Initiation of Coverage

Allianz Malaysia

ALLZ MK
Sector: Finance

RM12.88 @ 3 July 2017

BUY
Upside: 26.6%

Price Target: RM16.30
Previous Target: N/A

Initiation: undervalued, underappreciated gem

Allianz Malaysia (AllianzM) is the Malaysian arm of Allianz SE, one of the largest insurers worldwide, with both the general and life operations housed under one roof in Malaysia. AllianzM's general unit remains its key earnings driver (70% of PBT) and looks well-positioned to face detariffication challenges. Its life unit is expected to see a rising contribution to PBT, underpinned by attractive demographic trends and the roll-out of new products. At RM12.88, we are of the view that AllianzM remains undervalued. We initiate coverage with a BUY call and SOTP-based 12-month TP of RM16.30.

AllianzM: best proxy to under-penetrated Malaysia market

Malaysia's favourable demographic patterns (young population, growing middle class and strong household formation) continues to be supportive of general and life-insurance industry growth in the mid-to-long term, in our view. Based on Malaysia's insurance-penetration and density measures, its market ranks far behind that of more developed and affluent Asian peers. As the largest listed insurance company (by asset size and gross written premiums) in Malaysia, we believe AllianzM is in the sweet spot to capture the untapped potential of Malaysia's insurance market.

General unit expected to weather industry challenges

We look for the company's general insurance operations to rebound from a lacklustre year in 2016, in tandem with stronger economic growth. With a sizable balance sheet, competitive pricing and support from its established parent, it is well positioned to face detariffication challenges.

Business growth at life unit to be driven by higher-margin products

AllianzM's life insurance operations have continued to strengthen. We expect annualised new premiums to grow at a double-digit pace, while new-business value rose by 45% yoy in 2016, partly due to strong sales of new higher-margin investment-linked products. We believe the life insurance segment margins will be stronger as a result of the repricing of medical-policy products and increased contributions from the new higher-margin products.

Valuation looks attractive, with strong profitability profile

Despite AllianzM's strong share-price rally YTD, we think the market has yet to fully appreciate the company's value, especially in its life operations. Using an SOTP methodology, we ascribe a 1.73x 2018E P/BV to its general operations and 1x 2018E P/EV to its life operations to derive our 12-month **Target Price** of **RM16.30**, implying 26.6% upside potential. Hence, we initiate coverage on AllianzM with a **BUY** rating. Key risks to our call: i) stronger-than-expected competition; ii) challenges in raising level of awareness and education on life insurance.

Earnings & Valuation Summary

FYE 31 Dec (RMm)	2015A	2016A	2017E	2018E	2019E
Gross written premium	4,132.7	4,182.6	4,399.7	4,651.9	4,974.2
Net earned premiums	3,504.3	3,690.5	3,874.6	4,098.2	4,382.3
Pretax profit	438.2	454.6	471.9	547.0	601.3
Net profit	308.9	312.1	326.5	378.8	416.2
Core net profit	308.9	312.1	351.5	378.8	416.2
Core EPS (sen)	89.4	90.8	95.0	110.2	121.1
Core EPS growth (%)	4.0%	1.6%	4.6%	16.0%	9.9%
Core PER (x)	14.4	14.2	13.6	11.7	10.6
BV/share (RM)	7.6	8.3	9.2	10.1	11.2
P/BV (x)	1.70	1.55	1.41	1.27	1.15
DPS (sen)	5.0	6.5	9.0	10.0	12.0
Dividend Yield (%)	0.4	0.5	0.7	0.8	0.9
ROE (%)	12.6	11.3	10.8	11.4	11.3
Affin/Consensus (x)	-	-	1.0	1.1	1.2

Source: Company, Bloomberg, Affin Hwang forecasts

Price Performance

	1M	3M	12M
Absolute	+0.6%	+11.4%	+28.5%
Rel to KLCI	+1.1%	+10.0%	+19.6%

Stock Data

Issued shares (m)	174.2
Mkt cap	2,243.6/521.9
Avg daily vol - 6mth	0.1
52-wk range (RM)	9.58-12.98
Est free float	20.8%
BV per share (RM)	8.52
P/BV (x)	1.5
Net cash/(debt)	652.7
ROE (2017E)	10.8%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

