

# LPI Capital Berhad

(8621 | LPI MK) Financial services | Insurance

**Maintain NEUTRAL**

## COVID-19 to exert pressure on premium income

**Revised Target Price: RM11.70**
*(Previously: RM15.50)*

### KEY INVESTMENT HIGHLIGHTS

- **1QFY20 normalised profit managed to grow by +12.4%yoy to RM85.9m which was within our and consensus' expectation**
- **Moving forward, we expect LPI's premium income to be beleaguered by the weakening economic indicators and subdued business activities due to the COVID-19 outbreak**
- **Nonetheless, the group's resilient cash flow generation and recurring profitable fire insurance from Public Bank would help to partially weather the storm**
- **Maintain NEUTRAL with a revised TP of RM11.70**

**Within expectations.** LPI Capital's (LPI) 1QFY20 normalised earnings grew by +12.4%yoy to RM85.9m. This accounted for 25.8% and 26.8% of ours and consensus' full year FY20 estimates. The growth was mainly attributable to the exclusion of the fair value losses of about RM8.0m in the equity and bond markets which in our view to remain volatile in coming months. Moving forward, we expect the group's quarterly earnings to be subdued due to the COVID-19 led movement control order (MCO) and weakening business sentiments.

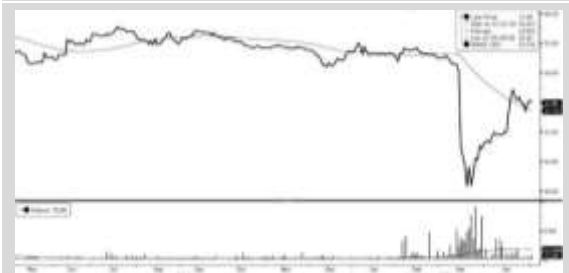
**Expecting a contraction in premium income.** In view of extended MCO and anticipated weakening business sentiments in 2QCY20, we are expecting the group's net earned premium (NEP) to be negatively impacted. This was predominantly due to the group's active exposure in the infrastructure space whereby we anticipate a delay of the construction projects and property launches. We are also foreseeing a decline in the premium income from the motor and fire insurance resulting from the possible weaker consumer spending. This is further compounded by the ongoing motor and fire liberalisation exercise which continues to add further downward pressure on premium pricing.

**Resilient combined ratio to be a cushion.** LPI's 1QFY20 combined ratio improved to 71.4% through a decrease of -2.5ppts yoy. This was resulted primarily from the drop in claims ratio and commission ratio by -1.2ppts yoy and -2.5ppts yoy to 46.3% and 2.7% respectively. As a result, this led to an increase of +10.4%yoy in the underwriting profit to RM67.8m. While we anticipate a premium contraction moving forward which would be putting pressure on the underwriting profit, the relatively low combined ratio as compared to industry average (i.e. 93% in CY19) would provide ample room for the group to partially maneuver through this unfavourable business environments. We are also taking comfort in the strong recurring profitable fire insurance business from Public Bank and its extensive agency as a backstop for the group's underwriting profit to be resilient. Meanwhile, the MCO and lesser traffic on the road could potentially lower the claims from the motor segment.

### RETURN STATISTICS

|                                       |             |
|---------------------------------------|-------------|
| Price @ 4 <sup>th</sup> May 2020 (RM) | 12.98       |
| Expected share price return (%)       | -9.9        |
| Expected dividend yield (%)           | +5.4        |
| <b>Expected total return (%)</b>      | <b>-4.5</b> |

### SHARE PRICE CHART



| Share price performance (%) | Absolute | Relative |
|-----------------------------|----------|----------|
| 1 month                     | 11.7     | 7.3      |
| 3 months                    | 11.9     | -4.1     |
| 12 months                   | -15.8    | 0.4      |


