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Harel's figures on new business show a strong lead over the other insurance companies

Although the information about new business is hidden in the insurance companies' reports, they should have greater weighting in the analysis of performance

The insurance companies market prices do not take into account significant differences in growth rates. Harel's impressive growth rate compared to the other insurance companies is not reflected in its market price.

IFRS in practice / Shlomi Shuv

It's not easy to learn about the performance of the insurance companies or to estimate their value simply by looking at their financial statements. Accounting practices based on past performance makes it difficult to address insurance business, which is primarily forward looking. To enhance transparency and provide investors with relevant information, the insurance companies have been required, in recent years, to publish information outside their financial statements about their Embedded Value (EV). This information is part of the EV report which is published annually together with the financial statements for the first quarter, and it addresses the value of existing business at the end of the preceding year – namely, the "inventory" of policies which are in force at December 31. So, for example, at the end of May 2013, together with the financial statements for Q1 2013, the insurance companies published their report on EV at December 2012.

Embedded Value is calculated by adding the value in force of the insurance portfolio (VIF), representing capitalization of the flow of future profits anticipated from the existing portfolio, to shareholders' equity, with certain adjustments. The insurance companies are required to include the long-term insurance policies (life and health insurance) in the value of the portfolio, and by choice they also include management of the pension funds.

EV is essentially forward-looking information, and it therefore relies, much more than accounting data based on past performance, on forecasts, estimates and assessments but it also includes economic and demographic variables (such as mortality and morbidity data), as well as other parameters such as cancellations, rates of exercising annuity, etc. Let's also not forget that the insurance companies' financial statements include insurance reserves, which are also based on forecasts and future estimates. However, since the publication of EV data was introduced, it appears that the market does not really believe the figure and investors don't price insurance companies based on their embedded value. This is partly due to the fact that there are several problems with the way in which EV is currently calculated, including that calculation makes use of a risk-free capitalization rate.

Nevertheless, if this figure is used not "as is", but as the sum of its parts, together with other data from the financial statements, we can learn a lot about the future profitability of an insurance company and about its growth rates and the quality of its growth. Such information can be gleaned by making an interesting sectoral comparison, using data which are hidden in the notes to the insurance companies' financial statements and in the EV report, with respect to data about the value of new business (VNB).

VNB represents the present value from the end of the year of the report up to the end of the policy period for the profits anticipated in respect of new policies that were sold during the reporting year. To obtain the profit rate inherent in new policies that were sold during the course of 2012, we can derive a ratio of VNB to the premium on new business in annual terms, commonly known as an "annualized premium". This information appears in the notes to the insurance companies' annual financial statements. To compare companies operating in the same sector, if we take an estimated average duration of premiums of 10 years, we will see that Harel shows profitability of 11.3% compared with 3.9% for Menorah and 4.1% for Clal. It is also worth noting that the average duration in health insurance is a little shorter so that the quality of Harel's profitability data, which is heavily biased towards health insurance, is even stronger.

Life assurance and health insurance – Harel can expect profitability which is double that of the other insurance companies
2012 figures, in NIS millions

	Migdal	Clal	Harel	Menorah	The Phoenix
VNB insurance business	539	304	823	123	302
Annualized premium	959	747	730	315	560
Profitability ratio (*)	5.6%	4.1%	11.3%	3.9%	5.4%

(*) For the sake of simplicity and comparison, the profitability ratio was computed by dividing the VNB by the annualized premium multiplied by 10, assuming that this is the average duration of the premiums

The figures show an exceptional result for Harel which can probably be attributed to its strength in the health insurance sector. The most profitable policies are in health insurance and the risk (term) element in life assurance, given that risk insurance and health products in particular are more profitable than savings and investment products. For example, in Harel, term assurance accounted for 42% of the total annualized premium from new business in 2012, significantly higher than that of the other companies.

But let's not forget that the VNB is based on the companies' internal models and assumptions which are not published in the companies' reports. The companies' forecasts of their profitability are therefore highly subjective, making it difficult to provide an accurate comparison between the companies in this sector. Another interesting review which can be performed with the purpose of invalidating the subjective assumptions is to compare VNB with VIF (value in force).

VIF already includes the VNB, so that the ratio between them provides an indication of the rate of growth in the year of calculation. In view of the fact that calculation of both VNB and VIF for a particular period is based on the same estimates and assessments, the comparison between the companies should be more reliable, neutralizing the problem of the subjectivity of the estimates.

Life assurance and health insurance – Harel posted 16.3% growth in 2012

	Rate of growth	Pace of creation of the portfolio (in years)
Migdal	9.5%	10.5
Clal	5.7%	17.5
Harel	16.3%	6.2
Menorah	5.4%	18.3
The Phoenix	9%	11.2

Here too, Harel's results are extremely impressive: a growth rate of 16.3% means that Harel will manage to re-create (double) the value of its portfolio at December 31, 2012, in 6.2 years. The companies with the lowest growth rate are Clal (5.7%) and Menorah (5.4%), meaning that their growth will double over 17.5 and 18.3 years, respectively.

Furthermore, an analysis of growth data for pension business also casts Harel in a favorable light. For example, the ratio between VNB and VIF in Harel's pension business is 11.6%, in the Phoenix it is 10.3%, in Clal 5.1%, in Menorah 4.1%, and in Migdal 3.7%. This means that Harel will manage to double the present value of its portfolio at December 31, 2012 in 8.6 years, whereas it will take Migdal 26.7 years to achieve the same result.

The market does not cost the pace of growth: insurance and pension business
Insurance companies – rated by pace of growth in 2012

	Pace of creation of present portfolio (in years)	**Present capital ratio**
Harel	6.6	0.96
The Phoenix	11	0.93
Migdal	13	1.25

Clal Insurance	18.1	1.04
Menorah	22	0.93

A look at the overall rate of growth in insurance business in 2012 (life assurance and health insurance) and pensions, ranks Harel in first place, far ahead of the other companies, taking 6.6 years to double the value of its present portfolio. Clal Insurance and Menorah are at the bottom of the ladder, with 18.1 and 22 years, respectively.

What's interesting is that these analyses, which indicate a clear advantage for Harel, are not really reflected in the insurance companies' market prices on the stock exchange. The market prices for the insurance companies relate more to the actual yield reflected in the financial statements over time and ignore the future profitability mentioned above. For example, Harel which has the fastest growth rate, is traded at below its shareholders equity (0.96), whereas Clal and Harel are traded at much higher equity ratios. Without going into the other considerations and components which affect the share price, Harel's excellent performance should justify relatively higher share prices.

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