

09 November 2015 | Sector Update

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# Insurance/Takaful Sector

## *Insuring growth*

**Upgrade to POSITIVE**  
*(previously NEUTRAL)*

### INVESTMENT HIGHLIGHTS

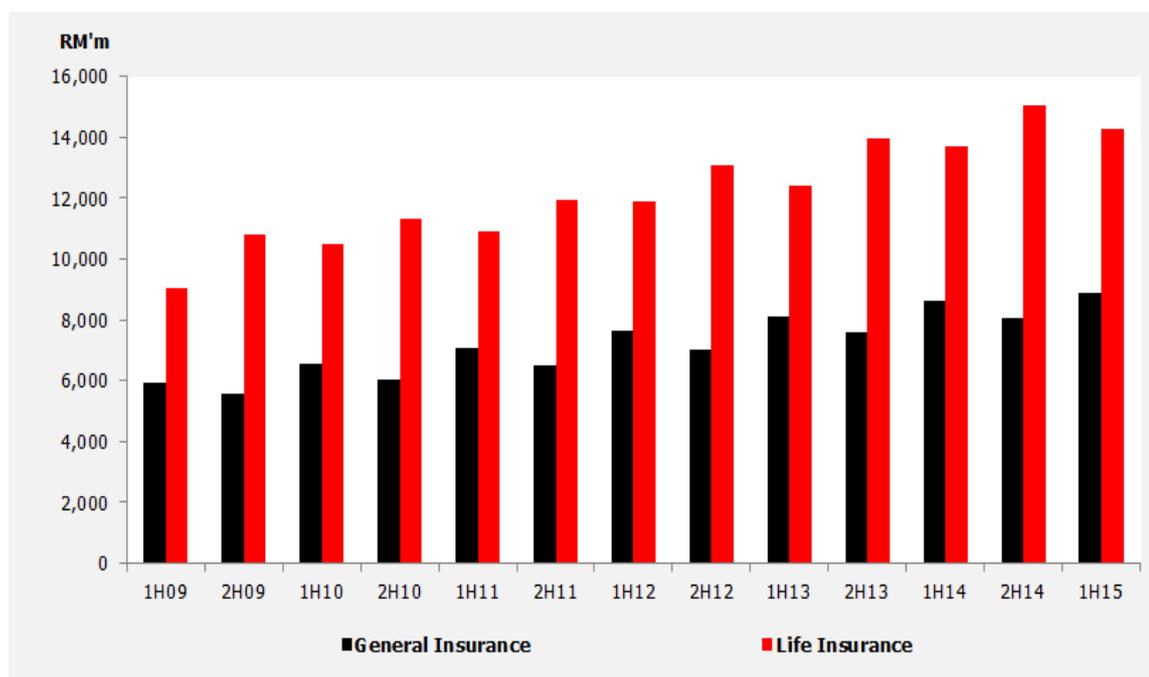
- Insurance/takaful industry's premium/contribution income growth has been on uptrend and we expect it will continue.
- The growth will be supported by stable macroeconomic outlook despite weak external environment.
- We believe most of industry players will benefit from the under-penetration of local insurance market, which in turn may translate into strong profitability.
- Hence we upgrade our recommendation on the sector to **POSITIVE**.

There are three key factors that support our revision to **POSITIVE** rating for the insurance/takaful sector, namely (i) growth prospect in premium/contribution income, (ii) steady macroeconomic outlook, and (iii) higher margin of safety of our top picks. We elucidate these points with the following investment thesis:

#### A. KEY INDICATORS OF THE INDUSTRY

**Premium income showed resilience in 1H15.** The pace of total premium income of insurance business was relatively sturdy in 1H15 at RM23.2b (+3.67%yoy). This was comparatively higher to the RM22.3b and RM23.1b premium incomes in 1H14 and 2H14 respectively. The growth was largely attributed to improvement in premium collection for both general (+2.8%yoy) and life (+4.2%yoy) segments during the period due to the increase in domestic demand and a greater awareness of insurance and benefits from insuring risks.

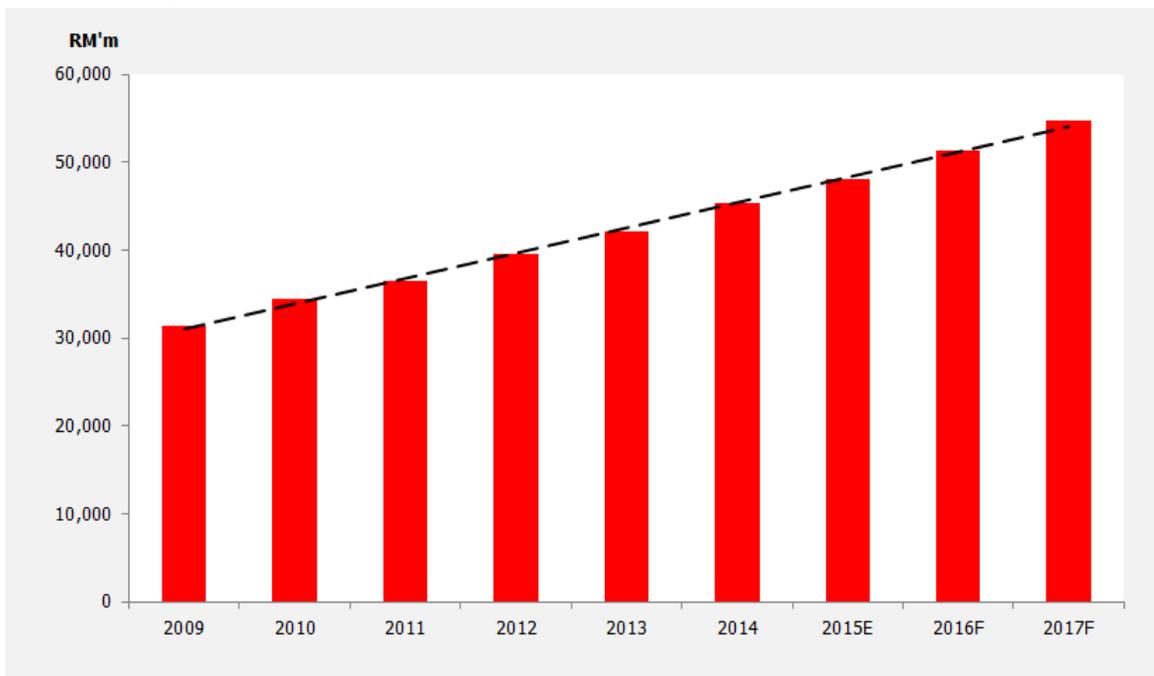
**Chart 1: Premium Income for both General and Life Insurance**



Source: Bank Negara Malaysia, MIDFR

**Positive but slower growth rate.** The growth story for insurance is likely continuing into 2015 with an estimated growth of 5.7%. Although things will be different next year with a detariffication of motor and fire for both insurance and takaful income, we view this paradigm shift would create more opportunities to industry players and strengthen their market share. With detariffication, we opine insurers may approach to design more refined products that differentiate their offering with a reasonable price to keep tab on the demand. Pursuant to this, we expect growth for insurance business will continue at 6.8% and 6.6% in 2016 and 2017 respectively (see chart 2). We derive our premium income projections from regression analysis.