Allianz SE	66.4%
EPF	4.1%
PERKESO	3.7%

Source: Affin, Bloomberg

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Allianz Malaysia: Investment thesis

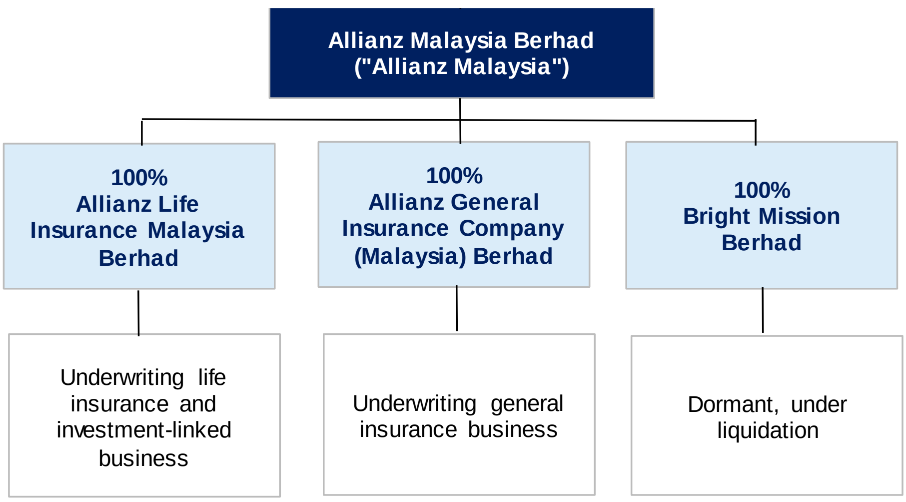
Competitive composite insurance player with scale in a growing market
We like Allianz Malaysia (AllianzM) due to its well-executed strategy and track record over the years as a composite-insurance player (general and life insurance) in Malaysia. It is one of the biggest insurance players in the country: it has the largest market share of gross-written premiums (GWP) at 11.8% in the general insurance segment, and it is the fifth-largest in the life insurance segment with 6.9% of annualized new premiums (ANP).

AllianzM comprises the Malaysian operations of the Allianz Group (ALV GR, EUR173, not rated), the Germany-based global insurance giant which is present in about 70 countries and serves more than 86 million customers worldwide. The Allianz Group has a current market capitalization of over €75 billion and in 2016 generated EUR122.4bn in revenue and EUR10.8bn in operating profit.

As part of the global Allianz Group, AllianzM can directly benefit from a well-marketed brand and track record as well as tap into its parent's or fellow subsidiaries' customers in Malaysia. It also has access to the expertise and experience of its parent's more established operations around the world. Such expertise and experience could be particularly useful as Malaysia is gearing up for the detariffication of motor and fire insurance, uncharted territory for the country's insurance industry, but which has already been experienced by insurers in many other countries.

We believe that Malaysia provides fertile ground for insurance players, as it not only enjoys favourable demographics but also remains relatively under-penetrated. There remains significant untapped potential in the market, which we believe AllianzM, being one of the largest general and life insurance companies, is strategically positioned to capture.

Fig 1: Allianz Malaysia business segments



Source: Company

AllianzM's opportunities and key strengths

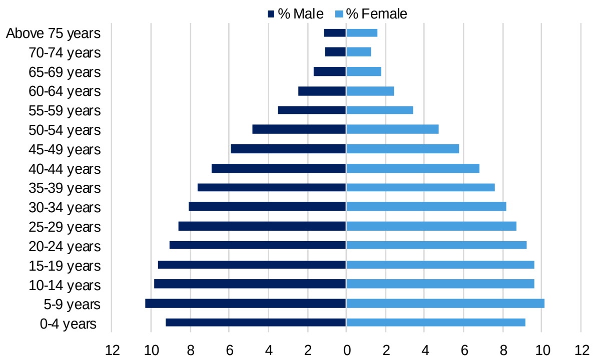
AllianzM, the best proxy for the favourable Malaysian market, in our view

We think Malaysia's young population, growing middle class and strong household formation are favourable demographic patterns which will continue to support general and life insurance industry growth in the mid- to long term.

