27 April 2020

Securities

AFFIN HWANG CAPITAL

Outthink. Outperform.

Facing an uphill battle against a 'new normal'

In our view, the general insurance industry is facing unprecedented challenges brought on by the COVID-19 pandemic and we expect 2020 to remain a bleak year. Depending on the extent of the MCO and restrictions which will be gradually lifted, we are of the view that business and consumer expectations may remain cautious at least for another year, hence adding on to the existing industry challenges such as price competition, new technological trends and higher claims cost. While downside risks may be mitigated by LPI's strong balance sheet, with a CAR in excess of 400%, we maintain our SELL and TP at RM9.50.

Industry 'gross written premium' may see a more drastic decline in 2020

In the domestic market, the general insurance industry saw a marginal 0.8% yoy decline in 'gross written premium' (GWP) in 2019. Nonetheless, we expect a more drastic decline in industry GWP in 2020 (our expectation is between -5% to -10%), exacerbated by weak economic activities while consumer sentiment may stay weak; the crisis years **1998** and **2009** saw the **industry GWP decline by 10.7% yoy and 3.9% yo**y respectively.

Changes in operating conditions to drive revenue contraction at LPI

In our view, LPI may potentially see a decline of 7% yoy in its overall 2020 GWP. Through a recent con-call with management, we gathered that a sharper contraction is expected in the construction and engineering segment (due to projects delay and deferred property launches), while the motor and fire insurance class may see a marginal decline yoy, supported by recurring business from Public Bank, its agency network and on-line platform.

Disruptive changes brought on by COVID-19 pandemic

We believe that the COVID-19 pandemic will result in more awareness for medical and hospitalization coverage and for business losses caused by interruptions due to infectious disease at the workplace. Meanwhile, lower motor and medical claims, which have become a boon for insurers during this MCO period, may start creeping up once the MCO is lifted up.

Maintain SELL rating; Target Price unchanged at RM9.50

We maintain our **SELL** rating on LPI, with a 12-month **TP** of **RM9.50** based on a 1.93x P/BV target on our 2020E BVPS of RM4.92. We maintain our 2020-22E earnings for LPI, based on these assumptions: i) GWP growth at -7.0% for 2020E and flat for 2021E; and ii) net claims ratio at 43%. We foresee 2020E net profit to decline by 14.5% yoy and stay flat in 2021E. Upside risks: recovery in economy, more transparency in medical fees.

Earnings & Valuation Summary

FYE 31 Dec (RMm)	2018	2019	2020E	2021E	2022E
Gross written premiums	1,469.4	1,524.4	1,417.7	1,417.7	1,460.2
Net earned premiums	930.8	1,011.5	884.7	868.8	892.0
Underwriting profit	303.5	305.1	275.7	262.6	277.0
Pretax profit	406.0	414.7	367.5	354.4	368.9
Net profit	314.0	322.4	275.5	276.4	287.8
Core net profit	314.0	327.9	275.5	276.4	287.8
Core EPS (sen)	78.8	82.3	69.2	69.4	72.2
Core EPS growth (%)	1.8%	4.4%	-16.0%	0.3%	4.1%
Core PER (x)	16.5	15.8	18.8	18.7	18.0
Single-tier DPS (sen)	68.0	70.0	50.0	50.0	50.0
Dividend Yield (%)	5.2	5.4	3.9	3.9	3.9
P/BV (x)	2.4	2.6	2.6	2.7	2.7
ROE (%)	15.4	16.3	14.0	14.1	14.8
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			0.85	0.8	0.88

Source: Company, Bloomberg, Affin Hwang forecasts

Company Update

LPI Capital

LPI MK

Sector: Insurance

RM12.98 @ 24 April 2020

SELL (maintain)