**Chart 2: Projected Premium Income**



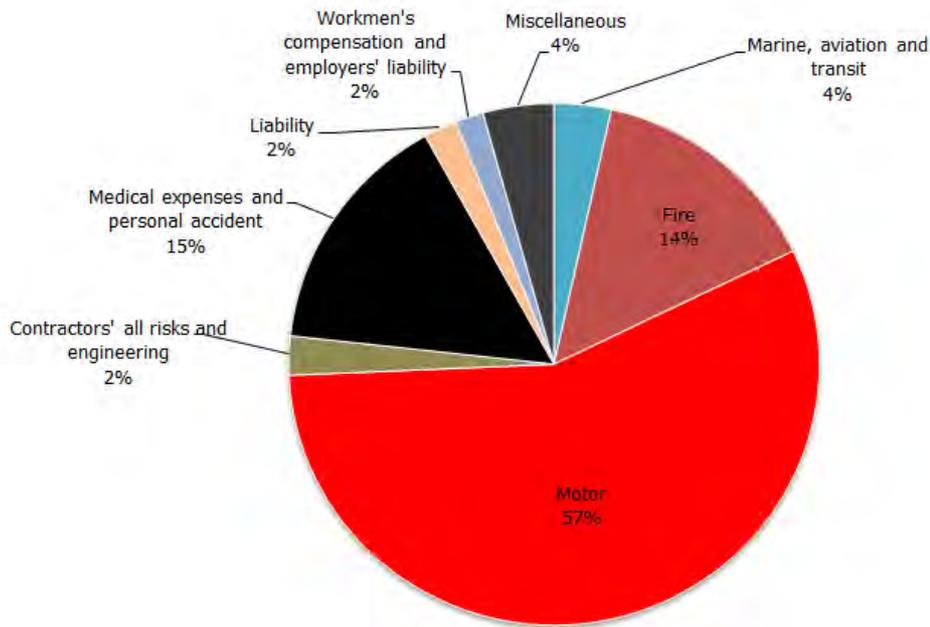
Source: Bank Negara Malaysia, MIDFR

**Motor insurance garnered the biggest chunk in general insurance business.** In terms of market share, motor insurance garnered the biggest chunk of insurance business classes with a share of 57% or RM7.7b (2013: 57% and 2012: 56%) of general insurance's net premium of RM13.7b. This was followed by the medical and personal expenses and fire classes which stood at 15% and 14% respectively (see chart 3). We expect motor insurance to continue to be dominant business line for general insurers in the coming years. In 2014, it registered a steady 5.7% growth.

**Claims ratio sustained at 57.2% in 2014.** Having said the above, motor insurance claim of 71% was the highest across the classes in 2014. The claims cost were burdened by compensation for bodily injuries and property damages caused by road accidents as well as vehicle theft. Overall, the figure remained sustainable at 57.2% as opposed to previous years before 2012 of more than 60%.

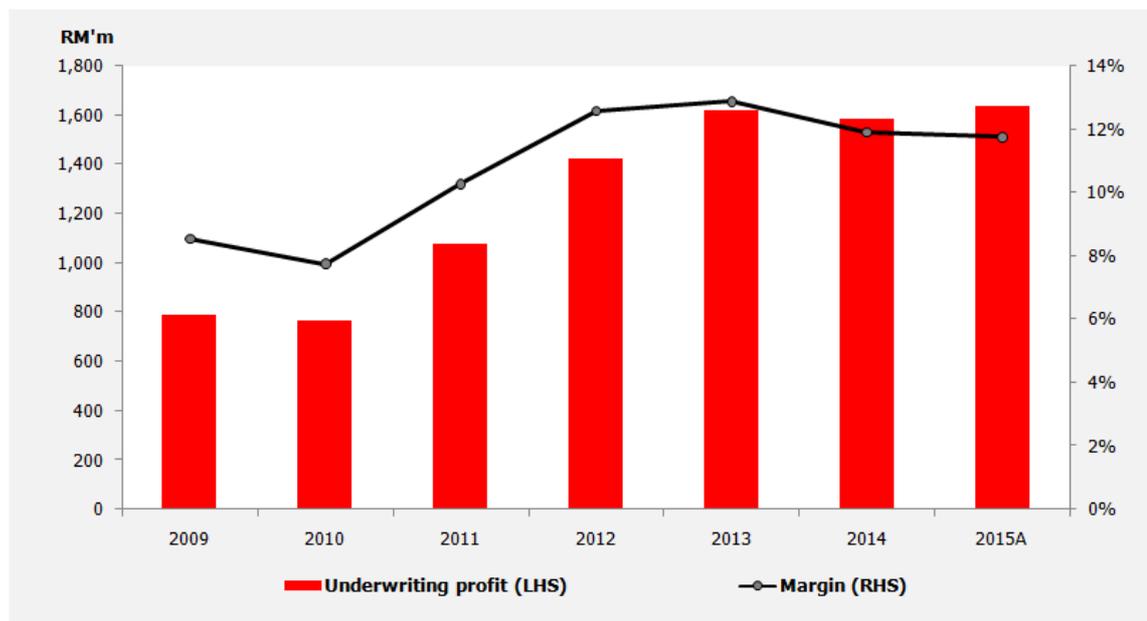
**Underwriting profit.** Furthermore, we anticipate underwriting profit to grow at an annualised rate of 3.3% this year with a stable margin of 12% (see chart 4). We expect insurance providers may focus on their management and operational expense efficiency in order to address possible soft pricing challenges that could constrain their profit margin.