As illustrated in Figures 2 and 3 (Malaysia's demographic trends in 2016 vs. 2006), a larger number of young Malaysians are coming of age and entering the workforce (the age group 20-29 increased from 25.9% in 2006 to 29.2% in 2016). The purchasing power in these age groups' is expected to increase over time, in tandem with Malaysia's improving household income growth (Fig 4) as the nation aims to achieve a higher level of gross national income by 2020. This would support the nation's economic and private consumption growth, in turn benefiting the general insurance industry.

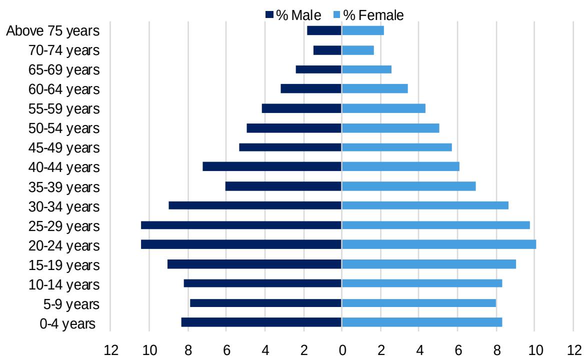
We also have observed that the pace of household formation (Fig 5) remains decent in Malaysia, at a CAGR of 2.7% from 2007-16, in line with the CAGR of 2.6% for age group 20-39 in the nation's young population. We expect there to be a higher tendency to purchase life insurance policies as marriages take place and as family units expand. Simultaneously, rising healthcare costs are likely to spur purchases of more medical policies in order to keep up with medical cost inflation and to ensure adequate financial protection.

Fig 2: Malaysia population pyramid, 2006



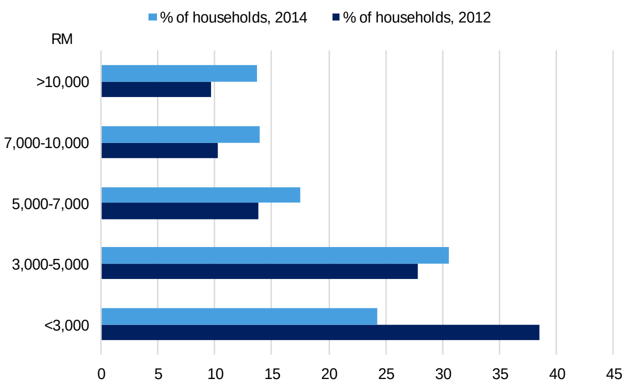
Source: Department of Statistics, Affin Hwang

Fig 3: Malaysia population pyramid, 2016



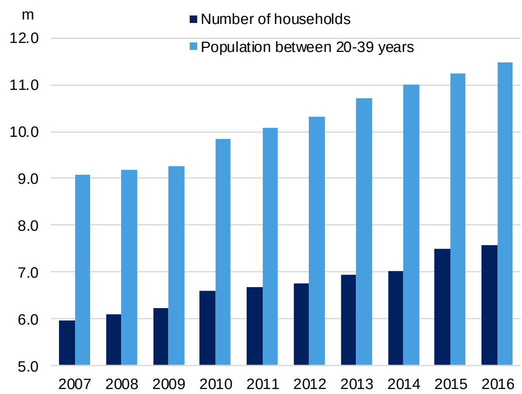
Source: Department of Statistics, Affin Hwang

