolio holding HDFC Ltd. HDFC Life is an excellent example of the type of EM company that we seek, which offers:

- structural growth in a large, addressable market,
- an attractive industry structure, and
- a company with competitive advantages over its rivals.

## A large, growing market opportunity

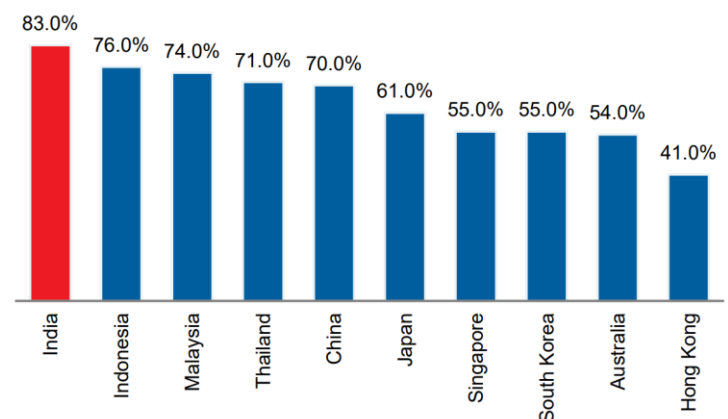
Life insurance in India is highly under-penetrated which creates a long runway of growth for HDFC Life and the industry. According to HDFC Life, just one out in every 40 Indians (2.5%) who can afford a policy is buying one – see Exhibit 1.

**Exhibit 1: Just 1 out of every 40 Indians (2.5%) who can afford life insurance is buying one (Source: HDFC Life)**

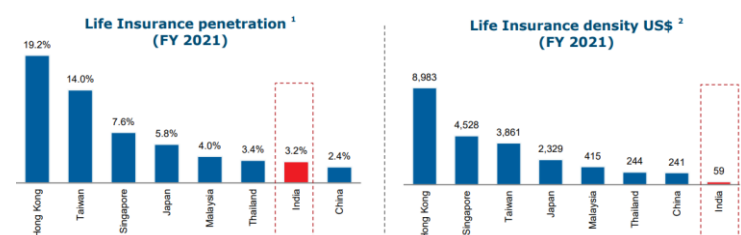


**At approximately \$9 trillion, India has one of the world’s highest protection gaps,** which measures the degree of ‘underinsurance’ in a market – see Exhibit 2. India is also vastly under-penetrated based on penetration (premiums/GDP) and density (annual premium underwritten to total population) – see Exhibit 3. Life insurance adoption typically follows an ‘S-curve’ trend where once a country’s GDP/capita rises above US\$5,000 then demand for protection starts to increase materially as a greater percentage of the population have assets and livelihoods worth insuring. India is still a fair way off this level, but there are still around 166mn Indian households with income in excess of US\$4,000 (near the S-curve sweet spot), and this figure is expected to reach 329 million by 2030, according to Bain & Company data.

**Exhibit 2: Life insurance gap in Asia (Source: Swiss Re)**



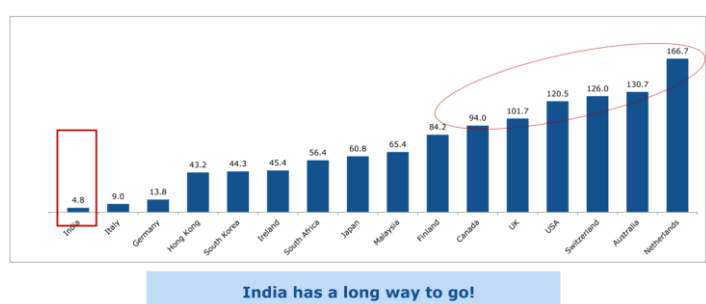
**Exhibit 3: Life insurance penetration in India well below regional peers (Source: Swiss Re)**



In addition to protection type life insurance, the Indian life insurers also offer financial products, helping Indians save for their retirement. **Compared to global benchmarks, India’s pension market is woefully underpenetrated at 4.8% of GDP – see Exhibit 4.**