### KEY STATISTICS

|                                  |                 |
|----------------------------------|-----------------|
| FBM KLCI                         | 1,367.59        |
| Syariah compliant                | No              |
| Issue shares (m)                 | 398.38          |
| Estimated free float (%)         | 48.3            |
| Market Capitalisation (RM'm)     | 5,171.01        |
| 52-wk price range                | RM 9.9 – RM16.2 |
| Beta vs FBM KLCI (x)             | 0.77            |
| Monthly velocity (%)             | 11.02           |
| Monthly volatility (%)           | 6.64            |
| 3-mth average daily volume (m)   | 0.17            |
| 3-mth average daily value (RM'm) | 2.15            |
| Top Shareholders (%)             |                 |
| Consolidated Teh Holdings        | 42.74           |
| Sompo Holdings Inc               | 8.54            |
| Retirement Benefits Fund         | 4.71            |

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**Earnings estimates.** In view of the potential disruption to premium income and expected further fire liberalisation process and rising claims environment, we are revising downward our earnings forecasts by -15.8% and -16.7% for FY20 and FY21 to RM280.2m and RM290.2m respectively. Note that we are introducing our FY22 earnings forecasts as well.

**Target price (TP).** We are revising our TP to **RM11.70** (*previously RM15.50*) as we rollover our valuation to FY21. This is achieved via pegging its FY21 core EPS of 72.8sen to a lower PER of 16.1x (*previously 18.6x*). The revised PER represents the group's -1SD discount to its 5-year historical average to take into account the subdued business environments arising from the COVID-19 outbreak.

**Maintain NEUTRAL.** While the group was able to register decent growth in 1QFY20, we are of the view that COVID-19 led extended MCO and further weakening economic indicators to cause the group's upcoming financial performance to be subdued. This was mainly attributable to the lower premium across most major insurance classes, particularly the construction and engineering segment arising from potential delay in projects and property launches. Social distancing guidelines and weaker consumer spending could also dampen the performance of its fire and motor insurance segments as well due to lower motor purchases and lesser increase in mortgages in the medium term. Nonetheless, we are comfortable with the group's relatively low combined ratio which provides larger headroom to maneuver through these uncertain times. Coupled with the group's ability to generate adequate positive cash flow for its operation remaining intact which is evidenced by its healthy ratio of cash flow from operating activities to net income of 119.8% as of 31 March 2020, we maintain our **NEUTRAL** stance on LPI Capital. 

## INVESTMENT STATISTICS

| FYE Dec                           | FY18A        | FY19A         | FY20E        | FY21F        | FY22F        |
|-----------------------------------|--------------|---------------|--------------|--------------|--------------|
| Operating Revenue                 | 1513.7       | 1602.7        | 1570.6       | 1578.5       | 1589.5       |
| <b>Net earned premiums (RM'm)</b> | <b>930.8</b> | <b>1011.5</b> | <b>855.7</b> | <b>909.9</b> | <b>999.4</b> |
| <b>Underwriting profit (RM'm)</b> | <b>303.5</b> | <b>299.2</b>  | <b>254.0</b> | <b>265.7</b> | <b>280.0</b> |
| Operating profit (RM'm)           | 402.0        | 414.4         | 355.0        | 367.7        | 383.1        |
| Pre-tax profit                    | 406.0        | 414.7         | 356.9        | 369.7        | 385.1        |
| Net profit                        | 314.0        | 322.4         | 280.2        | 290.2        | 302.3        |
| <b>Normalised net profit</b>      | <b>314.0</b> | <b>322.4</b>  | <b>280.2</b> | <b>290.2</b> | <b>302.3</b> |
| Basic EPS                         | 78.8         | 80.9          | 70.3         | 72.8         | 75.9         |
| Core EPS (sen)                    | 78.8         | 80.9          | 70.3         | 72.8         | 75.9         |
| Recurring EPS growth (%)          | 1.0          | 2.7           | -13.1        | 3.6          | 4.2          |
| PER (x)                           | 16.5         | 16.0          | 18.5         | 17.8         | 17.1         |
| Net Dividend (sen)                | 68.0         | 70.0          | 70.0         | 70.0         | 70.0         |
| Net Dividend Yield (%)            | 5.2          | 5.4           | 5.4          | 5.4          | 5.4          |
| BVPS (RM)                         | 5.0          | 5.3           | 5.6          | 5.9          | 6.3          |
| PBV (x)                           | 2.6          | 2.5           | 2.3          | 2.2          | 2.1          |
| ROE (%)                           | 14.6         | 15.9          | 15.0         | 14.2         | 13.4         |