Fig 4: Malaysia household income distribution



Source: Department of Statistics, Khazanah, Affin Hwang

Fig 5: Outstanding households

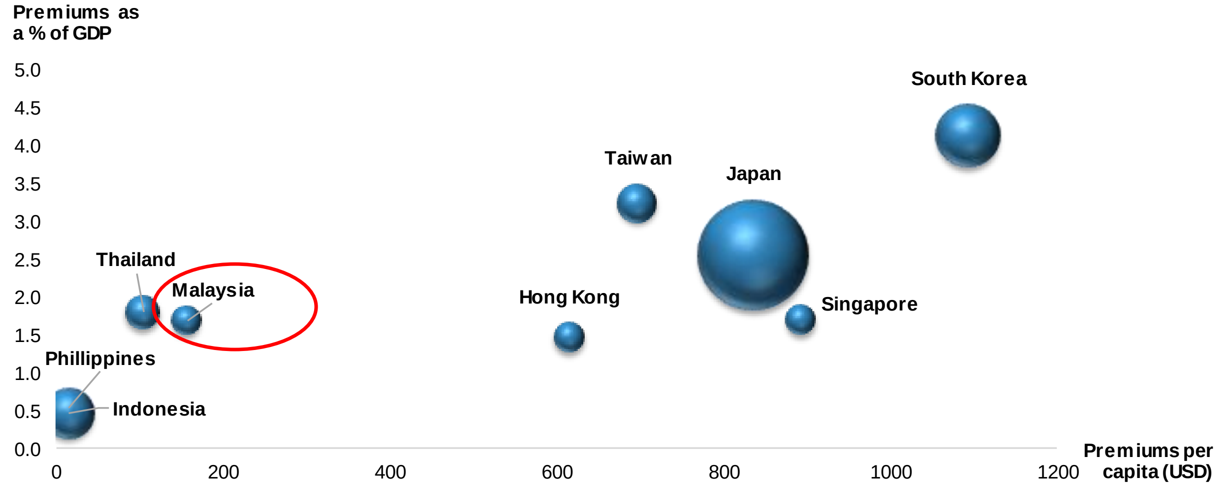


Source: Department of Statistics, Affin Hwang

Malaysia market remains under-penetrated

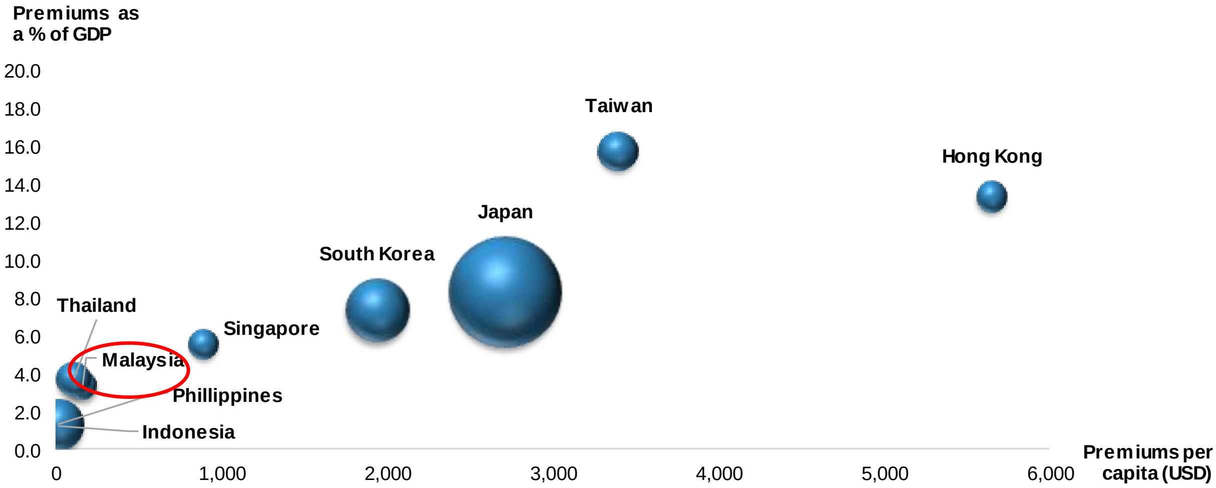
Besides the favourable demographics, Malaysia's general and life insurance markets also remain significantly under-penetrated compared to the country's more developed and affluent Asian peers. Both the insurance-penetration (premiums as % of GDP) and insurance-density (premiums per capita) of Malaysia's general and life insurance industry still trail many of its Asian peers by a significant margin (Figs 6 and 7). This suggests that the Malaysian consumer's awareness of insurance products remains relatively low and that there remains massive untapped potential in the Malaysian market.

