Sector Update | Thursday, 05 March 2020

INSURANCE

Insurance sector seen entering a soft market cycle

***Downgrade to* NEUTRAL**

(previously POSITIVE)

KEY INVESTMENT HIGHLIGHTS

- **The Malaysian insurance sector may be experiencing a soft market cycle, indicating a possible lower average premium and increasingly competitive industry dynamics moving forward**
- **Ongoing detariffication of the motor and fire insurance and increased competition to continue adding downward pressure on the underwriting margin of the General Insurance and General Takaful segment.**
- **Nonetheless, the overall insurance sector will still be mainly supported by the sustained growth coming from the Life Insurance and Family Takaful segments.**
- **Downgrade to NEUTRAL on the Insurance and Takaful sector**

A looming soft market cycle. Concluding the 4QFY19 earnings season of the insurance companies under our coverage, we noticed that its net earned contributions (NEC) and premiums (NEP) as well as earnings were experiencing tapering growth or a decline. This trend was particularly more discernible with general insurance companies, possibly due in large part to the detariffication of the motor and fire insurance class. We are of the view that this might indicate that the insurance sector might be entering into a soft market cycle. Note that the characteristics of a soft market include; (i) Lower insurance premiums, (ii) Broader coverage and relaxed underwriting criteria, (iii) Increased competition and capacity. Thus, a soft market will be put a downward pressure on insurance companies' bottom line as premium is the main revenue source. Factors fuelling the soft market could comprise of; (a) Softening macroeconomic indicators, (b) Low insurance penetration rate, (c) Deregulation of the general insurance industry, (d) Increased number of insurance providers and products.

Economic indicators to be moderated. Based on the Business Tendency Survey, the overall weakening business confidence of -2.1% in 1QCY20 was the lowest point since 1QCY19. Breaking down into sector, the business confidence on the services sector in 1QCY20 slumped to 1.0%, the lowest point since 2QCY18 in which insurance was one of the components as well. This was mainly attributable to the slowdown in tourism activity affecting hotels, transport and retail trade due to COVID-19 outbreak. The decline of -8.0ppts yoy in the business confidence of the insurance sector to 4.2% (the lowest since 2QCY18) in 1QCY20 also partly contributing to the lower business confidence as well. In addition, the business expectation survey for the insurance sector for the next six months (i.e. January 2020 to June 2020) slid by -4.1ppts yoy to 12.5% which was the lowest since 1QCY19. Meanwhile, our economics team foresee private consumption and services sector to grow at a softer pace, predicating on expectation of rising inflationary pressure and slightly easing employment on top of trade tension and a moderate commodity prices that could stifle domestic demand. Consequently, we opine that the above indicators and developments will dampen the demand for insurance products in the medium term. Nonetheless, the recent stimulus package and two consecutive OPR cuts in 1QCY20 could provide partial support to the insurance demand.

COMPANY IN FOCUS

Syarikat Takaful Malaysia Keluarga Bhd
Maintain NEUTRAL | Unchanged target price: **RM5.10**
Price @ 4th March 2020: RM4.49

- Expected lower growth of contributions from its Family and General Takaful segment
- Potential loss of a bancatakaful partner (i.e. RHB Islamic Bank) to put pressure on earnings
- However, we are cautiously optimistic on the group's digital initiatives and other bank deals

Share price chart

LPI Capital Bhd
Maintain NEUTRAL Unchanged target price: **RM15.50**
Price @ 4th March 2020: RM14.50

- Unfavourable claims environment and escalating competition to put pressure on earnings
- Deregulation of the motor and fire insurance to continue to add pricing pressure
- Combined ratio of the group remains low at about 70%, providing more room for aggressive growth opportunities