**Chart 3: General Insurance Business Market Share in 2014**



Source: Bank Negara Malaysia, MIDFR

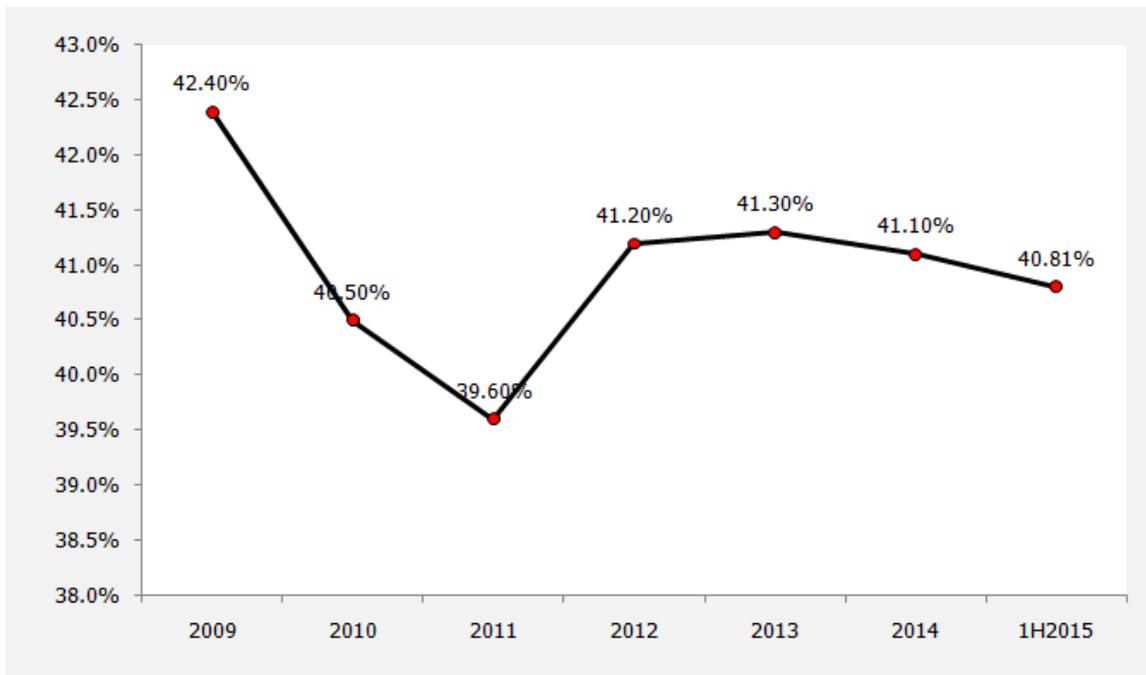
**Chart 4: General Insurance's underwriting Profit and its Margin**



Source: Bank Negara Malaysia, MIDFR

**Life insurance has plenty of room for growth.** With the noticeable under-penetration in life insurance business segment so far, we believe its potential growth will persist towards the penetration level of 50% (or a combined life insurance and family takaful of 75%) by 2020 as targeted under the Government's Economic Transformation Programme (ETP). While we deem the target ratio as rather flattering, nonetheless it reflects the enormous untapped potential in Malaysia insurance sector (see chart 5).

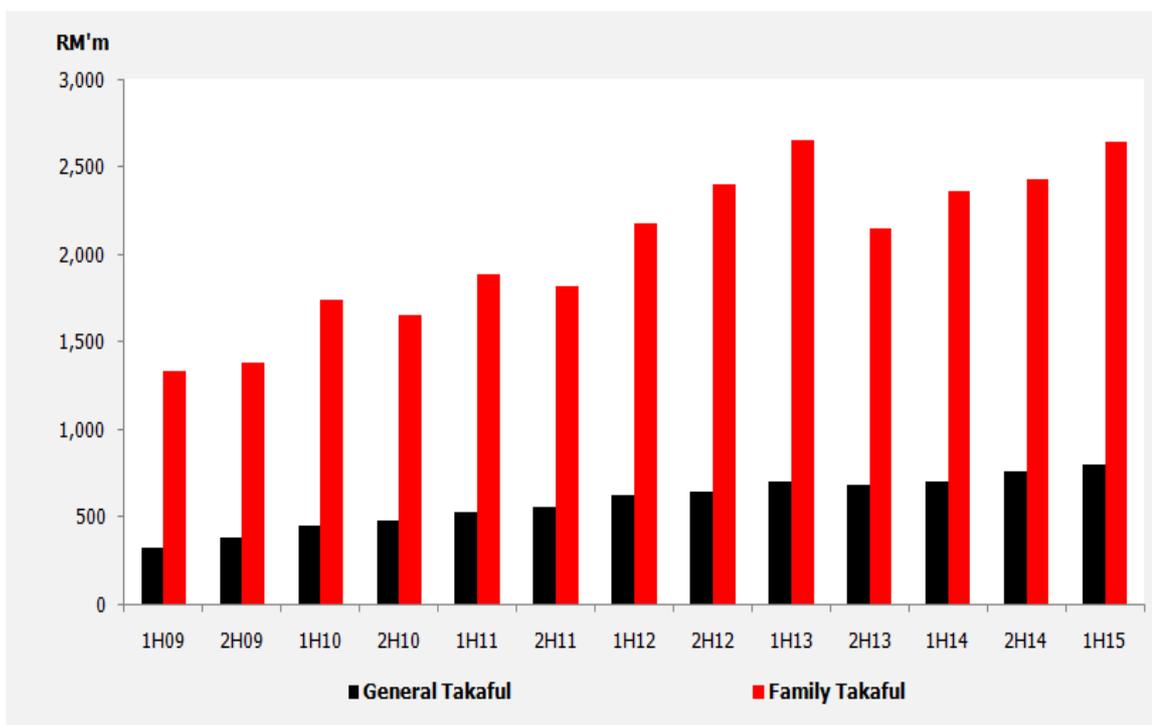
**Chart 5: Life Insurance Penetration Rate**



Source: MTA, MIDFR

**Takaful's contribution income chalked a healthy growth rate.** Takaful is also experiencing a robust growth with the segment registering total contribution income of RM3.4b in 1H15, a leap of 12.2% over the same period last year. We opine the rise in demand for sharia compliant products could be one of the factors that lead to strong pace of growth in Takaful business. More than a few Takaful products have been developed to meet different needs and wants of customers on insurance. This has opened up new opportunities in the rapidly growing markets.

