Statement by Mr. Deepak Parekh, Chairman, HDFC Limited & HDFC ERGO General Insurance Company Limited

Acquisition of 51.2% stake in Apollo Munich,
followed by merger with HDFC ERGO

June 19, 2019

Today marks another significant milestone for the HDFC group.

We have just made an announcement to the stock exchanges that HDFC Limited and Apollo Hospitals Group at their respective meetings held today, have approved entering into definitive agreements for HDFC to acquire the entire 50.8% shareholding of Apollo Group, in Apollo Munich Health Insurance Company for a consideration of Rs. 1,336 crore and a further 0.4% shareholding held by a few employees for a consideration of Rs. 10.84 crore. At the outset, I should state that this of course, is subject to the receipt of necessary regulatory approvals.

In any acquisition or merger, it is very important to be absolutely convinced about the rationale of a deal. So from HDFC's perspective, I will highlight the key reasons why we have entered into this transaction and I will leave the finer details to Ritesh Kumar, the Managing Director & CEO of HDFC ERGO.

I never tire of saying that financial penetration in India is still very low across any segment – be it consumer credit, mortgages, mutual funds or life insurance. But the lowest penetration lies in the non-life insurance sector. When one refers to penetration in non-life insurance, it is the annual premium as a percentage of GDP.

Non-life premium as a percentage of GDP at a global level stands at 2.8%.

- In developed countries like the US, the ratio is 4.3%, in Europe it stands at 2.7%
- Across many countries in Asia, including China, non-life penetration is 1.9%
- In India, however, it stands at 0.9%.

Yet the situation is not all dismal. In 2001 non-life insurance penetration in India was 0.5%, so at least we are moving in the right trajectory. There is growth, but it needs to be significantly scaled up.

Not surprisingly, India’s health expenditure which is the sum of public and private expenditure is under 4% of GDP compared to a global average of 10%. If one looks at many western countries,the spend on healthcare is predominantly by the public sector or through insurance. In India, public health& insurance expenditure accounts for one-third, while an overwhelming two-thirds is met by out-of-pocket expenditure, where the individual consumer bears the cost of his or her own healthcare. In the global context, out- of -pocket expenditure stands at only 18%.

Understandably, in India, fiscal resources are limited and the government alone cannot take on this mantle. But due credit must be given to the government for recognising the important of medical insurance. The Prime Minister has been at the forefront championing the flagship Ayushman Bharat Yojana.Good progress has been made on the scheme so far, where nearly 4 crore of e-cards have already been issued.The aim is to cover 10 crore poor households by providing a coverage of up to Rs 5 lakh per household for hospitalisation. It is indeed a visionary scheme for the vulnerable sections of society.

Against the backdrop of rising life expectancy and high out-of-pocket expenses, it is clear that the potential for growth in health insurance is immense.

- Accident & health is currentlythe fastest growing segment in the non-life insurance sector.
- The share of accident & health has increased from 9% in FY 2001 to 30% in FY 2019.

- An estimated 42 crore individuals have health insurance, which includes government and corporate schemes. But when these schemes are stripped out, only 3.3 crore individuals have a retail health policy.

- Clearly, there is a huge opportunity to reach out to more individuals to get them a health insurance policy.Fortunately, there is a changing mindset where people are beginning to recognise that health insurance should not be construed as an expense, but as a necessity and as an investmentto safeguard their future.

- In the general insurance space, it is expected that the share of accident & health insurance will rise from 30% currently to 39% in the next five years. This growth means that accident & health will have a larger share and overtake motor insurance which currently accounts for the largest component in general insurance.

- These potential shiftscalls for a re-think on the medium and long-term growth strategy of general insurance companies. We believe the time is right for HDFC ERGO General Insurance Company to capitalise on inorganic opportunities in the Health space.

Last year HDFC Limited had raised capitalfor our investments in associate and subsidiary companies. Of the capital raised, we deployed Rs 8,500 crore in HDFC Bank Limited to retain our shareholding in the bank. We had also indicated that some of the capital would be utilised towards widening our footprint in the health insurance sector.

At this juncture, we envisage that the transaction will be concluded in two stages, subject to receipt of requisite approvals.

- In the first stage, HDFC would acquire the entire equity stake of Apollo Hospitals Group&equity stake of some employees totalling to51.2% in Apollo Munich, subject to receipt of approvals by HDFC's regulator, the National Housing Bank, the insurance regulator, IRDAI and the Competition Commission of India. Thus, Apollo Munich will be held as a subsidiary of HDFC Limited.

- In the second stage, there will be a merger of Apollo Munich with HDFC ERGO, subject to approval of the National Company Law Tribunal and final approval of IRDAI. Post the scheme of amalgamation, HDFC ERGO and Apollo Munich will merge into one entity under the HDFC ERGO brand.

It is difficult to put an exact timeframe for these two stages, but we are hopeful that the entire process should be completed over the next 9-12 months.

As with any successful merger, the sum of the whole should be greater than the sum of the parts.

The key question is what made Apollo Munich Health Insurance, the second largest standalone healthcare insurance company an attractive proposition for HDFC ERGO?

- I have to say that the starting point was the comfort with both,the joint venture partners. As far as the Apollo group is concerned, I have professionally and personally known Dr Prathap Reddy and the family for decades. He is an outstanding visionary, widely regarded forhaving changed the face of modern healthcare in India.Shobana, the founder and chairperson of Apollo Munich has nurtured the company from inception for over a decade. Under her leadership, Apollo Munich has built an impressive business and a strong distribution network, which is key for any retail insurance business.

- ERGO, a subsidiary of Munich Re, has been our joint venture partner in HDFC ERGO since 2008.

- When the Apollo group indicated that it wanted to exit thebusiness, it seemed a perfect fit for HDFC to have Munich Re as our partner.

- The merger with HDFC ERGO will create a strong health insurance franchise, with a combined gross direct premium of Rs 10,807 crore in FY19.

- The acquisition of Apollo Munich will make HDFC ERGO the second largest private insurer in both, accident & health and health insurance. The combined market share in accident & health will be8.2% and 7.2%for health insurance.

- On an overall basis, the combined entity will have amarket share of 6.4% (as against the standalone market share of HDFC ERGO of 5.1%).

- What is particularly attractive for us is Apollo Munich's strong agency network with over 70,000 agents. A diversified distribution network is essential to strengthen market position.

- We have assured that we will retain all the employees of Apollo Munich.

- We believe this transaction is beneficial for the policyholders & channel partners of both insurance companies. Apollo Munich, with its health expertise, has some of the best in class health products. HDFC ERGO is present across all lines of products and has a very strong digital service architecture. These combined strengths shall be advantageous to the policyholders and channel partners of the combined entity.

- The combined entity will also have deeper geographical reach for both distribution & servicing.

Based on the acquisition price of Rs 1,347 crore for 51.2% equity stake in Apollo Munich, the company is valued at a multiple of 1.2 times the gross written premium in FY19. We believe this valuation is reasonable and this transaction will result in strong synergies and bring in economies of scale.

We all need to play our part in making India a US$ 5 trillion economy. The government is creating a conducive environment to promote key sectors like financial inclusion, housing, education and healthcare,amongst others. These are large job creating sectors, but more importantly, they are key components in facilitating‘ease of living’, which is rightly a top priority of the new government.

The HDFC group will continue to endeavour to play a meaningful role in improving the quality of life of Indians and deepen its financial footprint.

I would like to acknowledge the support of all our due diligence and legal partners and employees of both the entities – who have worked very hard to bring this transaction to fruition.

Thank you.