Fig 6: General insurance penetration and general insurance density in select Asian countries



Source: Swiss Re, Affin Hwang

Fig 7: Life insurance penetration and life insurance density in select Asian countries



Source: Swiss Re, Affin Hwang

Industry reforms and measures underway to improve market penetration

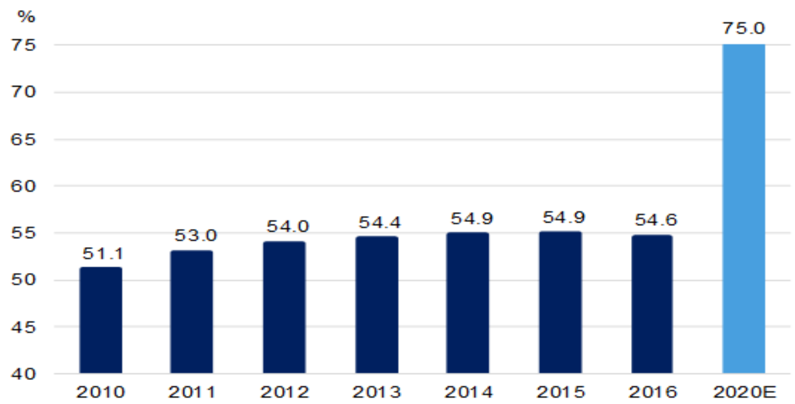
A low insurance penetration carries potentially high social costs. In an underinsurance study conducted back in 2013 by Life Insurance Association of Malaysia (LIAM) and Universiti Kebangsaan Malaysia, it was estimated that the average mortality protection gap (the difference between the amount of life insurance people carry and the amount they need to sustain their surviving loved ones based on age and current income levels) remains significant at around RM723,000 for families whose breadwinner was not covered by either life or medical insurance. This would create issues in terms of the population's financial security and social safety net.

The Malaysian government has recognised such problems and earmarked the improvement of life insurance penetration rates as one of the Entry Point Projects (EPP) in the Economic Transformation Program (ETP). The target under the EPP is to improve Malaysia's life insurance penetration rate to 75% (number of policies over population) and 4% of GDP by 2020. The penetration rate however, has stagnated below 55% (Fig 8), a far cry from the ETP target (due to lack of proper incentives, awareness programmes and high percentage of household in the lower income segment).

Under the LIFE Framework, Bank Negara Malaysia has introduced some measures such as proper incentivisation of agency force, diversification of distribution channels etc. in an effort to spur the take-up of life insurance policies. (Please refer to Appendix II for more details on the LIFE Framework)

We also believe that more direct measures or intervention from the government may be overdue. Currently, tax reliefs of up to RM6,000 per annum are available for life insurance premium and EPF contribution while tax relief of up to RM3,000 are available for medical and education insurance. These quantum have not been revised for more than 10 years and we believe these are no longer adequate, especially after taking into account the inflation costs over the years. Any increase in tax reliefs quantum or the unbundling of the tax relief categories would incentivise taxpayers and provide a much needed boost for the insurance industry, of which AllianzM would stand to benefit.

Fig 8: Historical penetration rate vs ETP target



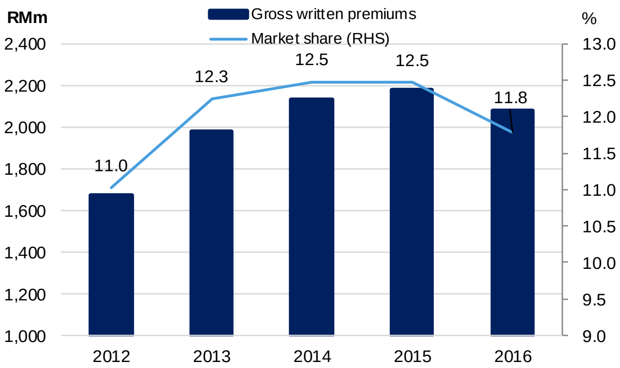
Source: Bank Negara Malaysia, ETP, Affin Hwang

Allianz Malaysia well positioned to capture market opportunities

Compared to insurance peers under our coverage universe, AllianzM is a composite insurer, ie, owns both the general and life insurance business under one roof, which have both achieved significant scale. Allianz General Insurance Company (Malaysia) Berhad ("Allianz General") is ranked 1st in terms of GWP with a market share of 11.8% (December 2016) (Fig 9), while Allianz Life Insurance Malaysia Berhad ("Allianz Life") is ranked 5th among the life insurance players based on ANP with a market share of 6.9% (December 2016) (Fig 10).