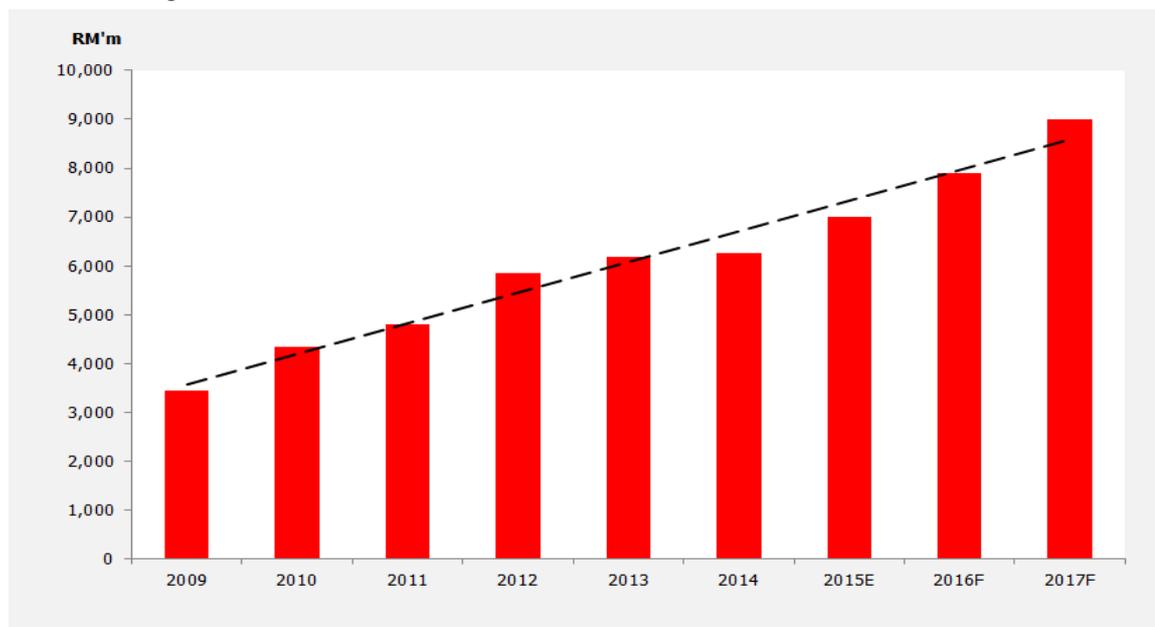
**Chart 6: Takaful's Earned Contribution Income**



Source: Bank Negara Malaysia, MIDFR

**Strong 5-year CAGR of 12.7%.** According to Malaysia Takaful Association (MTA), Malaysia has emerged as the world's second largest takaful market. This is not surprising as the sector experienced remarkable 5-year CAGR of 12.7% during 2009 to 2014 period. There has been persistent and significant growth in both general and family takaful business. This growth has outpaced the growth of the conventional general and life insurance respectively. We anticipate total contribution income growth will continue its buoyancy at 12.7% and 14.0% in 2016 and 2017 respectively from an estimated growth rate in 2015 of 11.9%.

## Chart 7: Projected Contribution Income

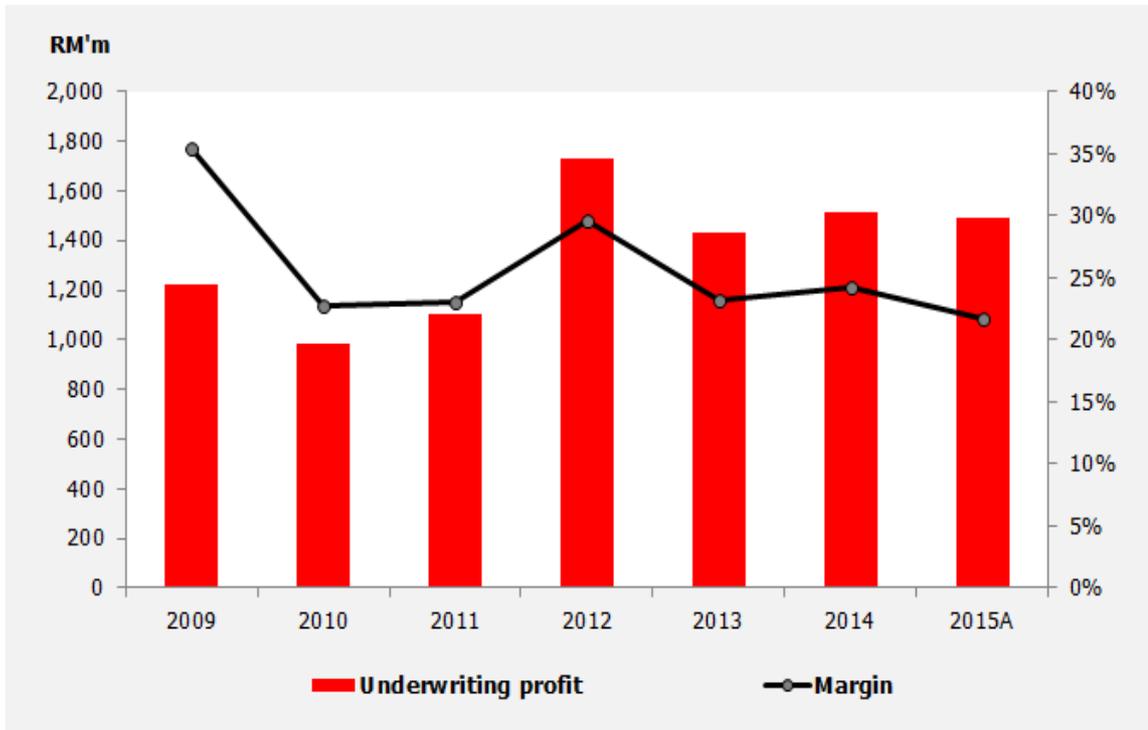


Source: Bank Negara Malaysia, MIDFR

**Overall underwriting profit stayed solid.** We expect total underwriting profit and margin for the industry will stay solid at the current level going forward (see chart 8). This is in tandem with contribution income growth momentum that may return to double digit starting this year, although we have seen growth contraction for the last two years following a stricter personal financing term which consequently impacted the Takaful credit cover. Meanwhile, we do not see any adverse impact to industry players' profitability at this juncture from the requirement to split the Life/Family and General Insurance/Takaful businesses imposed by Bank Negara Malaysia.