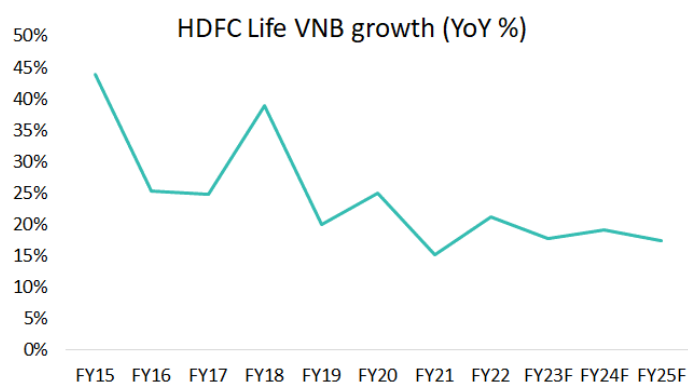
There is also limited welfare in India – people by-and-large have to look after themselves. Further, as the typical household size declines and more people move to the city (stimulating HDFC’s mortgage book growth), there is a loss of the extended family safety net which also forces more Indians to look after themselves.

**Exhibit 4: Pension asset/GDP ratio (Source: HDFC Life)**



As India’s life insurance penetration has risen from a very low base, **HDFC Life has grown its value of new business (VNB) by approximately 26% per annum since 2014** and is expected to keep growing at around 18% per annum over the medium-term. While other insurers saw their VNB drop during Covid, HDFC Life’s VNB growth still rose 15% in FY21 – see Exhibit 5. By contrast, developed market insurers are only growing in low single-digits, or in some cases shrinking.

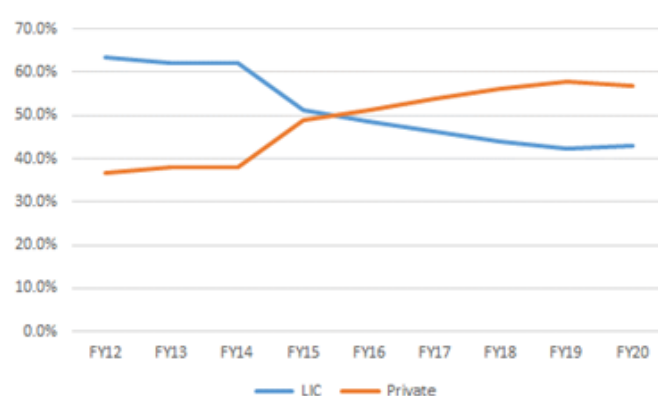
**Exhibit 5: HDFC Life Value of New Business Growth Rate 2015-2025E**



## An attractive industry structure

India’s life insurance industry structure is attractive with state incumbent LIC consistently losing share to the private players (from 63% in FY12 to 43% FY22) – see Exhibit 6. This is similar to the trend we have witnessed in the Indian banking sector, where private banks have gained share at the expense of the state banks thanks to their superior capital adequacy, technology and service, more motivated employees, product innovation, and greater customer trust and better overall risk management.