Share price chart

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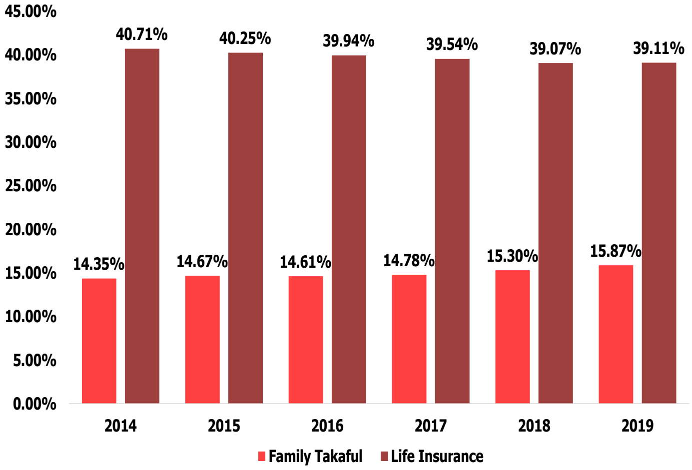
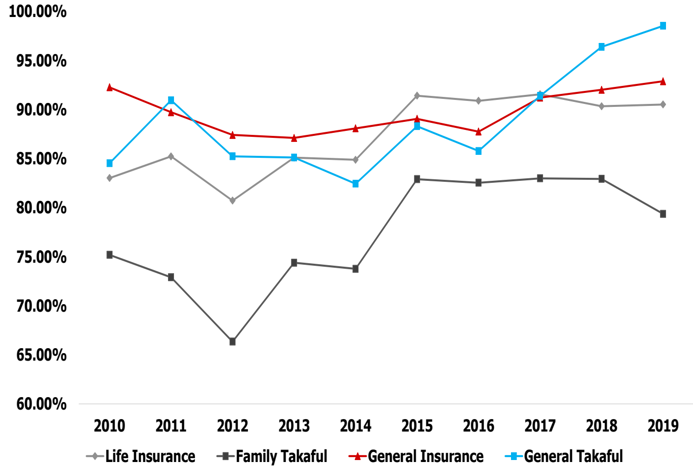
Chart 1: Malaysian Insurance Penetration Rate (%)



Source: BNM, MIDFR

Chart 2: Industry Combined Ratio by Segment

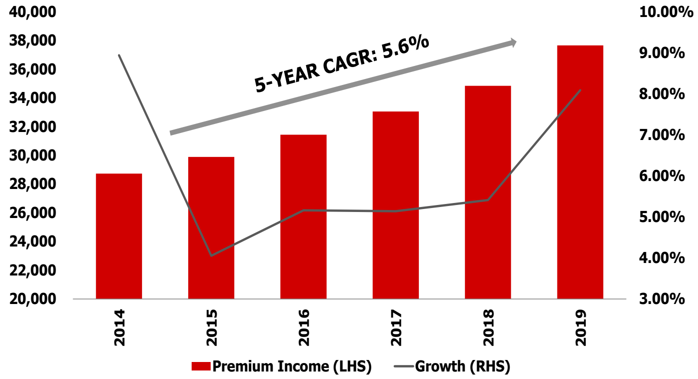


Source: BNM, MIDFR

Online distribution of insurance products in nascent stage. The penetration rate remains stagnant at about 54-55% *(refer to Chart 1)* for the past six years despite target set by Bank Negara Malaysia (BNM) to achieve the target of 75% by 2020. Under the requirement of Life Insurance and Family Takaful Framework, insurance companies have to introduce commission-free pure protection products through direct distribution channels (i.e. mainly online channels) to lower the cost of insurance to meet the target. Therefore, we observed that more insurance companies have been embarking on digitalisation and offering a wide array of insurance products via entirely online. The insurance products sold online normally will have lower premiums, less customisable and less stringent underwriting criteria to entice buyers. While the online distribution will help to improve the insurers' commission structure, we postulate that it wasn't enough to make up for the lower premium and higher management expenses at this juncture and might affect unfavourably to the underwriting margin *(refer to Chart 2)*. For instance, **Tune Protect Group Berhad** (TPG) **(NEUTRAL, TP: RM0.42)**'s management expenses ratio has been above industry average at above 45% due to its investments into technologies whereas **LPI Capital Berhad** (LPI) **(NEUTRAL, TP: RM15.50)**'s at about 20%.