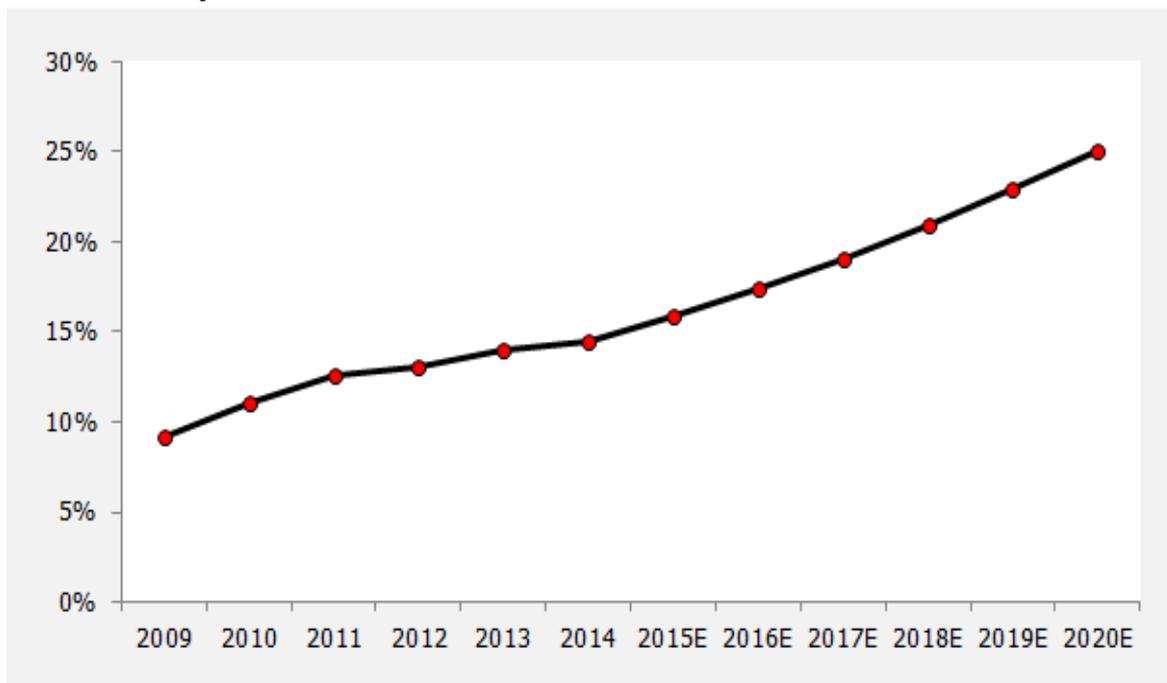
**Family takaful penetration level is expected to achieve 25% by 2020.** Parallel with life insurance situation, family takaful penetration level is still below optimal market rate despite a decade of accelerated growth in contribution income (see chart 9). The industry is expected to achieve the penetration level of 25% by 2020 based on the 11.2% average year-on-year growth rate in the number of certificates inforce for the period of 2009-2014.

**Chart 8: Takaful's underwriting Profit and its Margin**



Source: Bank Negara Malaysia, MIDFR

**Chart 9: Family Takaful Penetration Rate**

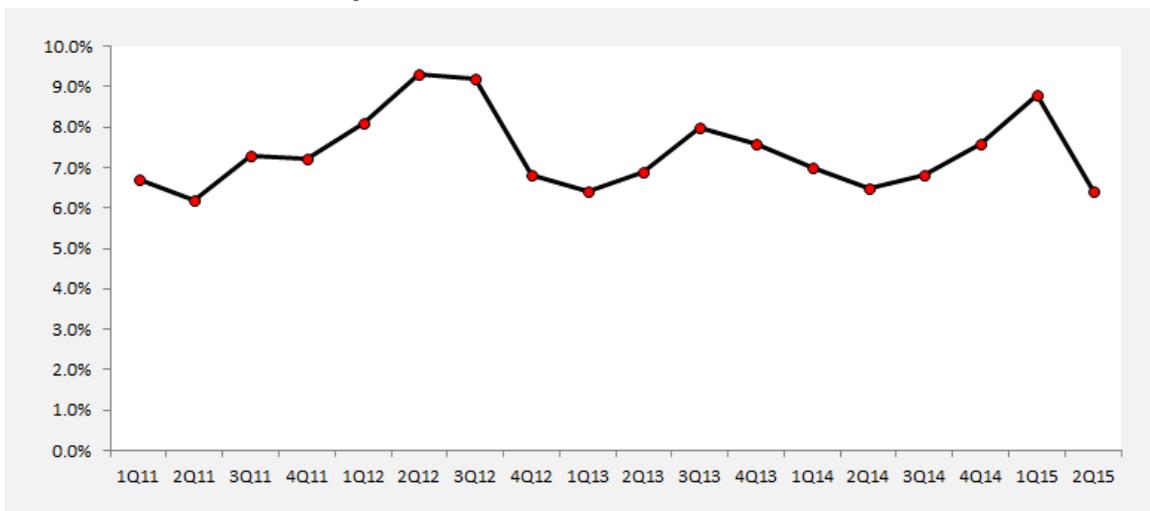


Source: MTA, MIDFR

## B. MACROECONOMIC OUTLOOK

**Economy starts to pick up next year.** Despite the uncertain external environment, our in-house economist remains relatively sanguine with 5.0% and 5.2% growth forecasts for Malaysia in 2016 and 2017 respectively. We are expecting that the economy will start to pick up in the second quarter next year, particularly led by private consumption with an expected growth of 7.0%. However, our assessment may be reviewed if the global economic slowdown persists in the fourth quarter of this year.

