13 April 2016 | Sector Update

Insurance/Takaful Sector

***Reiterate* POSITIVE**

Strategies to translate into decent growth

INVESTMENT HIGHLIGHTS

- **We believe that the industry players will be able to deliver decent growths in premium/contributions income this year despite of a weak consumer sentiment**
- **Liberalization of motor and fire tariffs will be on gradual phases and LIFE framework is expected to spur life/family penetration rate**
- **The growth will be attributable to the gist explained later in this report.**
- **We reiterate our POSITIVE stance on the sector**

With the flexibility in pricing for motor and fire insurance commencing on 1st July 2016, we believe that industry players need to position themselves well in the market to grow their earnings from higher demand for insurance coverage, greater product innovations and enhancements in distribution channels. Our POSITIVE recommendation on the overall sector remains unchanged based on the following reasons:

A. PROMISING STATISTICS

Sustained rising trend of conventional premium income and Takaful contribution income. The recent numbers released (see chart below) showed that total Takaful earned contributions continued to garner double digit growth of 11.0%yoy to RM8.2b in CY15, supported by a rise of 4.8%yoy in the number of certificates in-force. The growth rate has been inspiring despite of the dampened consumer sentiment as shown by the Consumer Sentiment Index which has declined from 83.0 points in 4QCY14 to 63.8 points in 4QCY15. Meanwhile, the conventional insurance business grew at reasonable pace as anticipated, by 3.3%yoy to RM43.8b in CY15.

Chart 1: Conventional premium income

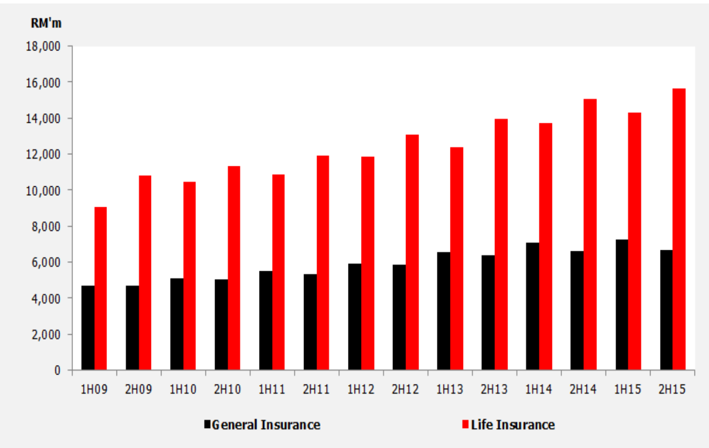
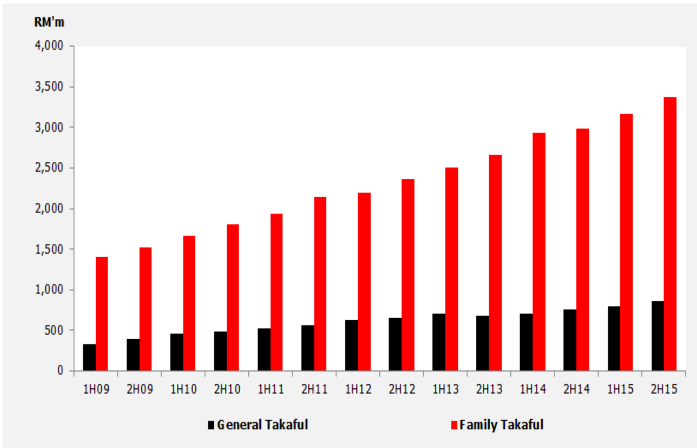


Chart 2 : Takaful contribution income



Source: BNM, MIDFR

Positive sectoral earnings performance. Quarterly, the combined general insurance and Takaful's underwriting profit improved in 4QCY15 to RM335.9m as compared to RM69.7m in 3QCY15, mainly due to lower claims. Operating profit was higher thanks to an improved investment income of RM659.9m in 4QCY15. Earnings of life insurers and family Takaful operators improved during the quarter with a positive excess income over outgo of RM5.2b against losses of RM0.4b in 3QCY15. This resulted in a favourable improvement of the insurance/Takaful companies' earnings under our coverage (see our 4QCY15 Earnings Wrap report dated 8th March 2016).

B. GROWTH DRIVERS FOR THE SECTOR

Takaful growth continues unabated. We believe that the untapped potential of the Takaful sector will continue to grow unabated. We expect this sector to continue to benefit from: (1) the continued growth of Islamic banking financing which will require Takaful insurance coverage, (2) migration of corporate clients to Takaful products, and (3) untapped potential of the market, mainly non-Muslims for Takaful insurance. These points support our BUY recommendation on Syarikat Takaful Malaysia, the only listed Takaful insurance company.

