21 September 2016 | Sector Update

Insurance/Takaful Sector

***Maintain* POSITIVE**

Lloyd's landing onshore

INVESTMENT HIGHLIGHTS

- **Lloyd's of London to expand its business onshore**
- **We foresee healthy competitive boost to the local reinsurance sector**
- **May help to reduce overall retention ratio, i.e. better risk control**
- **We reiterate our POSITIVE stance on the sector**

NEWS

Lloyd's to expand its business onshore. It was reported in the media yesterday that Lloyd's of London, a specialist insurance and reinsurance player, is eyeing an onshore Tier-1 reinsurance license in Malaysia. Its chairman, John Nelson, is hopeful that Bank Negara Malaysia will approve the application for the license within two months. Operations are likely to begin in the first quarter of 2017. Lloyd's currently serves as a Tier-2 reinsurer through its nine Labuan Service Companies and as a cross-border reinsurer from London and Singapore.

An onshore Tier-1 reinsurance license will enable it to contribute with greater capacity and offer specialist underwriting expertise in emerging and complex risks to serve the growing demands of the domestic insurance sector. Lloyd's will build on its marine, energy, construction, engineering and liability offering in Malaysia, working in partnership with local brokers to deliver solutions for many new infrastructure projects driven by the government's ETP initiatives. Lloyd's also sees the potential for Malaysia to develop as a commercial retakaful market.

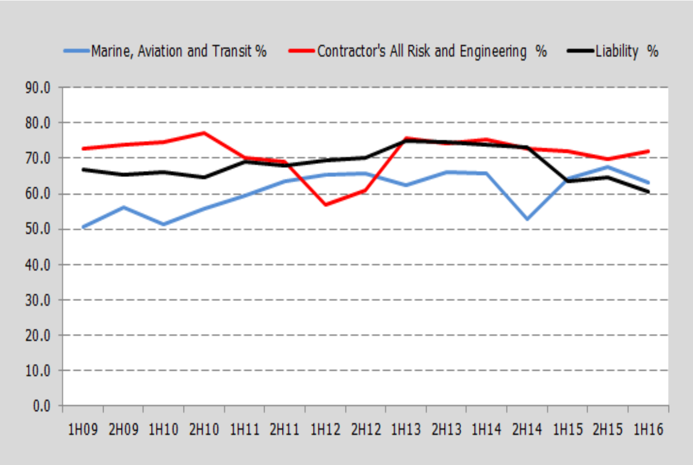
OUR VIEW

Competitive boost in reinsurance market… The admission of a new foreign entrant into the onshore reinsurance market is not unexpected as BNM has opened up the reinsurance industry fully to foreign competition. On this score, the entrance of Lloyd's may in fact help to generate healthy competitive boost to the local reinsurance sector.

…shall promote better financial stability. We are of the view that this will play an important role to insurance industry as a whole, offering financial strength to the ceding companies by reducing volatility of underwriting profit and sophisticated risk management. In addition, Lloyd's is rated A (excellent) by A.M. Best, AA- (very strong) by Fitch and A+ (strong) by Standard & Poor's reflecting its robust financial position. As Lloyd's is keen on reinsuring abovementioned insurance classes, this may benefit related-insurers (see table 1) to spread their risks against large deviations from expected losses (claims).

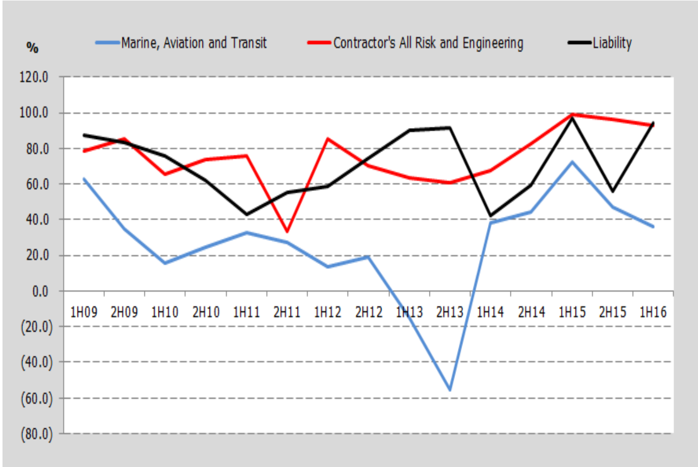
Historically high retention ratio and volatile retention levels. For the overall general insurance and takaful sector, insurers are retaining the premium rather than transfer the risks to reinsurers. This is evident from the increased retention ratio for general insurance and takaful from 91.8% and 92.1% respectively in 1H09 to 93% and 99.0% respectively in 1H16. It was largely contributed by (1) medical expenses and personal accident, (2) motor, and (3) workmen's compensation and employers' liability. Zooming into insurance classes, reinsurers have been instrumental in supporting insurers in controlling the risks in marine, contractor's all risk and engineering and liability classes. The retention levels have been volatile (see chart 1 and 2) over the last few years as they had different scale of risks.

Chart 1: Net Retention Ratio for General Insurance



Source: BNM, MIDFR

Chart 2: Retention Ratio for General Takaful



Source: BNM, MIDFR

Recommendation. We opine the entrance of Lloyd's of London is a net positive development to the local insurance/takaful industry. Hence, we maintain our **POSITIVE** stance on the sector. We reiterate our **BUY** calls for all insurance/takaful companies under our coverage universe, namely **Syarikat Takaful Malaysia (TP: RM4.65)**, **LPI Capital (TP: RM17.84)**, and **Tune Protect (TP: RM2.28)**.

Risks. Downside risks to the sector includes: (1) Unfavourable regulatory changes, (2) unanticipated profit margin compression due to intense competition, (3) higher-than-expected claims, and (4) interest rate movements that could impact industry players' investment returns.

Table 1: Among Beneficiaries Based On 2015 Market Share

Company	Marine Hull	Company	Contractor's All Risks & Engineering	Company	Liability
Etiqa	20.60%	MSIG	12.20%	Allianz General	18.80%
Pacific	14.30%	Allianz General	11.60%	AIG	11.10%
QBE	13.80%	Lonpac	9.80%	Lonpac	9.20%
AXA Affin General	9.90%	Pacific	8.90%	Ace Jerneh	8.10%
Tune	7.90%	QBE	6.20%	QBE	6.30%

Source: ISM Insurance Services, MIDFR

Table 2: Peer Comparison

Stock	Last price (RM)	Recom.	TP (RM)	EPS (sen)		PER (x)		Div. yield (%)		PBV (x)	
				FY16F	FY17F	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F
STMB	4.13	BUY	4.65	21.3	23.7	19.4	17.4	2.2	2.9	4.8	4.6
LPI Capital	16.80	BUY	17.84	78.1	87.1	21.5	19.3	4.2	4.2	2.9	2.8
Tune Protect	1.62	BUY	2.28	13.1	14.7	12.4	11.0	2.6	2.7	2.2	2.0

Source: MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.