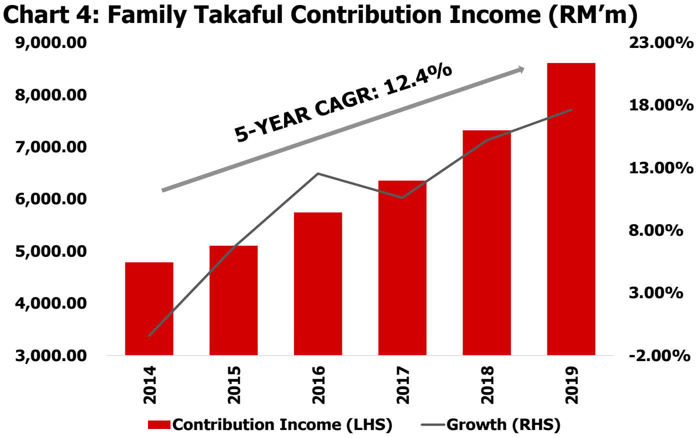
Increased competition seen arising in the Takaful segment. We opine that the attractive 5-year CAGR of Family Takaful and General Takaful segments *(refer to chart 4 and 6)* and the low penetration rate *(refer to chart 1)* have enticed major insurance players vying in this increasingly competitive space. Coupled with the industry's push to achieve Takaful's penetration rate of 25% via the campaign – "Race for Cover –Towards Takaful (RfCTT) 2020", we are seeing that most major insurers have rolled out varied Takaful products into the market. We observed that these Takaful products have competitively lower pricing, broader coverage and higher capacity in a bid to increase the adoption of Takaful products. In addition, we are seeing aggressive market expansion by insurers such as FWD Takaful Bhd in the Family Takaful industry. We are also of the view that the non-renewal of the bancatakaful deal between **Syarikat Takaful Malaysia Keluarga Berhad** (STMB) **(NEUTRAL, TP: RM5.10)** and RHB Islamic Bank is a sign of increasingly competitive industry dynamics whereby other players might be offering a better deal to capture market share. If **STMB** could not successfully renew the collaboration, we opine that its underwriting profit growth might be dampened.

Chart 3: Life Insurance Premium Income (RM'm)



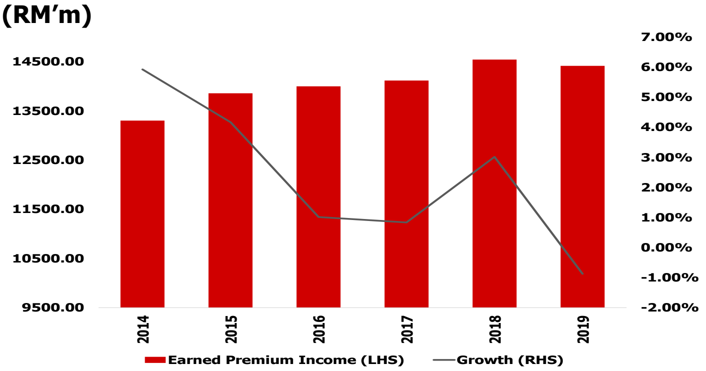
Source: BNM, MIDFR

Chart 4: Family Takaful Contribution Income (RM'm)



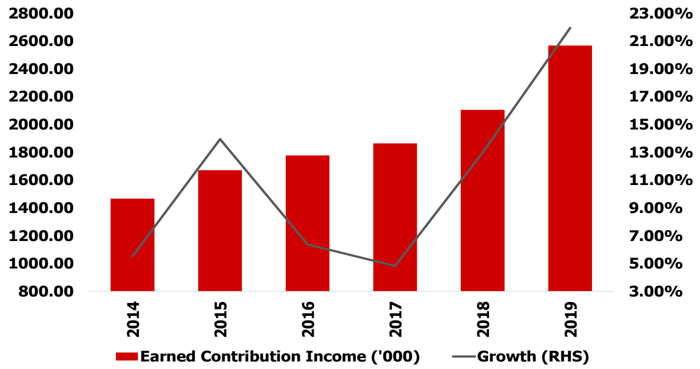
Source: BNM, MIDFR

Chart 5: General Insurance Gross Premium Income (RM'm)



Source: BNM, MIDFR

Chart 6: General Takaful Contribution Income (RM'm)