Downside: 26.8%

Price Target: RM9.50

Previous Target: RM9.50

Price Performance

	1M	3M	12M
Absolute	22.7%	-13.7%	-16.8%
Rel to KLCI	15.6%	-0.9%	-0.5%

Stock Data

Issued shares (m)	398.4
Mkt cap (RMm)/(US$m)	5,171/1,185.3
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	9.90-16.28
Est free float	48.3%
BV per share (RM)	4.95
P/BV (x)	2.62
Net cash/(debt) (RMm)	138.8
ROE (2020E)	14.0%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

TS Teh Hong Piow	42.7%
Sompo Holdings Inc	8.5%

Source: Affin, Bloomberg

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A 'new normal' that may not normalize so soon

Operating conditions not expected to normalize in the next one year

In our view, the general insurance industry is facing unprecedented challenges brought on by the COVID-19 pandemic and we expect 2020 to be a bleak year. Depending on the extent of the 'movement control order' (MCO) and restrictions which will then be gradually lifted, we are of the view that social-distancing will be a new practice or 'new normal' in our society and likely to change business and consumer expectations. We expect business and consumer sentiment to stay weak at least for a year from now.

Industry GWP may experience a drastic decline in 2020

In the domestic market, the general insurance industry saw a marginal 0.8% yoy decline in 'gross written premium' (GWP) in 2019. Nonetheless, with economic activities (including external trade) expected to slow down sharply while the weak consumer sentiment may potentially stay on until end-2020, our economist is projecting a 2020E real GDP of -3.5% yoy, compared with the crisis years of **1998** and **2009** when the **industry GWP declined by 10.7% yoy and 3.9% yoy** respectively, as the **country's real GDP also contracted by 7.4% yoy (1998) and 1.5% yoy (2009)**. Hence, we are of the view that a 5% to 10% decline in industry GWP in 2020 is not too far-fetched.

Subsequently, as the economy recovered from post-crisis periods, the industry GWP saw a marginal growth rate of 0.6% yoy in 1999 and a stronger growth rate of 6.6% in 2000. In 2010, the industry GWP recovered by growing +9.1% yoy.

How did the general insurance industry fare in 2019?

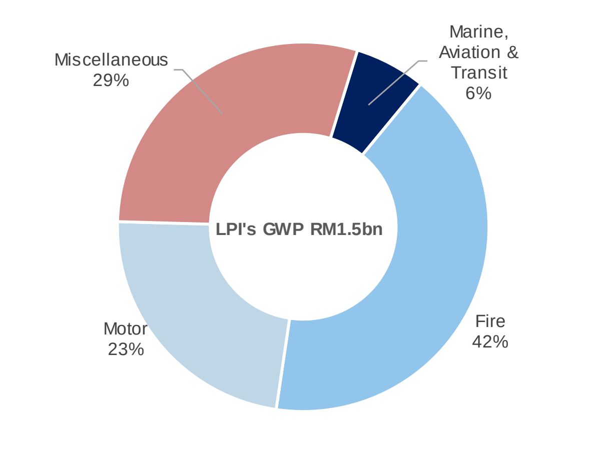
In Malaysia, the general insurance industry saw a marginal decline of 0.8% yoy in GWP for 2019. The key general insurance classes, ie, motor (accounting for 48.3% of domestic GWP), saw a marginal decline of 0.4% yoy in 2019 while fire insurance (19.3% of domestic GWP) grew by 1.1% yoy and MAT (7.7% of domestic GWP) was up 5.3% yoy. The other miscellaneous insurance classes such as the contractor's all risk & engineering (due to scaling-down of certain large construction projects), medical and personal accident, liability and workmen's compensation (due to transfer of the foreign working compensation scheme to SOCSO) continued to decline yoy for 2019.

LPI's GWP growth bucked industry trend in 2019

We estimate that LPI garnered a market share of 8.8% in 2019's general insurance market, based on GWP (LPI's 2019 GWP was up 3.7% yoy). Meanwhile, it remains the No. 1 player in the fire insurance segment (GWP up 1.3% yoy), with a market share of 18.8% in 2019 (relatively unchanged from 2018). In the motor segment, LPI (GWP up 7.1% yoy) has a market share of 4.2% in 2019 vs. 3.9% in 2018.