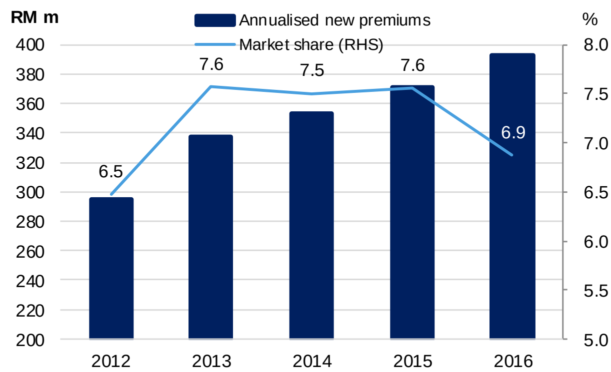
As most of its closest peers are not publicly listed, AllianzM is easily the largest listed insurance company (by asset size and gross written premium) in Malaysia with presence in both the general and life-insurance segment, thus providing the best exposure for investors who are keen to capture the nation's untapped potential.

Fig 9: General insurance GWP and market share



Source: Bank Negara Malaysia, Company, Affin Hwang

Fig 10: Life insurance ANP and market share



Source: Bank Negara Malaysia, Company, Affin Hwang

Above-industry GWP and ANP growth; competitive pricing ability

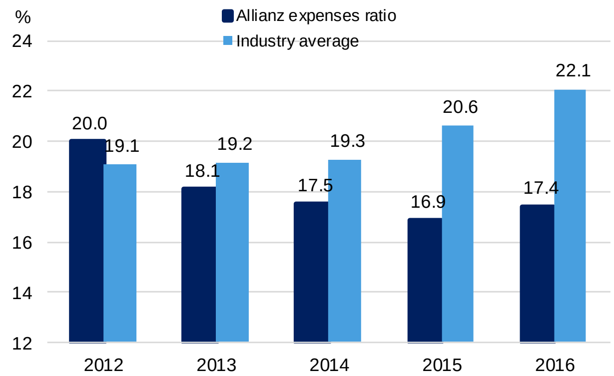
Despite being one of the largest insurance players in Malaysia with an asset size of RM15.4bn (as at end-March 2017), AllianzM has continued to show robust GWP and ANP growth ahead of the industry. For the past 5 years from 2012 to 2016, Allianz General's GWP has grown at a CAGR of 5.6%, outpacing the industry growth of 3.9%, while Allianz Life's ANP has risen at a CAGR of 7.4% against the industry growth at 5.8%.

Allianz General's robust growth is driven by its competitive-pricing ability, which is underpinned by a lower management expense ratio of 17.4%, vs. peers at 22.1% (as at December 2016), as depicted in Fig 11. Given that management expenses are mostly fixed costs by nature, the firm would have greater economies of scale, as the fixed costs are spread over a larger number of policies compared to peers which operate on smaller scales.

Meanwhile, in Fig 12, though Allianz General's overall claims ratio of 61.9% in 2016 was higher than the industry average of 54.6% (as a result of its higher percentage of exposure to motor insurance – Allianz General at 59.2% vs. peers at 46.5% as at December 2016), the general unit remains profitable, thanks to its lower management expense ratio. Despite a thinner underwriting margin. its bigger industry market share of 11.8% (as mentioned in the previous section) allows the general unit to contribute significantly to AllianzM's overall profitability, on an absolute basis.