**Chart 10: Private Consumption Growth**

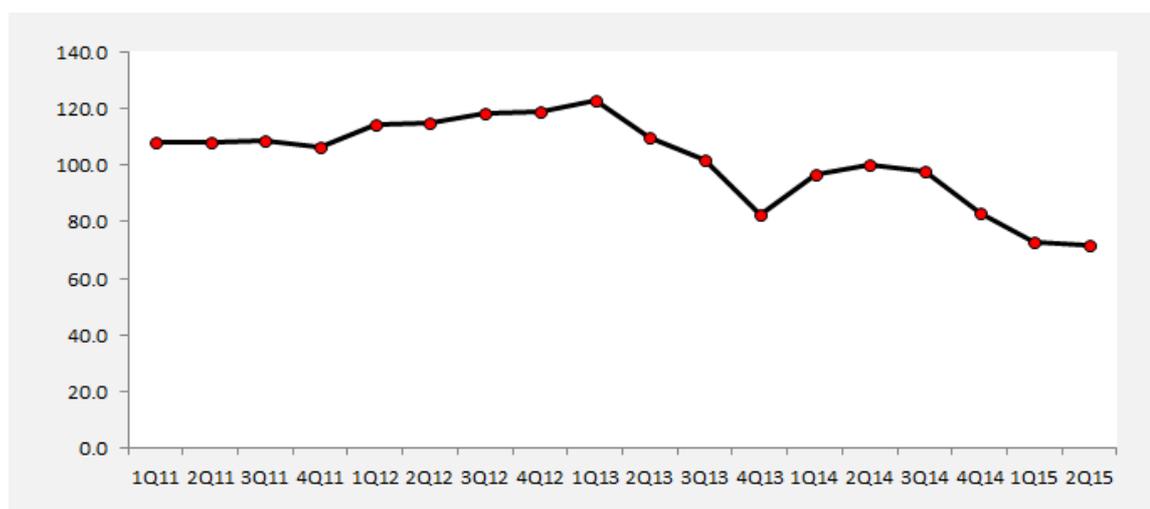


Source: Bank Negara Malaysia, MIDFR

**Private consumption will continue to grow modestly.** It is not surprised to see the decline in household spending in 2Q15 as it indicated a shrinking appetite for household spending due to implementation of GST (see chart 10). However, the figure came in above ours and consensus expectation as it remained above 6%. As population age bracket between 25 and 34 years old is expected to grow during 2015-2020 period, we anticipate moderate growth in domestic consumption to derive new number of certificates and income for both insurance and takaful.

**Consumer confidence poised to recover.** Currently, consumer confidence index is still signifying negative sentiment as consumers are adjusting to the higher cost of living environment and lower future expenditure planning. We expect it will persist for few quarters before the index starts to recover in 2H16.

**Chart 11: Consumer Sentiment Index**



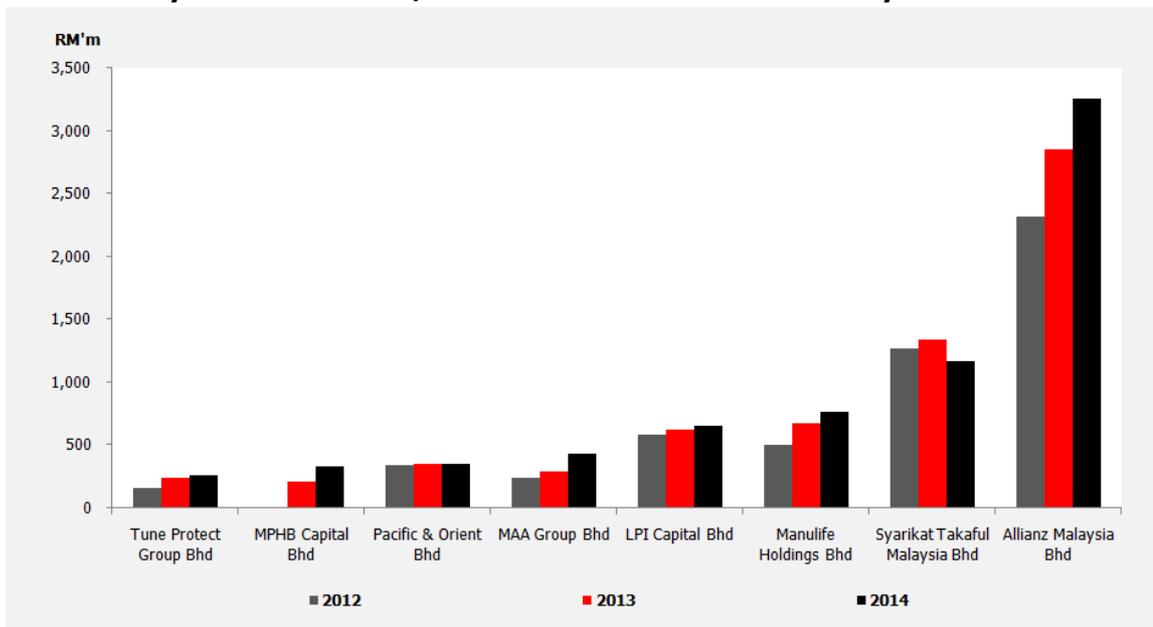
Source: Bank Negara Malaysia, MIDFR

## C. PUBLIC LISTED INSURER AND TAKAFUL OPERATOR PERFORMANCE

To further support our sectoral investment thesis, it should be also worthwhile to keep track of the performance of all the nine public listed insurers and takaful operators:

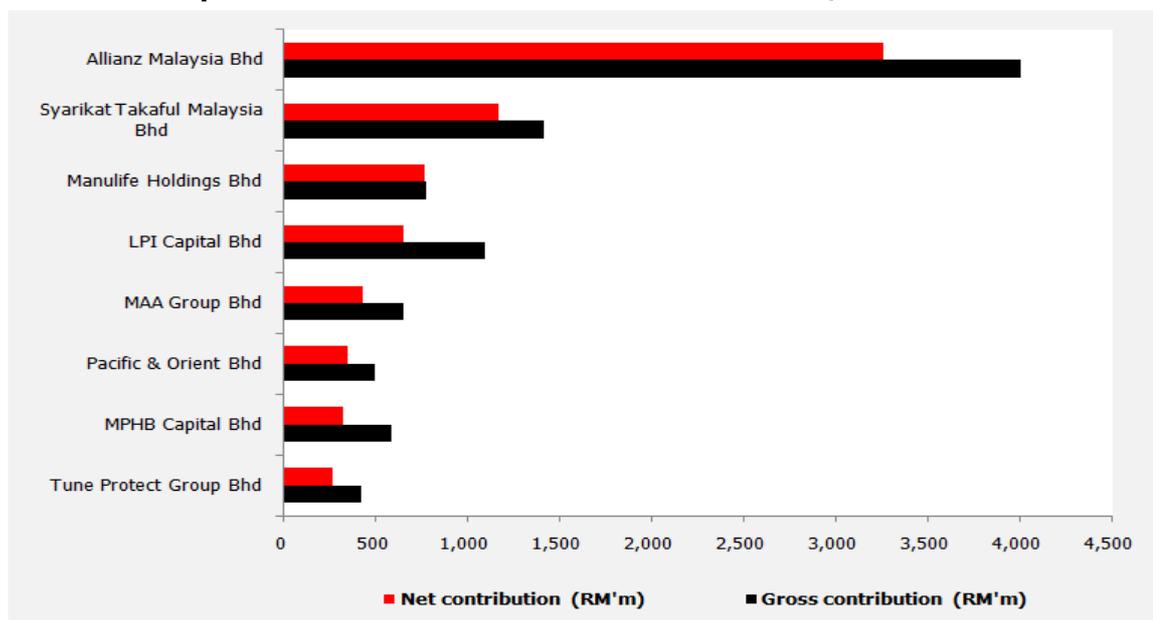
**A comparison of net premium/contribution income size.** In this comparison, Allianz Malaysia Bhd (Allianz) has been the largest listed insurance/takaful player with a net premium income of RM3.3b, followed by Syarikat Takaful Malaysia Bhd (STMB) of RM1.2b and Manulife Holdings Bhd of RM768m making up top three. Motor business remained the larger contributor to the former's premium income, made up more than 60% of Allianz General's portfolio. As of 1H15, Allianz's net earned premium of RM1.7b registered a growth of 5%yoy.

