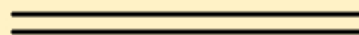


MIXED BLESSING

IPO-bound LIC's \$130B equity holdings are its magic potion—and its Achilles' heel

As India's largest asset manager, LIC owns a piece of nearly 280 listed companies. But its mammoth investment book is a double-edged sword for the life insurer's valuation, and LIC's complicated relationship with the government certainly doesn't help



[Seetharaman G, Anand Kalyanaraman](#), 17 Feb 2022

LIC's \$8 billion IPO will be of interest to many; its assets under management of \$526 billion outstrip India's entire mutual fund industry by 8%

Investors will have to be wary—a 20% drop in the value of its equity holdings could lead to a 14% decline in its embedded value

They may not fully benefit from the gains in LIC's portfolio, either, thanks to LIC's surplus distribution policies

Meanwhile, there's the big government question—will LIC have the freedom to exit struggling State-owned companies like MTNL?



Read a 200 word free summary.

HIDE SUMMARY

Life Insurance Corporation—or LIC, as it's generally known as—is a mammoth. It's nearly 70 years old, is the country's largest insurer and the country's largest asset manager. LIC's assets under management (AUM) of ~Rs 39,60,000 crore (\$526 billion), as of September 2021, outstrip India's entire mutual fund industry by 8%.

So when a company like this announces an \$8 billion IPO, heads tend to turn.

LIC has far more sway on India's bourses than any other investor. As of 11 February, LIC's investments were worth \$129 billion, which is more than the combined holdings of the next four largest investors. And it doesn't include companies in which LIC holds less than 1%.

Simply put, LIC, which has 280 investee companies including 28 out of the 30 companies part of the benchmark Sensex index, is a mutual fund by proxy.

By buying LIC shares, you are not just hoping to benefit from LIC's dominance in life insurance, but you are also looking to capitalise on its investee companies' performance.

But this is where it gets dicey.

For one, the impact of a rally or a slump in LIC's investments is borne more by its policyholders than its shareholders. There's also the question of what portion of its investments is the result of LIC doing the government's bidding.

Seetharaman and Anand have a cracker of a story for you today. Dive in.



How often do you come across an initial public offering (IPO) where the company's investments are of as much interest to potential investors as its core business? But then, few boast of a portfolio with sizeable holdings in some of India's most valuable companies—Reliance Industries, State Bank of India, and Infosys, among others.

State-owned Life Insurance Corporation of India (LIC), which filed for what could reportedly be a Rs 60,000 crore (\$8 billion) share sale on Sunday, is not just India's largest life insurer by a distance. It is also the country's biggest asset manager. LIC's assets under management (AUM) of ~Rs 39,60,000 crore (\$526 billion), as of September 2021, outstrip India's entire mutual fund industry by 8%.

LIC holds far more sway on India's bourses than any other investor. As of 11 February, LIC's equity investments were worth ~Rs 9,71,000 crore (\$129 billion), according to information sourced from Prime Database, a capital markets data provider. This is more than the combined holdings of the next four largest investors. And it doesn't include companies in which LIC holds less than 1%.



In a league of its own

LIC's equity holdings are considerably higher than those of the top mutual funds*

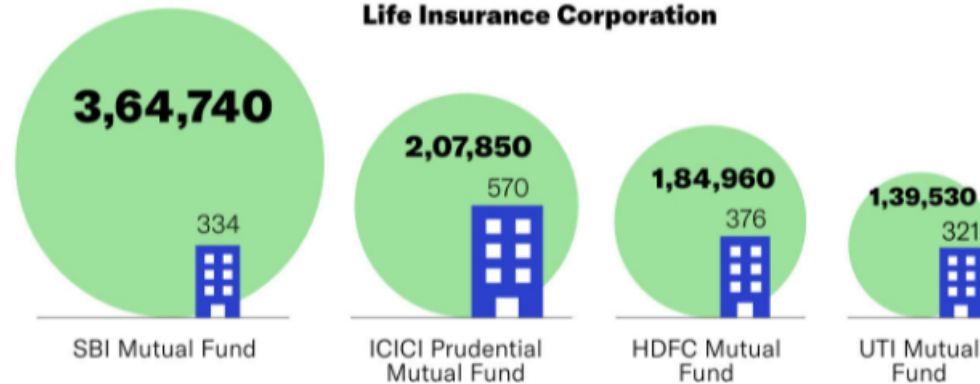
🏢 Companies invested in* ● Market value of investment (Rs cr)**