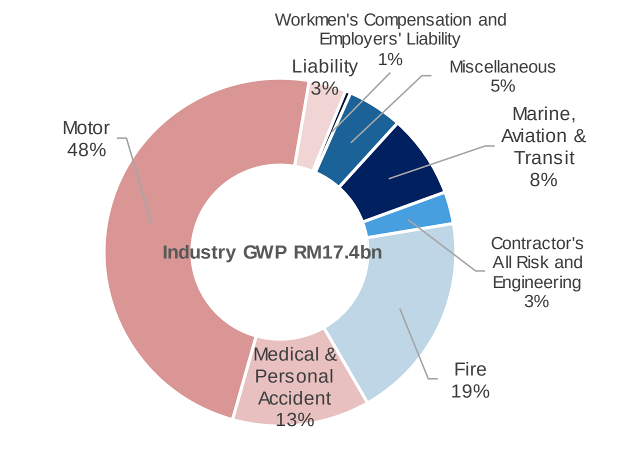
We have laid out the comparison between LPI's GWP breakdown and its growth rate against the industry in Fig 1-4 below.

Fig 1: LPI's GWP breakdown in 2019 (RM1.52bn)



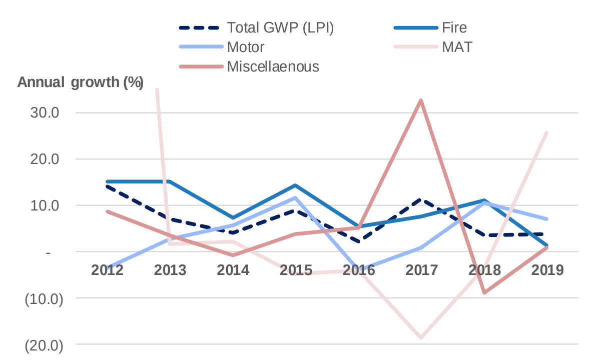
Source: Company, Affin Hwang

Fig 2: Industry GWP breakdown in 2019 (RM17.4bn)



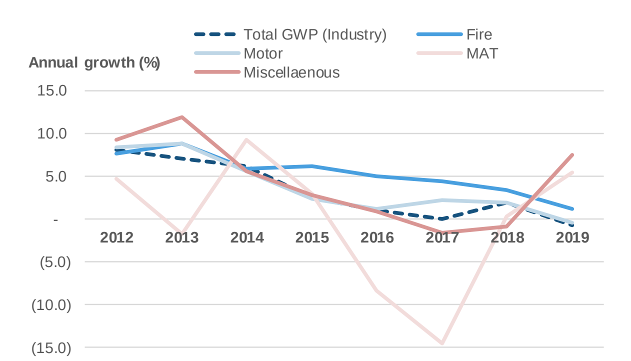
Source: BNM

Fig 3: LPI's GWP growth by segment



Source: Company, Affin Hwang

Fig 4: Industry's GWP growth by segment



Source: BNM

Changes in operating conditions may drive overall revenue lower

In our view, LPI may potentially see a decline in its overall 2020 GWP (our forecast is -7% yoy for 2020E), while GWP in 2021E may stay flat. On a more positive note, we are expecting a pick-up in GWP of +3% yoy in 2022E.

Through a recent con-call with LPI's management, we gathered that the group may potentially see a sharper contraction in the construction and engineering segment (due to project delays and deferred property launches), hence affecting its miscellaneous segment's growth. Meanwhile, the motor and fire insurance class may see a marginal decline yoy, supported by recurring business from Public Bank, its agency network and on-line platform. At this juncture, insurance renewals appear to be slower, due to the MCO.