Source: BNM, MIDFR

Detariffication of motor and fire insurance to add further pricing pressure. We posit that the ongoing phased liberalisation of the motor and fire insurance will keep the conventional and takaful general segments under pressure. This is primarily attributable to undercutting of products' pricing in order to gain market share. According to the BNM's Financial Stability Review, the premium rates for the 8.2m in-force private car policies as at end June 2019 were either lower or maintained for 43% of policies. For the first 9 months of CY19, the Malaysian general insurance industry also posted a 1.0% contraction in gross written premium. As such, we foresee that the general insurers' gross premium and contribution income growth under our coverage will continue to be subdued, particularly the more matured general insurance segment *(refer to chart 5 and 6)*. To recall, the motor and fire insurance are the two biggest insurance classes in the general segment, accounting for 70% and 80% for general insurance and general takaful respectively. While motor has been almost fully liberalised, we postulate that the review of further de-tariffication of the fire insurance possibly in coming quarters might be an area of concern for insurers who have a larger exposure such as **LPI**. Moving forward, we are of the view that the continued deregulation of the industry to have a moderated impact on the general insurers' margin as evidenced by the weakening combined ratio of **LPI** and **TPG.**

On a positive note, Life and Family takaful segments (LIFE) to remain resilient. The overall insurance and takaful sectors' aggregate capital adequacy ratio (CAR) of 230% was well above the regulatory minimum of 130% as at end June 2019. Moreover, the profitability of the overall insurance and takaful sector have been improving as driven largely by the higher growth of net premiums and contributions in the life insurance and family takaful segments *(refer to chart 3 and 4).* This was predominantly attributable to improved sales of non-participating endownment policies via bancassurance arrangements, and higher contributions from medical and health takaful products for the lower income segment. While the Minimum Allocation Rate (MAR) which came into effect on 1 July 2019 for life insurance is expected to affect new business growth and profitability of investment-linked products (ILP), we believe the growth will be partly sustained by the insurance tax relief of RM3,000 and the increasing popularity of ILP. To recall, the ILP accounted for 59% and 36% of the new business growth for Life Insurance and Family Takaful segments respectively in CY19. Moving forward, we opine that the growth in the insurance sector will largely coming from the life segments as compared non-life which is going through a transition period towards a liberalised market.

Downgrade to NEUTRAL. In our view, the outlook of the Malaysian insurers' earnings will be less encouraging. This is premised on the softening of the economic indicators such as weakening of the business confidence and expectations on the insurance sector as well as slumping retail sales growth which will possibly dampen the demand for insurance products. With the relatively stagnant penetration rate, we are seeing an increasing number of major insurers rolling out competitive products that are more affordable, offering a broader coverage, and relaxed underwriting criteria in order to incentivise mass market to gain market share. This is especially getting prominent in the Takaful segment in view of the favourable demographics in Malaysia that could entice major insurers to adopt aggressive market share expansion. Consequently, the possible lower premium pricing and higher expenses might soften the underwriting margin of insurers under our coverage as it vies for market share in the anticipated increasingly competitive insurance industry. We also postulate that the expected further de-tarrification of the fire insurance will be putting further downward pricing pressure on the general insurers. Nonetheless, we expect the growth from the Life Insurance and Family Takaful to remain resilient with the insurance tax relief of RM3,000 and banking on the popularity of investment-linked insurance products. All factors considered, we are downgrading our stance on the sector to **NEUTRAL** from previously POSITIVE.

PEER COMPARISON TABLE

Stock	FYE	Rec.	Price @ 4-Mar-20	Tgt Price (RM)	Core EPS (sen)		CORE PE (x)		Net DPS (sen)		Net Dvd Yield (%)	
					CY20F	CY21F	CY20F	CY21F	CY20F	CY21F	CY20F	CY21F
LPI Capital Bhd	Dec	NEUTRAL	14.50	15.50	83.5	87.4	17.4	16.6	70.0	70.0	4.8	4.8
Syarikat Takaful Malaysia Keluarga Bhd	Dec	NEUTRAL	4.49	5.10	39.8	40.9	11.3	11.0	15.0	15.0	3.3	3.3
Tune Protect Group Bhd	Dec	NEUTRAL	0.41	0.42	6.1	6.5	6.7	6.3	3.0	3.0	7.3	7.3

Source: Company, MIDFR

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (197501002077(23878-X)).
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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.