9,71,020

278[^]



Life Insurance Corporation



*Data only for holdings more than 1%; *As of December 2021; **As of 11 February 2022;
^Includes the four companies in which LIC is classified as a promoter: IDBI Bank, Axis Bank, LIC Housing Finance, Tourism Finance Corporation of India

THE KEN

Graphic by Adhithi Priya R, 16 Feb '22

Source: Prime Database



Insurers, by the very nature of their business, have to invest the premiums they collect in equity and debt. And LIC, thanks to a 65% market share by **new business premium**, naturally has a far bigger kitty to deploy than its peers in the private sector.

But viewed differently—and a bit crudely—LIC is a mutual fund by proxy. And a giant one at that.

By buying LIC shares, you are not just hoping to benefit from LIC's dominance in life insurance, but you are also looking to capitalise on its investee companies' performance.

“It's a quasi capital markets story,” says a fund manager with a large mutual fund house. “The degree of correlation to how the markets perform is not as much [here] as in the case of an **AMC** or a broker, but there is an element of that.” The fund manager and a few others *The Ken* spoke to for the story requested anonymity since they are not authorised to comment on the IPO.

But the impact of a rally or a slump in LIC's investments is borne more by its policyholders than its shareholders, argues Mithil Sejpal, founder of ValuEnable, an insurance consultancy. This is because 95% of LIC's



surplus payouts have traditionally been distributed to policyholders, with the rest going to its shareholders. Even if that has been tweaked in favour of the shareholders, their share maxes out at 10% for most of LIC's policies.

Still, LIC's investors are quite vulnerable to swings in its equity holdings. A 20% drop in its equity portfolio could result in a nearly 14% decline in its **embedded value**—which, in turn, affects LIC's market capitalisation—according to an **actuarial** assessment that is part of LIC's IPO filing. LIC could potentially be worth more than Reliance Industries, whose market capitalisation of Rs 16,32,000 crore (\$217 billion) makes it India's most valuable company.

Then, there's also the question of what portion of its investments is the result of LIC doing the government's bidding. LIC came to the government's aid in buying a majority stake in debt-laden IDBI Bank in 2019. Similarly, it may not be free to divest its stakes in some companies if the Centre doesn't want it to. This includes stakes in struggling state-owned telco Mahanagar Telephone Nigam Ltd (MTNL) and tobacco giant ITC.



The elephant that can dance

The average investor, not well-versed in the complexities of the life insurance business, would want to subscribe to the IPO for one—or a combination—of three reasons:

1. Multi-generational familiarity with LIC as a trusted brand
2. LIC's leadership in life insurance, even two decades after India ended its monopoly
3. LIC's investments in some of India's largest companies

LIC policyholders' affinity for the brand is hard to quantify. But, in a story in August, we wrote about how LIC's continued dominance hinges on changing its product mix and business model.

Where things get really interesting is LIC's investment book.