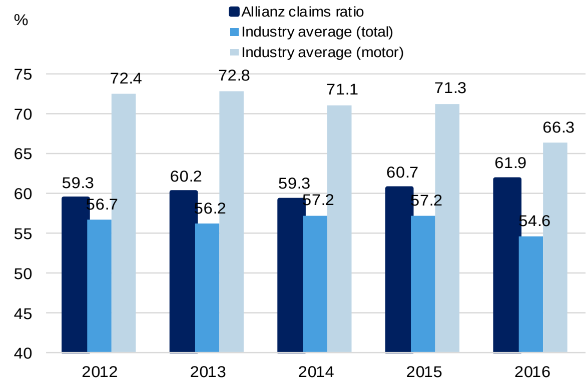
Fig 13-14 illustrate the GWP breakdown of Allianz General vs. industry peers.

Fig 11: Allianz General management expenses ratio vs. industry



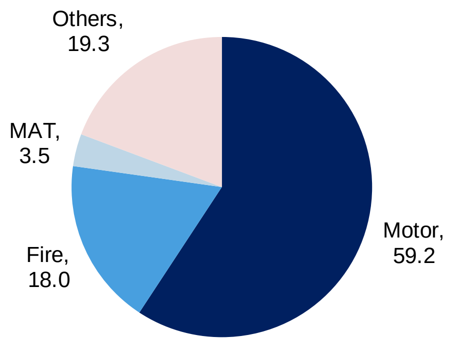
Source: Bank Negara Malaysia, Company, Affin Hwang

Fig 12: Allianz General claims incurred ratio vs. industry



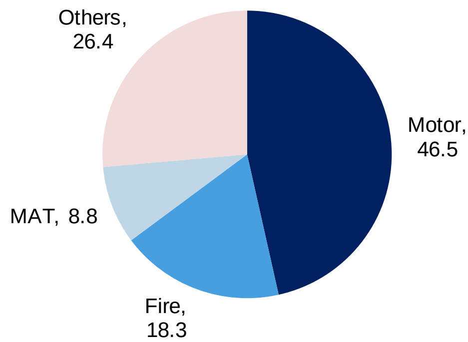
Source: Bank Negara Malaysia, Company, Affin Hwang

Fig 13: Allianz General GWP mix 2016



Source: Bank Negara Malaysia, Company, Affin Hwang

Fig 14: Industry GWP mix 2016



Source: Bank Negara Malaysia, Company, Affin Hwang

No significant negative impact expected from general industry detariffication

While some stakeholders fear of a price war post-detariffication, we believe it is highly unlikely due to the following reasons:

i) No free-floating of premiums

For motor policies, premiums are only allowed to deviate by ±10% from the current tariff levels. Meanwhile for fire policies, new products with premiums within 30% of current tariff rates can be introduced.

However, any deviation outside such a range would need to be submitted to BNM for review. We also understand that any new policy wordings would need approval from PIAM (General Insurance Association of Malaysia) and the rating models would need to be substantiated by statistical data and actuarial calculations.

ii) Inherent high motor-claims ratio

Motor segment has the highest claims ratio among all segments. The claims ratio has improved in recent years, thanks to the higher third-party policy premiums and lower incidence of fraud and car theft. However, high accident rates, high vehicle parts replacement costs, medical costs and court compensation costs continue to pressure insurers profitability within this segment.

Therefore, we believe it is unlikely for insurers to have significant room to reduce the premium rates, especially for the motor segment.

iii) Stringent capital requirements

In Malaysia, insurers are governed under the risk-based capital framework. Should a player engage in aggressive price competition, it is likely to deplete its capital (due to losses incurred) while the risk charges increase in line with the value of policies sold. These would place severe strain on an insurer's capital and could require fresh injection of equity to sustain its operations. Such a move, coupled with poor profitability, may not be well-received by its shareholders, in our view.

BNM has also repeatedly stressed that it would like to see a controlled and rational liberalization of the industry. Therefore, should the competition get out of hand, BNM may intervene by blocking the premium reduction or by requiring higher capital requirements.

Impact of detariffication is manageable for Allianz General

Contrary to expectations of adverse impact, the industry detariffication could in turn present an opportunity to Allianz General. Barring stiff competition, we expect the new risk-based pricing of motor policies to be gradually adjusted to better reflect the policy-risk profile. Should this materialise in the longer term, this would result in a better claims ratio for the motor-insurance segment. With its larger exposure to the relatively less profitable motor segment, Allianz General would likely stand to benefit more than its peers.