**Exhibit 6: LIC’s share has steadily fallen vs. private players over time (Source: IRDAI)**

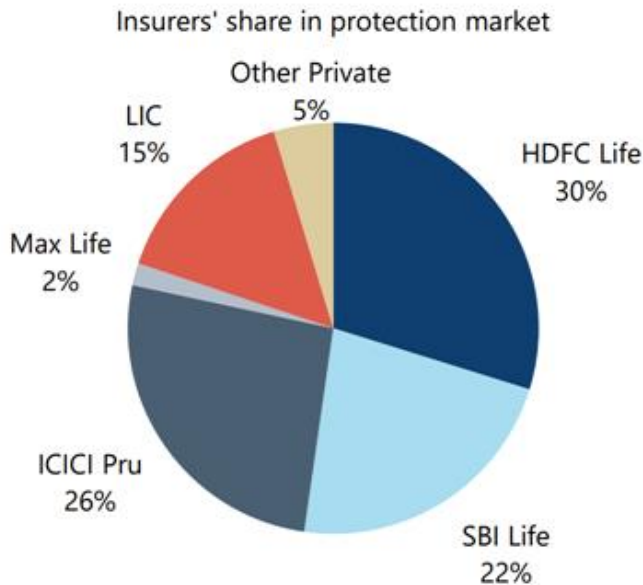


**Protection is the most attractive segment within life insurance in emerging markets given its superior margins, and significant under-penetration.** In protection, customer selection depends more on the policyholders’ comfort with the insurers’ standing in the long-term to honour their commitment, than merely the pricing of policies. The protection segment of life insurance in India is highly consolidated with HDFC Life capturing the #1 market share and the four leading players capturing more than 90% of the market – see Exhibit 7. This consolidated market structure and high barriers to entry augurs well for the long-run profitability of protection in India.

We are however expecting to see a greater share of protection sales relative to savings from HDFC Life going forward. Covid made it difficult for customers to have the necessary medical tests which resulted in upward revisions in protection premiums.

HDFC Life’s share of sales coming from protection has slipped to around 15% (from 18% previously). By contrast, more established, highly profitable insurance companies such as AIA have 70% of their sales coming from protection. HDFC Life should head in this direction in time as the Indian life insurance market matures, and Indian household wealth continues to rise.

**Exhibit 7: HDFC Life has #1 market share of protection in India**



**HDFC Life's competitive advantages**

We believe there are **four key competitive advantages** that underpin HDFC Life's sector leadership:

- 1. Strong branding – HDFC is one of the most widely admired and respected brands in India.** As discussed, trust in the brand is critical for the sale of long-term protection products.
- 2. Wide and diversified distribution –** HDFC Life has access to the HDFC group's 12,000+ branch network, and its prime customer base. It has the widest and most diversified channel amongst life insurers in India across agents, non-banking financial companies, brokers, and emerging channels, e.g. fintechs in India.
- 3. Consistent product innovation –** HDFC Life has been an industry leader in the launch of new products over time to cater to changing customer behaviour and needs. Many of its products have been industry firsts, uniquely tailored to Indian consumers' needs, and have since become the industry norm.
- 4. Leading technology –** digital initiatives are at the heart of HDFC Life's strategy, strengthening its competitive position post-Covid. Premium renewals are now over 90% online, and around 80% of customer service performed without direct staff involvement.

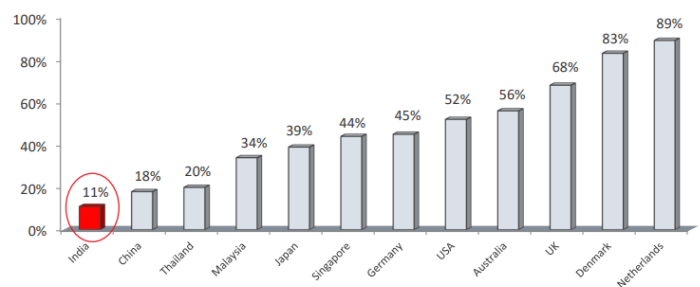
These competitive advantages mean that HDFC Life is able to **generate solid returns on equity at around 20%**, and has the highest VNB margins in the sector.

HDFC Life is not presently in the Northcape EM portfolio, but we do have exposure via HDFC Ltd, which owns 48% of the company. For now, we consider HDFC Ltd's shares to be more attractively valued with its core mortgage business priced at just 1.6x price/book. Like life insurance, mortgage penetration in India is deeply underpenetrated – **see Exhibit 8.**

In June we will return for our first on the ground visit to India since December 2019.

**Exhibit 8: Low Indian mortgage penetration implies room for growth (Source: European Mortgage Federation, Hofinet, HDFC)**

**MORTGAGES AS A PERCENT OF NOMINAL GDP**



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