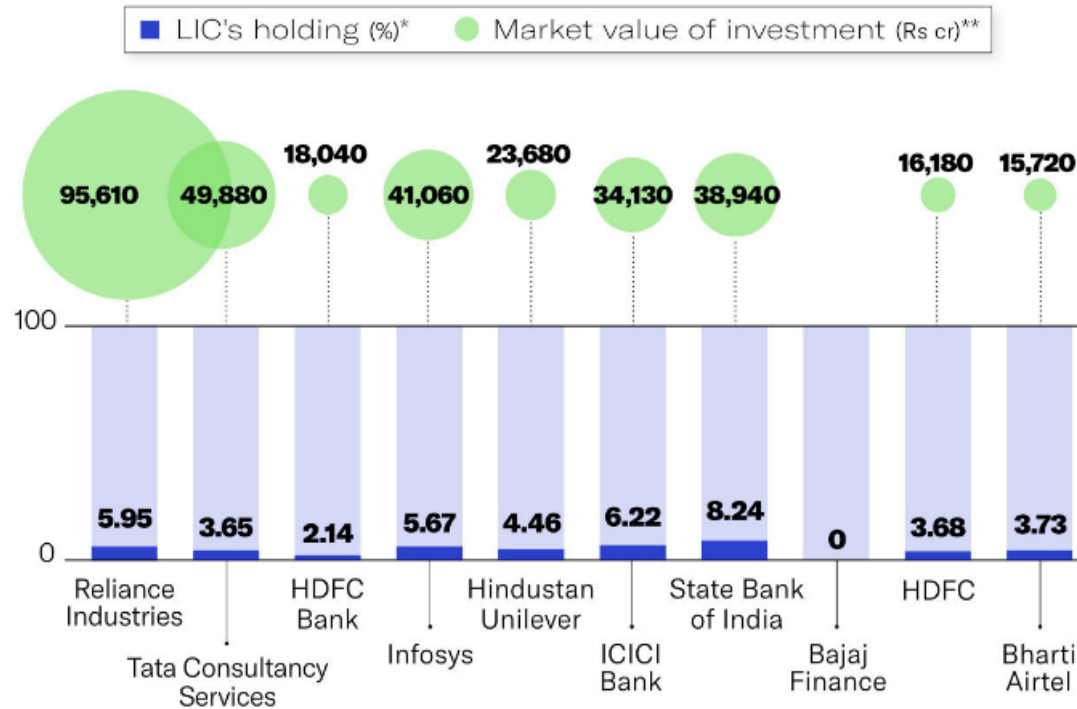
Only one-fourth of LIC's AUM is invested in equities, as of September 2021, compared to over a third for its peer HDFC Life and nearly half for ICICI Prudential Life. But that becomes irrelevant next to LIC's size.

Name a large company, and chances are LIC owns a piece of it.



Across the board

LIC has a stake in all but one of India's 10 most valuable companies



*As of December 2021;**As of 11 February 2022

THE KEN

Graphic by Adhithi Priya R, 16 Feb '22

Source: Prime Database



Among the 30 companies that are part of the benchmark Sensex index, LIC has a stake in all but two. It controls anywhere between 1.5% (in financial services firm Bajaj Finserv) and over 16% (in ITC). It's even listed as a promoter for one of them—Axis Bank—with its holding at around 8%.

Besides ITC, Axis Bank, and IDBI Bank, LIC also has directors on the boards of engineering and construction giant Larsen & Toubro and automaker Mahindra & Mahindra.

It's not just the range of LIC's bets that inspire awe among other investors. "To their credit, they tend to be very smart traders," says the mutual fund manager quoted earlier.

LIC has a reputation for buying low and selling high. In early 2020, it took advantage of the slump in the markets, thanks to the onset of Covid, to buy into FMCG giant Hindustan Unilever and IT services firm HCL Technologies. It also upped its stakes in truck maker Ashok Leyland and Tata Steel. LIC reportedly booked a record profit in the quarter ended June 2021 by riding the recovery on the bourses.

Just as it's going to take years, if not decades, for a rival life insurer to dislodge LIC from its perch, it's going to be a long, long while before LIC has a comparable investor of its size.



With a portfolio spanning around 280 companies, it's tempting to think of LIC as a mutual fund by another name. But the link between how the underlying stocks perform and what an investor gains or loses is not quite as straightforward as in the case of a mutual fund.

And that's to do with where LIC's AUM is invested and how it distributes the money it makes.

Predominantly policyholders' money

Of LIC's total AUM of \$526 billion as of September 2021, 99.84% was held in policyholders' investments and the rest in shareholders' investments.