Booming construction sector to benefit insurance players. We do not rule out that conventional insurance may also register growth this year. We anticipate that the growth in conventional insurance will continue to be a single digit, supported mainly by general insurance. Aside from motor insurance coverage, we expect the growth to be derived from fire and liability insurance for multi-billion infrastructure construction projects, particularly MRT line 2 project. Recall that LPI Capital was the leader in providing insurance coverage for MRT line 1 project.

Gradual phase out of tariff pricing for motor and fire insurance for the general insurance segment. We view that Bank Negara Malaysia's (BNM) roadmap on removing the tariff pricing for motor and fire insurance as positive with the adjustments will be on a gradual basis without creating much disruption to the insurance sector. It will allow opportunities for industry players to restrategize their operations earlier ahead of the effective implementation phased liberalization of the motor and fire tariffs. We believe that the phased in approach has taking into consideration the softness of global and local economies. Indeed, the phase in approach will not pose much of the adverse impacts on the sector as earlier expected by some industry observers. The recent announcement on detariffication is only a preliminary concept paper to provide guidance on the detariffing process. We understand that BNM has invited initial feedbacks from the insurance/Takaful industry players to discuss on the paper in greater depth in the coming weeks.

Liberalisation may strengthen industry players' financial position instead. In the absence of details abovementioned, it is difficult to ascertain the overall impact on net earned premiums/contributions and claims ratio over the liberalisation timeline. Nonetheless, we are of the view that liberalisation will strengthen industry players' financial position over the long run as players are expected to be well prepared to defend their market share. It has been since 2012 that the four-year adjustment to motor insurance premium began. We believe that these insurance companies have invested in IT infrastructure to develop premium rating models as well as to improve their processes and distribution channels. These companies have the economies of scale and greater operational flexibility to offer newer products at market-based prices.

Table 1: Phased Liberalisation Implications

Phase	Implications
2016 onwards	New products will be based on marked rates. This will lead to an incentive to offer new insurance products to increase premiums/contributions income. Claims ratio may stand to benefit as adequate risk premiums are charged based on the risk profile of the insured on the new insurance products.
2017 onwards	For motor insurance, it is still early to gauge the movement in premiums and loss ratios due to lack of details on the pricing adjustments. Likewise, the impact on fire insurance cannot be determined at this juncture without details on the downward pricing adjustment for specific asset classes. However, the application of risk-based pricing framework may establish the floor to pricing of insurance post-liberalisation. Thus, it is expected to limit the intense pricing competition among the players and margin compression to a certain extent.

Source: MIDFR

LIFE framework to spur life/family penetration rate. The growth potential of under-penetration life/family insurance business segment is still a catalyst to stronger forward to industry players' earnings over the long-term as the regular premium/contributions from policyholders will translate into recurring income to the players. With more transparency and a wider range of distribution channels under LIFE framework announced in November 2015, we expect this translate in higher take-up rate of life insurance/family coverage.

C. VALUATION AND RECOMMENDATION

Maintain POSITIVE. In short, we reiterate our **POSITIVE** recommendation on the sector. The constructive planned reforms by BNM will continue to support the long-term development of the conventional insurance and Takaful industry that will provide secular earnings visibility and strengthen capital position to withstand the downside risk. Our top pick for the sector is **Syarikat Takaful Malaysia (TP: RM4.65)** and for small cap, **Tune Protect (TP: RM1.89)**. We advocate investors to HOLD **LPI Capital (TP: RM15.80)** as the company possess (i) good forward earnings growth potential, (ii) inherent underwriting profit and margin quality, and (iii) generous dividend payout.

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

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
Insurer/Takaful											
STMB	4.10	BUY	4.65	20.3	21.4	20.2	19.2	3.9	4.1	4.8	4.5
Tune Protect	1.45	BUY	1.89	8.7	9.8	16.7	14.8	2.4	2.7	2.5	2.2
LPI Capital	15.62	NEUTRAL	15.80	68.9	71.3	22.7	21.9	3.2	3.2	2.9	2.8
Allianz Malaysia	10.50	NR	-	-	-	-	-	-	-	-	-
MPHB Capital	1.51	NR	-	-	-	-	-	-	-	-	-
Manulife Holdgs	2.91	NR	-	-	-	-	-	-	-	-	-
Pacific & Orient	1.33	NR	-	-	-	-	-	-	-	-	-
MAA Group	0.96	NR	-	-	-	-	-	-	-	-	-
Reinsurer											
MNRB Holdings	2.87	NR	-	-	-	-	-	-	-	-	-

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.