Disruptive changes brought on by COVID-19

More awareness for additional coverage

We believe that the COVID-19 pandemic will result in more awareness for medical and hospitalization coverage (due to the health risks) while more business owners will look for additional coverage (under fire insurance) to include for business losses caused by interruptions of infectious disease at the workplace. In future, this could benefit LPI when the economy recovers. Nonetheless, as we understand, these additional insurance coverage features will not come cheap and hence, may not be affordable to everyone.

Extended MCO, business downsizing – negative drivers for LPI

Depending on the extent of the MCO and when restrictions will be gradually lifted, we are of the view that business and consumer expectations may remain cautious at least for another year, hence adding on to the existing industry challenges such as price competition, new technological trends and higher claims cost. With the prospect of rising unemployment becoming more certain as more employers are planning to downsize their workforces (*source: the Malaysian Trade Union Congress*), the insurance industry may suffer even more as businesses cut back allocation for insurance coverage, while lesser purchasing power of individuals reduces the growth in motor class insurance.

How would COVID-19 affect the industry's combined ratio?

In our view, COVID-19 and the extension of the MCO has also brought on a positive impact on the insurers' claims ratio (2019 claims ratio stood at 58.1%) as there are currently less road accidents and fatalities. The motor class, of which has claims hovering around 70% in the last 3 years, has been the main dampener to most general insurers' underwriting profit. In fact, according to PIAM (Malaysia Association of General Insurers), the industry's motor underwriting profit suffered an underwriting loss of RM355m in 2019 and had made a total payout of RM5.5bn in net claims. Nonetheless, should the MCO be lifted and business activity gradually resumes, the motor claims ratio is expected to creep up again.

Meanwhile, insurers which have been suffering from high medical claims over the years due to medical inflation (annual inflation of 13% p.a.) and a lack of price transparency in medical billings, will see a reprieve during the MCO period as hospitalization rates had actually declined.

Overall, as lower motor and medical claims have become a boon for insurers during this MCO period, we expect the overall impact on insurers' combined ratio to be unchanged on a yoy basis.

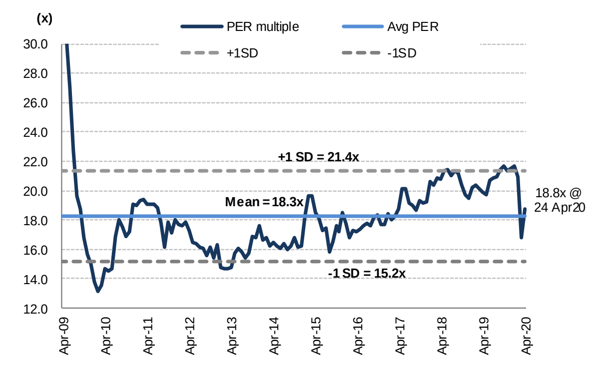
Valuation & Recommendation

Maintain SELL with our unchanged TP of RM9.50

We maintain our 2020E-22E earnings for LPI, which is underpinned by the following key assumptions: i) GWP growth at -7.0% for 2020E and flat for 2021E, while recovering in 2022E with a +3% growth yoy; ii) net claims ratio at circa 43%; and iii) combined ratio of circa 70%. We foresee 2020E net profit to decline by 14.5% yoy, a flat year in 2021E and a +3% yoy growth in 2022E. We maintain our **SELL** rating on the stock, with a 12-month **Target Price** of **RM9.50**, based on a 1.93x P/BV target on our 2020E's BVPS of RM4.92. Meanwhile, downside risks are mitigated by LPI's strong balance sheet, with a CAR in excess of 400% vis-à-vis the minimum CAR requirement of 130%.