**Chart 12: 3-year Net Premium/Contribution Income of Listed Players**



Source: Bursa Malaysia, MIDFR

**Chart 13: Comparison between 2014 Gross and Net Premium/Contribution**

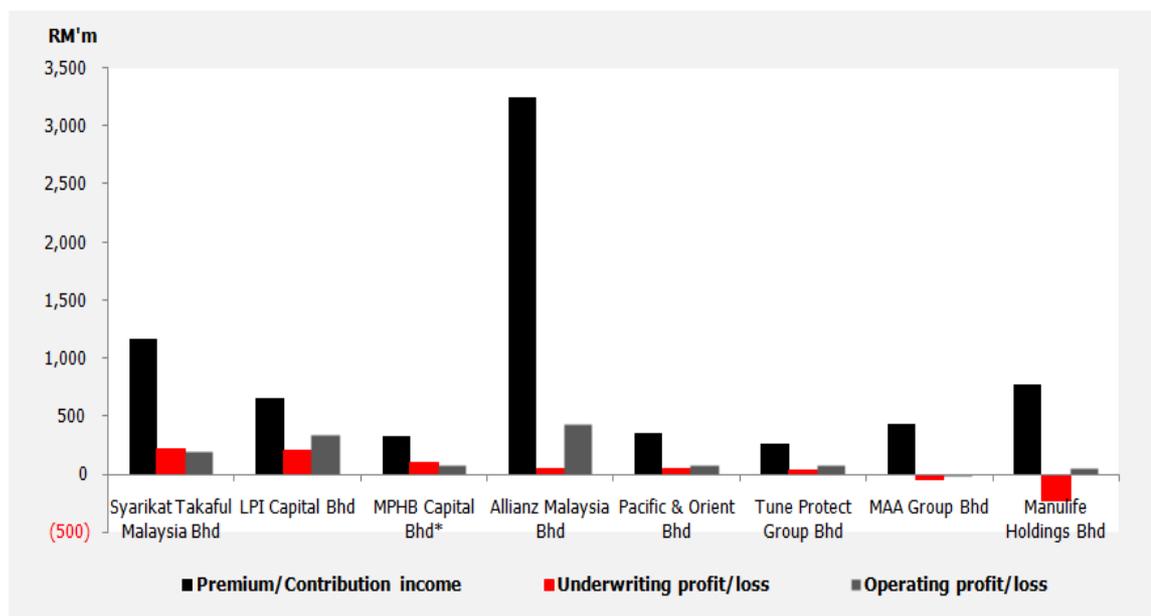


Source: Bursa Malaysia, MIDFR

**Syarikat Takaful Malaysia Bhd shines as the most profitable underwriter.** Aside from being among the largest in net earned contribution, STMB is also keeping tight cost and claims management with underwriting profit size of RM224.8m in 2014. It was followed close behind by LPI Capital Bhd (LPI) at RM203.9m. However, it was LPI that has a greater margin size of not less than 30%.

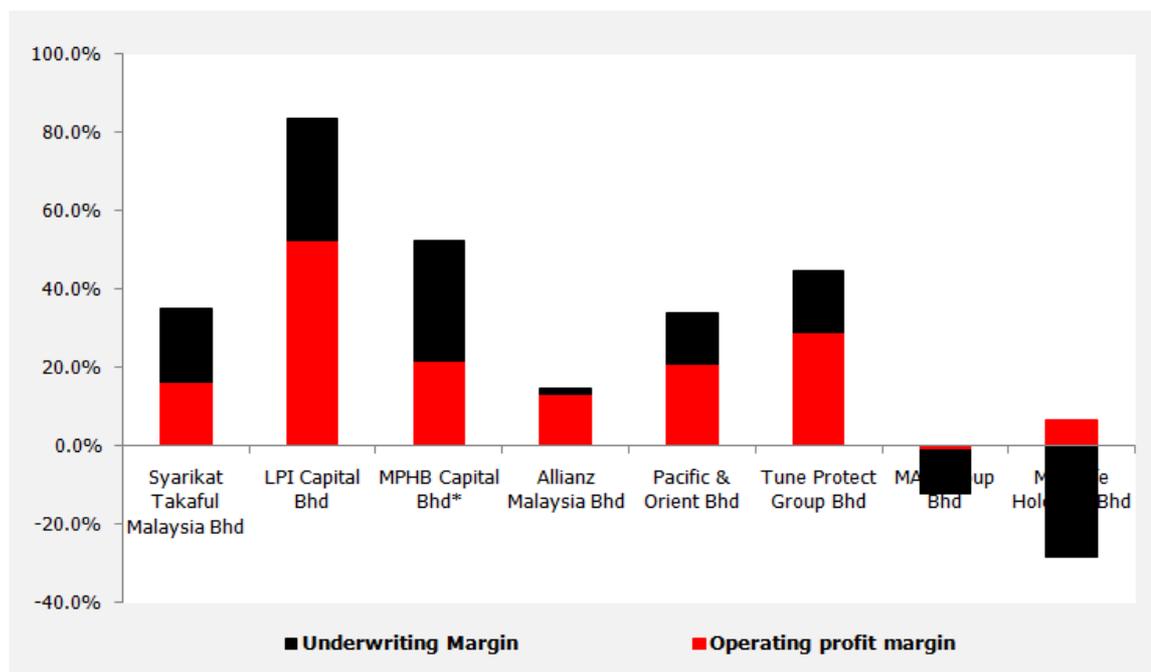
**Allianz topping the operating profit size.** As a whole, Allianz came in as the highest in operating profit size in 2014 among overall insurance players. Their higher profitability was mainly attributable to increase in investment income for that particular year.