A mutual fund play? Not quite

Most of the individual policies LIC sells are participating policies. These schemes allow their holders to partake in the profits of the insurer, through dividends or bonuses. Till now, LIC has apportioned the surplus between policyholders and shareholders—in other words, the government—in the ratio of 95:5.



But the split is being changed in favour of shareholders, who, besides the Centre, will now include retail and institutional investors. LIC's shareholders will be eligible for a tenth of LIC's surplus from the year ending March 2025.

“So the entire market movement is not flowing to the bottomline. Only 10% is,” says Sejpal.

LIC was also providing 95% of its surplus for those holding non-participating policies. Like the name suggests, these policyholders aren't entitled to any surplus. So this has been altered to give shareholders 100% of the surplus.

Even so, given the AUM mix—roughly two-thirds in participating funds and most of the rest in non-participating funds—you stand a better chance of reaping the dividends of LIC's investment book as a holder of its policies than as an investor in LIC. And that applies not just to LIC's equity holdings, but also to the different kinds of debt, including government bonds, that make up three-quarters of LIC's overall AUM.



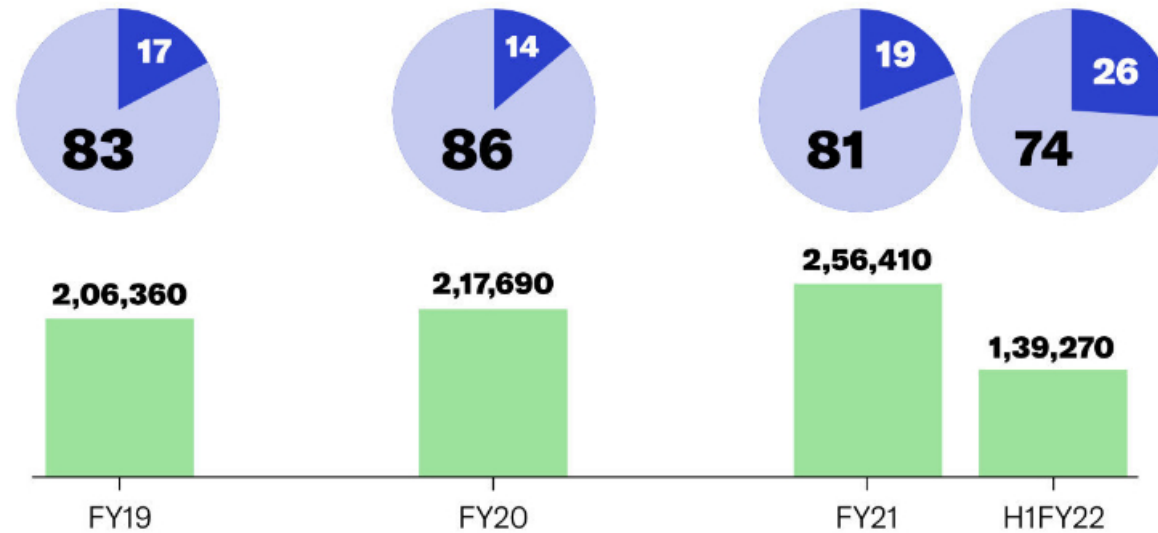
Stocking up

Equities' contribution to LIC's investment income has been on the rise

Share of LIC's investment income (%)

■ Equity ■ Debt and fixed deposit

■ Investment income (Rs cr)



THE KEN

Graphic by Adhithi Priya R, 16 Feb '22

Source: LIC's IPO filing



Having said that, LIC's investments do have a bearing on those who buy its shares, especially as the listing comes at a particularly challenging time in both the equity and debt markets.

After rising 25% in the year to January 2022, the Sensex has slid 5% since. And despite the Reserve Bank of India maintaining status quo on interest rates yet again last week, they are expected to rise, sooner or later, given the inflationary pressures in India and also globally. With bond rates and prices inversely related, rising interest rates could pull down the market value of the debt investments in LIC's portfolio.