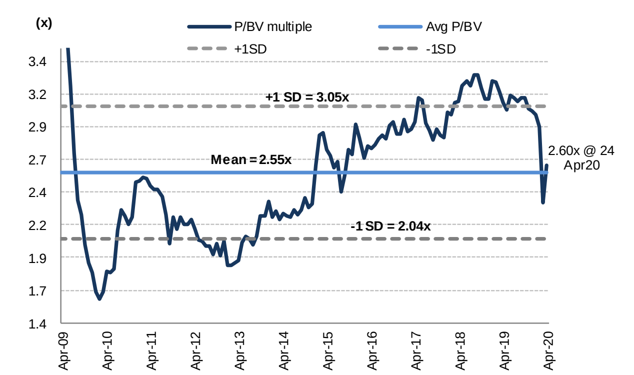
Though the implied P/BV multiple average (from Mar09-Apr20) stood at 2.66x (Fig 6), with a range from as low as 1.7x (at -2SD) to as high as 3.3x, our target valuation of 1.93x (based on a Gordon Growth Model) implies a P/BV of -1SD, which takes into account the prospects of an industry contraction given the recessionary outlook in 2020E.

Fig 5: LPI: P/E multiple trend (Mar09-Apr20)



Source: Bloomberg, Affin Hwang forecasts

Fig 6: LPI: P/BV multiple trend (Mar09-Apr20)



Source: Bloomberg, Affin Hwang forecasts

Fig 7: Insurance sector: Peer comparison

Company Name	Bloomberg Ticker	Rating	Price (24 Apr)	TP	Mkt Cap	Core PE (x)		Core EPS growth (%)		P/BV (x)		ROE (%)		DPS (sen)		Div Yield (%)	
			(RM)	(RM)	(RMm)	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E
ALLIANZ MSIA*	ALLZ MK	SELL	13.90	11.20	4,813.6*	14.6	13.8	(32.9)	5.4	1.4	1.4	9.7	10.2	55.0	55.0	4.0	4.0
LPI CAPITAL	LPI MK	SELL	12.98	9.65	5,171.0	18.8	18.7	(16.0)	0.3	2.6	2.7	13.9	13.9	50.0	50.0	3.9	3.9
SYKT TAKAFUL MSIA	STMB MK	HOLD	4.27	3.55	3,519.4	12.0	11.8	(19.1)	1.5	2.7	2.4	23.4	21.6	16.0	16.2	3.7	3.8
Average						**15.0**	**14.6**			**2.2**	**2.1**	**17.8**	**13.3**			**3.9**	**3.9**

*** Includes market cap for preference shares*

Source: Bloomberg, Affin Hwang forecasts

Upside risks

Upside risks: i) upward revisions in premium pricing, especially in the employee-benefits segment; ii) containment of medical cost inflation and more transparency in consultation fee; iii) decline in road accidents and fatalities; iv) improving health conditions.

Appendix

Quarterly performance results

Fig 8: LPI: Key insurance ratios

Underwriting Results	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Group Retention ratio (%)	**61.9**	**67.1**	**65.7**	**68.6**	**65.8**	**68.5**	**66.2**	**70.0**
Fire	62.1	68.4	62.4	70.6	63.5	69.4	63.1	70.8
Motor	89.9	92.6	92.2	95.7	94.4	95.4	94.9	97.8
Marine, Aviation & Transit	22.6	31.9	21.6	23.8	22.9	22.4	18.8	24.7
Miscellaneous	50.1	51.4	58.9	55.1	56.2	56.0	57.3	55.3
Net claim incurred ratio (%)	**47.1**	**41.0**	**37.2**	**39.1**	**47.4**	**44.9**	**43.6**	**40.3**
Fire	19.0	9.3	10.8	14.4	13.6	13.4	12.6	10.0
Motor	84.8	76.6	64.3	69.2	70.6	73.7	71.5	73.6
Marine, Aviation & Transit	13.3	19.0	21.1	9.2	62.7	(10.6)	34.6	32.4
Miscellaneous	51.6	54.4	46.8	46.5	71.5	64.8	59.1	49.7
Net commission ratio (%)	**3.6**	**6.1**	**7.7**	**7.6**	**5.2**	**7.1**	**7.7**	**7.0**
Fire	5.7	6.1	7.5	7.7	7.6	6.8	6.9	7.1
Motor	9.2	8.5	9.5	9.4	9.6	9.6	9.7	9.5
Marine, Aviation & Transit	(15.1)	(2.8)	(3.8)	(3.6)	(36.3)	(4.1)	(11.1)	(6.6)
Miscellaneous	(5.1)	3.8	6.4	6.0	(0.7)	5.5	7.5	4.5
Management expense ratio (%)	21.7	22.3	20.2	17.6	22.0	20.2	20.2	17.3
Combined ratio (%)	72.5	69.4	65.1	64.3	74.6	72.3	71.4	64.6
Annualized ROE (%)	15.7	13.6	18.3	16.3	14.9	18.2	23.2	23.6