Source: Company, MIDFR

## 1QFY20 RESULTS SUMMARY

| FYE Dec (RM'm)                    | Quarterly     |               |               |                |                |
|-----------------------------------|---------------|---------------|---------------|----------------|----------------|
|                                   | 4Q19          | 1Q19          | 4Q19          | %YoY           | %QoQ           |
| <b>Operating revenue</b>          | <b>403.9</b>  | <b>392.7</b>  | <b>399.3</b>  | <b>2.9%</b>    | <b>1.2%</b>    |
| Gross earned premiums             | 367.5         | 358.2         | 379.6         | 2.6%           | -3.2%          |
| <b>Net earned premiums</b>        | <b>237.1</b>  | <b>235.6</b>  | <b>265.5</b>  | <b>0.6%</b>    | <b>-10.7%</b>  |
| Investment income                 | 36.4          | 34.5          | 19.6          | 5.5%           | 85.6%          |
| Commission income                 | 37.2          | 28.5          | 24.0          | 30.3%          | 54.9%          |
| <b>Other income</b>               | <b>75.0</b>   | <b>65.4</b>   | <b>47.3</b>   | <b>14.6%</b>   | <b>58.5%</b>   |
| Gross claims paid                 | -139.8        | -122.4        | -158.0        | 14.2%          | -11.5%         |
| Claims ceded to reinsurers        | 42.8          | 29.0          | 57.9          | 47.6%          | -26.1%         |
| <b>Net claims incurred</b>        | <b>-109.7</b> | <b>-111.8</b> | <b>-107.0</b> | <b>-1.9%</b>   | <b>2.5%</b>    |
| Commission expenses               | -43.5         | -40.8         | -42.7         | 6.6%           | 1.9%           |
| Management expenses               | -53.2         | -50.1         | -44.7         | 6.2%           | 18.9%          |
| <b>Other expenses</b>             | <b>-105.5</b> | <b>-94.4</b>  | <b>-90.1</b>  | <b>11.8%</b>   | <b>17.1%</b>   |
| <b>Operating profit</b>           | <b>96.9</b>   | <b>94.9</b>   | <b>115.8</b>  | <b>2.1%</b>    | <b>-16.3%</b>  |
| Share of associates and JV        | 1.5           | 0.8           | 0.5           | 96.4%          | 198.6%         |
| <b>Profit before tax</b>          | <b>97.9</b>   | <b>95.4</b>   | <b>115.3</b>  | <b>2.6%</b>    | <b>-15.1%</b>  |
| Taxation                          | -20.0         | -18.3         | -28.7         | 9.4%           | -30.3%         |
| <b>Net profit</b>                 | <b>77.9</b>   | <b>77.2</b>   | <b>86.6</b>   | <b>1.0%</b>    | <b>-10.0%</b>  |
| <b>Normalised net profit</b>      | <b>85.9</b>   | <b>76.4</b>   | <b>86.6</b>   | <b>12.4%</b>   | <b>-0.8%</b>   |
| <b>Underwriting profit/(loss)</b> | <b>67.9</b>   | <b>61.5</b>   | <b>94.1</b>   | <b>10.4%</b>   | <b>-27.8%</b>  |
| Core EPS (sen)                    | 21.6          | 19.2          | 21.7          | 12.4%          | -0.7%          |
|                                   | <b>1Q20</b>   | <b>1Q19</b>   | <b>4Q19</b>   | <b>+/- pts</b> | <b>+/- pts</b> |
| Claims ratio                      | 46.3%         | 47.4%         | 40.3%         | -1.2           | 6.0            |
| Management expense ratio          | 22.4%         | 21.2%         | 16.8%         | 1.2            | 5.6            |
| Commission ratio                  | 2.7%          | 5.2%          | 7.0%          | -2.5           | -4.4           |
| <b>Combined ratio</b>             | <b>71.4%</b>  | <b>73.9%</b>  | <b>64.2%</b>  | <b>-2.5</b>    | <b>7.2</b>     |
| Retention ratio                   | 64.5%         | 65.8%         | 69.9%         | -1.3           | -5.4           |
| Underwriting margin               | 28.6%         | 26.1%         | 35.8%         | 2.5            | -7.2           |