**Chart 14: 2014 Listed Players Performance**



Source: Bursa Malaysia, MIDFR

**Chart 15: 2014 Profitability Margins among Listed Players**



Source: Bursa Malaysia, MIDFR

## D. VALUATION AND RECOMMENDATION

**Upgrade to POSITIVE.** In summary, we upgrade our recommendation on the insurance/takaful sector to **POSITIVE**. We believe that the good potential growth of the sector will translate into strong profitability among the insurance/takaful companies. Our top pick for the sector is **Syarikat Takaful Malaysia (TP: RM3.42, under review)** while our small cap pick is **Tune Protect Group (TP: RM1.86)**. We reckon the stock price of these companies are in good stead to outperform the broader market as they possess (i) good earnings growth potential, (ii) inherent underwriting profit and margin quality, and (iii) attractive valuation. It is also noteworthy that Tune Protect provide higher expected total return at 26.5%.

We also like **LPI Capital (TP: RM13.66)** on the reason of (i) both healthy underwriting and operating profit margins, and (ii) generous dividend payout of more than 50%. Its higher profitability should justify our valuation at a premium to asset value. Nevertheless, we view the stock now as fully valued.

**Risks.** Downside risks to the sector include (1) regulatory changes, (2) interest rate movement that could affect insurer portfolio returns and product pricing, (3) intense competition from detariffication of motor and fire insurance and (4) higher-than-expected claims. 

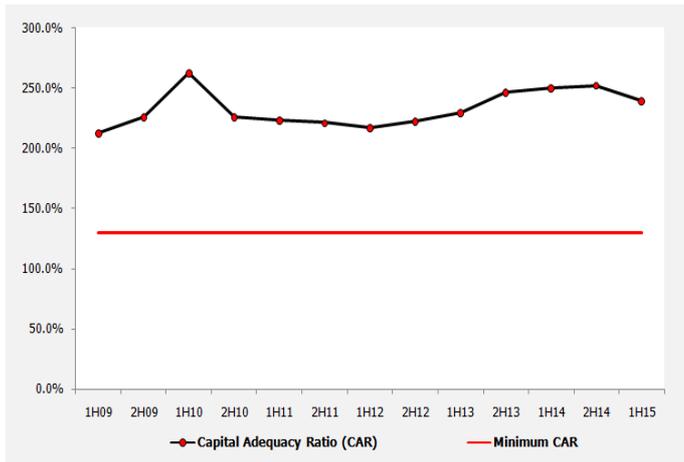
**Table: Peer Comparison**

	Last price (RM)	Market cap. (RM'm)	Recom.	TP (RM)	EPS (sen)		PER (x)		DPS (sen)		Div. yield (%)		PBV (x)	
					FY15F	FY16F	FY15F	FY16F	FY15F	FY16F	FY15F	FY16F	FY15F	FY16F
<b>Insurer/Takaful</b>														
LPI Capital	14.86	4,939.9	NEUTRAL	13.66	68.9	71.3	21.6	20.8	50.0	50.0	3.4	3.4	2.9	2.8
STMB	3.78	3,075.7	NEUTRAL	3.42	20.3	21.4	18.6	17.7	16.0	17.0	4.2	4.5	4.8	4.5
Tune Protect Group	1.47	1,127.6	BUY	1.86	8.7	9.8	16.9	15.0	3.5	3.9	2.4	2.7	2.5	2.2
Allianz Malaysia Bhd	10.70	1,811.6	NR	-	-	-	-	-	-	-	-	-	-	-
MPHB Capital	1.63	1,136.9	NR	-	-	-	-	-	-	-	-	-	-	-
Manulife Holdings	2.85	576.8	NR	-	-	-	-	-	-	-	-	-	-	-
Pacific & Orient	1.39	332.2	NR	-	-	-	-	-	-	-	-	-	-	-
MAA Group	0.79	228.3	NR	-	-	-	-	-	-	-	-	-	-	-
<b>Reinsurer/Retakaful</b>														
MNRB Holdings	3.49	745.7	NR	-	-	-	-	-	-	-	-	-	-	-

Source: MIDFR

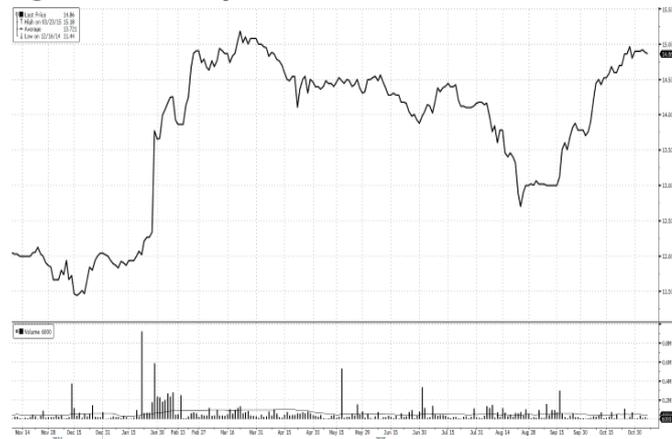
## APPENDICES

**Figure 1: CAR of General Insurance**



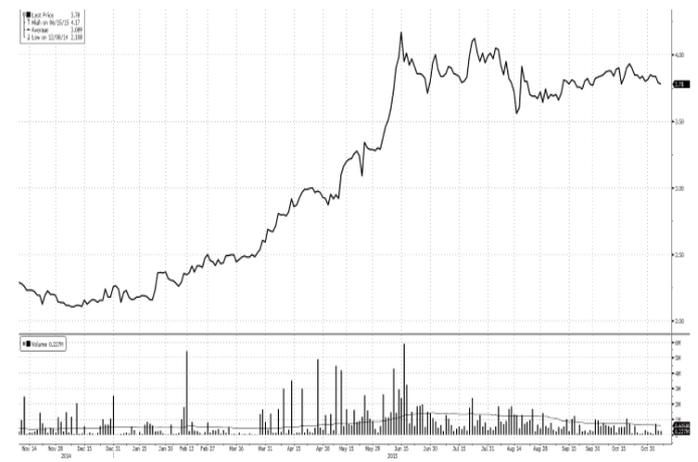
Source: Bank Negara Malaysia, MIDFR

**Figure 3: LPI Capital Price Chart**



Source: Bloomberg, MIDFR

**Figure 2: STMB Price Chart**



Source: Bloomberg, MIDFR

**Figure 4: Tune Protect Group Price Chart**



Source: Bloomberg, 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 <i>rise</i> 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 <i>fall</i> 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.