Source: Company, Affin Hwang

Fig 9: LPI: Segmental contribution

Segmental breakdown	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Net earned premium (%)								
Fire	42.5	43.5	40.5	42.3	40.7	41.3	41.2	42.4
Motor	30.8	31.1	31.0	30.6	32.5	31.8	32.2	32.4
Marine, Aviation & Transit	2.3	2.0	1.8	2.0	2.3	1.9	1.5	2.0
Miscellaneous	24.4	23.4	26.6	25.2	24.5	25.0	25.1	23.2
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Underwriting surplus (%)								
Fire	65.0	69.5	60.0	61.8	67.8	68.8	68.0	66.7
Motor	3.8	8.8	14.8	12.2	13.6	11.1	12.4	10.4
Marine, Aviation & Transit	4.8	3.2	2.7	3.5	3.5	4.6	2.4	2.8
Miscellaneous	26.5	18.5	22.5	22.4	15.1	15.5	17.2	20.2
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, Affin Hwang

LPI Capital – FINANCIAL SUMMARY

Profit & Loss Statement

FYE Dec	2018	2019	2020E	2021E	2022E
Gross written premiums	1,469.4	1,524.4	1,417.7	1,417.7	1,460.2
Net earned premiums	**930.8**	**1,011.5**	**884.7**	**868.8**	**892.0**
Net claims incurred	(381.0)	(444.5)	(377.5)	(373.5)	(382.2)
Net commission expenses	(58.8)	(68.7)	(52.3)	(57.2)	(55.5)
Other expenses	(193.9)	(199.2)	(179.2)	(175.6)	(177.3)
Underwriting profit	**297.1**	**299.1**	**275.7**	**262.6**	**277.0**
Realised gains	(0.1)	0.1	-	-	-
Other investment gains	104.9	113.2	90.0	90.0	90.0
Associates' contribution	4.0	1.8	1.8	1.8	1.9
Finance costs	(0.0)	(1.4)	-	-	-
PBT	**406.0**	**414.7**	**367.5**	**354.4**	**368.9**
Tax	(91.9)	(92.4)	(92.0)	(78.0)	(81.2)
Net profit	314.0	322.4	275.5	276.4	287.8
Core net profit	**314.0**	**322.4**	**275.5**	**276.4**	**287.8**

Balance Sheet Statement

FYE Dec	2018	2019	2020E	2021E	2022E
Financial assets	2,583.4	1,265.6	1,254.7	1,238.7	1,223.2
Reinsurance assets	798.2	731.8	695.2	695.2	716.1
Other assets	690.2	2,048.5	2,048.5	2,089.5	2,131.3
Total assets	**4,240.6**	**4,045.9**	**3,998.4**	**4,023.4**	**4,070.5**
Insurance contract liabilities	1,859.0	1,807.2	1,771.1	1,806.5	1,860.7
Other liabilities	224.8	266.8	266.8	266.8	266.8
Total liab	**2,083.8**	**2,074.0**	**2,037.8**	**2,073.3**	**2,127.5**
Shareholders' Funds	**2,156.8**	**1,971.9**	**1,960.6**	**1,950.1**	**1,943.1**