This doesn't augur well for LIC. A report by actuarial firm Milliman Advisors, which is part of the IPO filing, points out LIC's vulnerabilities in the current scenario. A one percentage point increase in the reference rates could reduce LIC's embedded value (EV) of ~Rs 5,40,000 crore (\$72 billion) by under 1%. On the other hand, a 20% drop in the value of its equity holdings could lop nearly 14% off its EV.

This matters because the EV determines an insurer's market capitalisation. For instance, LIC's listed peers' valuations are between 2.4X and 4.1X of their EV. Assuming a median market cap/EV multiple for LIC would give



it a valuation of over Rs 17,00,000 crore (\$226 billion), making it India's top company by market capitalisation.

The current adverse market conditions are not the only reason to view LIC's investments with a fair degree of scepticism, however.

Serving the master

Given the size of the LIC IPO, it's easy to ignore that the government is only selling 5% of its holding in the company. As a result, the risk of LIC being the government's investor of last resort will certainly continue, according to a second fund manager.

A year before LIC bailed out IDBI Bank, it increased its stake in crisis-ridden financier Infrastructure Leasing & Financial Services (IL&FS). LIC reportedly upped its holding beyond the prescribed limit of 15% without the requisite approvals from the insurance regulator.

LIC acts as a proxy for the government in its other listed entities. Fifty of LIC's 280 investee companies are state-owned. While these include behemoths such as Oil and Natural Gas Corporation and Indian Oil Corporation, also on the list are duds such as MTNL. Despite the telco's



worsening prospects, and falling market value, LIC became more entrenched in the company. LIC now holds 13% of MTNL, with its investment worth a paltry Rs 220 crore (\$29 million).

Another investment, one of LIC's largest, is puzzling for a different reason. LIC holds 16.2% in ITC, up from 14.3% five years ago. This was thanks to LIC stepping in to acquire a 2% stake the government held in ITC through a different entity in 2017, thereby contributing to the Centre's disinvestment proceeds.

Even if the government has pared its stake in ITC since 2017, it still controls a shade under 30%, through LIC and other state-run companies. "The government has a bizarre relationship with ITC," says the first fund manager quoted earlier, referring to its attempts to curb smoking by taxing cigarettes more, which in turn has hurt ITC's prospects.

That and large institutional investors' anti-tobacco investment stance has resulted in ITC shares sliding 17% in the past five years when the Sensex has doubled in the same period.



In the past, the government has stepped in to prevent British American Tobacco (BAT), which has a similar holding in ITC, taking control of the company, including through restrictions on foreign investments in tobacco. The idea behind that was to make sure ITC remained an ‘Indian’ company. That hardly makes sense in the current environment where startups funded primarily by foreign venture capital are going public, and the Centre wants to divest its stakes in state-owned companies. Not to mention ITC’s near-monopoly position in cigarettes—the hugely profitable business could easily be another reason for the government’s reluctance to exit the company.

As shrewd a trader as LIC is, it will continue to have large holdings that are dictated not by market dynamics but by its biggest owner’s compulsions. And therein lies the paradox of LIC’s influence as an investor.

Image credit: Artem Maltsev/Unsplash



HDFC Life

ICICI Prudential Life

LIC

LIC investment book

LIC IPO

Life Insurance Corporation

SBI Life

AUTHOR

SEETHARAMAN G

Starting out as a business journalist in 2008, Seetharaman has written about energy, climate change, retail, banking, and technology. He has worked with Business Today, a fortnightly, and the Sunday edition of The Economic Times.

[VIEW FULL PROFILE >](#)

AUTHOR

ANAND KALYANARAMAN

A certified Chartered Accountant, Anand chose to pack the power of numbers with words when he left a career of seven years in accounting, putting together MIS reports, and investment research to enter journalism. Before joining The Ken, Anand was Deputy Editor at The Hindu BusinessLine, a newspaper he worked at for 11 years.

[VIEW FULL PROFILE >](#)