| Segmental breakdown                 | 1Q20  | 1Q19  | 4Q19  | YoY             | QoQ             |
|-------------------------------------|-------|-------|-------|-----------------|-----------------|
| <b>Net earned premiums (RM'm)</b>   |       |       |       |                 |                 |
| Fire                                | 87.1  | 96.0  | 112.5 | -9.2%           | -22.6%          |
| Motor                               | 85.5  | 76.6  | 86.1  | 11.6%           | -0.7%           |
| Marine, aviation & transit          | 5.0   | 5.4   | 5.2   | -7.8%           | -4.6%           |
| Miscellaneous                       | 59.5  | 57.7  | 61.7  | 3.2%            | -3.6%           |
| <b>Net claims incurred (RM'm)</b>   |       |       |       |                 |                 |
| Fire                                | -11.8 | -13.1 | -11.2 | -9.7%           | 5.2%            |
| Motor                               | -64.3 | -54.1 | -63.4 | 18.9%           | 1.5%            |
| Marine, aviation & transit          | -1.1  | -3.4  | -1.7  | -68.0%          | -35.9%          |
| Miscellaneous                       | -32.5 | -41.2 | -30.7 | -21.2%          | 5.9%            |
| <b>Net claims incurred (%)</b>      |       |       |       | <b>+/- ppts</b> | <b>+/- ppts</b> |
| Fire                                | 13.5% | 13.6% | 10.0% | -0.1            | 3.6             |
| Motor                               | 75.2% | 70.6% | 73.6% | 4.6             | 1.6             |
| Marine, aviation & transit          | 21.7% | 62.7% | 32.4% | -40.9           | -10.6           |
| Miscellaneous                       | 54.6% | 71.5% | 49.7% | -16.9           | 4.9             |
| <b>Net commission (RM'm)</b>        |       |       |       |                 |                 |
| Fire                                | 1.2   | -7.3  | -18.5 | -116.2%         | -106.4%         |
| Motor                               | -8.2  | -7.4  | -8.1  | 11.4%           | 0.9%            |
| Marine, aviation & transit          | 1.3   | 1.9   | -1.0  | -31.5%          | -233.4%         |
| Miscellaneous                       | -0.7  | 0.4   | -14.6 | -257.4%         | -95.5%          |
| <b>Underwriting surplus* (RM'm)</b> |       |       |       |                 |                 |
| Fire                                | 76.5  | 75.6  | 93.3  | 1.2%            | -18.0%          |
| Motor                               | 13.0  | 15.1  | 14.6  | -14.2%          | -10.8%          |
| Marine, aviation & transit          | 5.2   | 4.0   | 3.9   | 31.7%           | 35.3%           |
| Miscellaneous                       | 26.4  | 16.9  | 28.2  | 56.4%           | -6.7%           |

Source: Company, MIDFR

\*Before Management Expenses

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### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

|                     |  |
|---------------------|--|
| <b>BUY</b>          | Total return is expected to be >10% over the next 12 months.   |
| <b>TRADING BUY</b>  | Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.  |
| <b>NEUTRAL</b>      | Total return is expected to be between -10% and +10% over the next 12 months.  |
| <b>SELL</b>         | Total return is expected to be <10% over the next 12 months.   |
| <b>TRADING SELL</b> | Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow. |

#### SECTOR RECOMMENDATIONS

|                 |  |
|-----------------|--|
| <b>POSITIVE</b> | The sector is expected to outperform the overall market over the next 12 months.   |
| <b>NEUTRAL</b>  | The sector is to perform in line with the overall market over the next 12 months.  |
| <b>NEGATIVE</b> | The sector is expected to underperform the overall market over the next 12 months. |