Cash Flow Statement

FYE Dec	2018	2019	2020E	2021E	2022E
PBT	**406.0**	**414.7**	**367.5**	**354.4**	**368.9**
Non-cash adjustments	(142.7)	(226.4)	(120.0)	(122.4)	(126.1)
Working capital changes	109.1	(143.2)	0.4	35.4	33.3
Cash tax paid	(90.7)	(98.2)	(92.0)	(78.0)	(81.2)
Others	99.9	105.1	100.0	100.0	100.0
Cashflow from operation:	**381.5**	**52.1**	**255.9**	**289.4**	**295.0**
Capex	(4.4)	(4.3)	(5.0)	(5.0)	(5.0)
Others	-	-	-	-	-
Cash flow from investing	**(4.4)**	**(4.3)**	**(5.0)**	**(5.0)**	**(5.0)**
Debt raised/(repaid)	-	-	-	-	-
Equity raised/(repaid)	-	-	-	-	-
Dividends paid	(253.0)	(274.9)	(286.8)	(286.8)	(294.8)
Others	(1.1)	(6.3)	(0.0)	(0.0)	(0.0)
Cash flow from financing	**(254.0)**	**(281.2)**	**(286.9)**	**(286.9)**	**(294.8)**
Free Cash Flow	**377.1**	**47.8**	**250.9**	**284.4**	**290.0**

Key Financial Ratios and Margins

FYE Dec	2018	2019	2020E	2021E	2022E
Growth					
Gross written premium (%)	3.4	3.7	(7.0)	-	3.0
Net earned premium (%)	9.5	8.7	(12.5)	(1.8)	2.7
Underwriting profit (%)	(1.1)	0.7	(7.8)	(4.8)	5.5
Pre-Tax Profit (%)	0.5	2.2	(11.4)	(3.6)	4.1
Core net profit (%)	1.8	2.6	(14.5)	0.3	4.1
Underwriting Results & Profitability					
Net Claims Ratio (%)	40.9	43.9	42.7	43.0	42.8
Commission Ratio (%)	6.3	6.8	5.9	6.6	6.2
Management Exp. Ratio (%)	20.0	19.7	20.3	20.2	19.9
Combined Ratio (%)	67.2	70.4	68.8	69.8	68.9
Underwriting Margin (%)	31.9	29.6	31.2	30.2	31.1
Core ROE (%)	15.4	15.6	14.0	14.1	14.8
Core ROA (%)	8.0	7.9	6.8	5.9	4.7
Liquidity					
Fin. assets over ins liab (x)	1.4	0.7	0.7	0.7	0.7
Op. cash flow (RMm)	381.5	52.1	255.9	289.4	295.0
Free cashflow (RMm)	377.1	47.8	250.9	284.4	290.0
FCF/share (sen)	94.6	12.0	63.0	71.4	72.8
Investment statistics					
PER (X)	16.5	16.0	18.8	18.7	18.0
EPS (sen)	78.8	80.9	69.2	69.4	72.2
EPS growth rate (%)	1.8	2.6	(14.5)	0.3	4.1
BV/share (RM)	5.4	4.95	4.92	4.90	4.88
P/BV	2.4	2.6	2.6	2.7	2.7
Dividend Payout (%)	86.3	86.5	72.3	72.1	69.2
DPS (sen)	68.0	70.0	50.0	50.0	50.0
Net yield (%)	5.2	5.4	3.9	3.9	3.9

Segmental contribution (%)

FYE Dec	2018	2019	2020E	2021E	2022E
Net earned premium					
Fire	42.2	41.4	46.0	46.0	46.0
Motor	30.9	32.2	29.0	29.0	30.0
MAT	2.0	1.9	1.4	1.5	1.5
Miscellaneous	24.9	24.4	23.6	23.5	22.5
Underwriting surplus					
Fire	63.9	67.8	70.0	70.2	70.2
Motor	10.2	11.8	13.0	13.0	13.0
MAT	3.5	3.3	3.0	3.0	3.0
Miscellaneous	22.4	17.1	14.0	13.8	13.8

Source: Company data, Affin Hwang estimates

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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