IPOs in Insurance Sector

Post 2008-crisis, the capital markets have now picked up pace in India. There have been many IPO issuances this year, with decent listings. Most popular among these have been IPOs of the insurance companies. Although the regulations for IPO issuance for insurance companies were announced way back in 2012, the companies have started launching their IPOs now. This was because the regulator required the companies launching the IPOs to have completed 10 years in the Indian markets. Moreover, most of the insurers hadn't turned profitable then. As insurance companies have been looking out for avenues to raise capital, IPOs represent an opportunity for the original promoters to unlock the potential gain in their primary investments, as the liquidity in the capital markets scales new high. Industry estimates suggest that insurance companies are eyeing a mop-up of Rs30,000-35,000 crore this financial year.

As the insurers launch their IPOs, this article gazes upon several facets of the new avenue of raising the capital. The most important aspect which tends to engage both retail and institutional investors is the valuation of these companies. The valuations of life insurance companies are based on multiple called embedded value which comprises of present value of future profits and adjusted net asset value. Apart from this multiple, several other factors that are specific to the insurance industry such as new business premiums, persistency ratios, solvency margins, expense ratios, market share, PAT, claim ratio, commission ratio, renewal premium etc. are also used for comparative evaluation of the companies.

However, the valuation still remains a complicated business. For the current IPOs, it is believed by many that there have been huge premiums that have been included in the issue price. The embedded value multiples in India for life insurance companies have been in the range of 3-5. Comparing them with the global standards, China has valuation multiple of 1.26-1.89, whereas insurers in UK have multiples of around 0.65-0.8 times. The high multiples are attributed to higher prospects of growth of insurance sector in India, since the market remains highly under penetrated and represents a huge opportunity on account of increase in disposable income and literacy levels.

Although the above multiples are attached to Indian markets in general, the specific companies are pricing their issues high on account of market share enjoyed, maturity in the markets, distribution channels, good investment portfolio, etc. Since, distribution is viewed as an important part of the insurance company, they are also basing out the premium in valuation on the distribution channel that they maintain. Companies with banks as their promoters may command higher premiums in pricing, on account of sound bancassurance channels. Thus, IPOs represent a way to acquire capital at dream cost while arbitraging it against yield in the investment portfolio.

With the insurance sector in India maturing, there have been attempts by the promoters to encash their stakes in the companies. Similar attempts are being made by the promoters through IPOs. A close observation leads to an understanding that in very few cases, fresh equity is being issued by these companies, which points towards dilution of the stakes by the promoters. There is also an observation that the foreign promoters are diluting their stakes in India. This may be an indicator of negative sentiments on the profitability and long-term sustainability of the company. However, it may be also be on account of cash-crunch faced by the parent company at the global levels.

For foreign institutional investors, the returns from insurance-linked investments are not aligned with other capital market investments and depend more on the insurance/and or reinsurance loss events. However, in India, for most general insurance companies, the returns generated are mostly out of investment income, rather than returns from core business. This could be attributed to the fact that most of general insurance companies have not yet turned profitable. In that case, the FIIs may have to make informed investments in India-insurance sector.

Public listing would mandate the insurers to follow regulatory compliance in line with other publicly listed companies like legal and economic structure, governance, accountability to shareholders, information on company's financial health and operations and transparency. This reflects company's performance in many areas including growth, innovation, managing fraud, and customer service. This is expected to bring in more discipline and transparency in the insurance industry.

Thus, IPOs represent the opportunity to unlock the potential for the growth of insurance sector. The key takeaway from public listing would stand different for every component of the industry.

Public listing may also change the functioning of the industry. However, a general investor would expect the positive impacts to stay for the long-term and improve the dynamics of the industry.