Meanwhile, Allianz General has been preparing for the detariffication through the improvement of customer experience, including but not limited to providing value-added services such as roadside assistance, etc. Besides, its lower management expenses ratio and the ability to tap the experience and expertise of the other operations of Allianz Group, which have gone through detariffication, should also help AllianzM to navigate any potential challenges.

Insuring for the digital future

While there is increasing awareness of the potential threats and opportunities that can be created by fintech or insurtech companies, most insurers still lack a concerted effort or coherent strategy to approach the digital age, either by investing in digital assets, partnering or acquiring fintech companies.

Despite already being one of the largest players in the industry, AllianzM has moved fast in the attempt to get itself ready for potentially new trends as well as to cater to the customers' needs. Fig 15 showcases a list of its current and potential digital partners while Fig 16 demonstrates its ongoing initiatives to collaborate with government agencies as well as the fintech communities to embrace and explore industry innovation and opportunities.

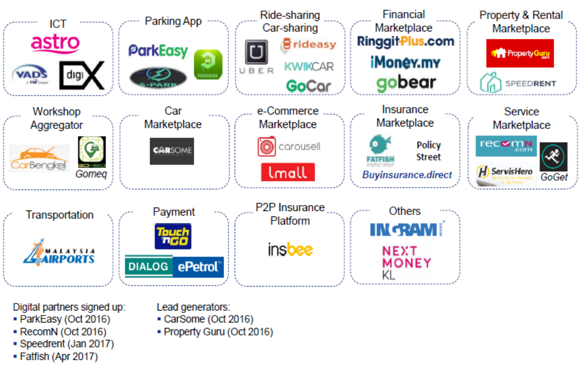
It has started various partnerships such as ParkEasy (parking application), Recomn.com (services provider) and Speed Rent (property rental). These partnerships and collaborations are a series of small investments with high potential returns. We believe it is a sensible strategy to protect AllianzM against the future trends and ensure the company remains relevant in the medium to long-term horizon without incurring significant upfront expenses.

AllianzM has also launched Allianz Online, its online platform for distribution of its product and the Allianz A2Z customer mobile application platform as well. Customers are now able to get quotations and purchase 4 general insurance products (HomeOwner/HomeContents, Enhanced RoadWarrior, Allianz Shield and ATM Shield) as well as a term-life product and hospital-cash product through Allianz Online. Besides, the company has also rolled-out an Interactive Voice Response System enhancement on its website and implemented the use of Messenger to handle customer enquiries from their Facebook page as a step towards digital customer service engagement. A LiveChat is also being considered as the next phase of customer service support. Within the organization, efforts to adopt digital technology have also been accelerated to improve productivity.

We view these digital initiatives and the embracement of technology positively and believe that these are instrumental for the company to reach out to the younger generation and improve internal productivity. While these are likely to result in higher management expenses in the short term, the investments are relatively manageable for a company of its size, in our view.

Fig 15: List of digital partners

6 signed up, 25 in negotiation, and more to come



Source: Company, Affin Hwang

Fig 16: Collaboration with agencies

Source: Company, Affin Hwang

Outlook and Financials

General insurance premium to rebound

In 2016, Allianz General suffered a decline in GWP, mainly due to the drop in total industry vehicle (TIV) sales as well as the company's decision to exit some unprofitable business such as the power-plant business. For 2017-18E, we expect Allianz General to resume the growth trend, but at a low single-digit rate (4.0-4.8%) as industry headwinds remain. On a more positive note, there is likely some potential upside to our premium growth assumptions should Malaysia's general economy grow above expectations.

Higher combined ratio expected in 2017E due to digital expenses

We expect Allianz General's claims incurred ratio and commissions ratio to remain relatively steady in 2017-19E. However, due to increased investments in digital assets in 2017E, which result in higher IT expenditures. Hence, we have pencilled in a higher combined ratio of 92%, while in the subsequent years 2018-19E, the combined ratio of the general unit should ease to 90%.

We also expect a spike in the expense ratio for 2017E due to a one-off provision for insurance receivables from a reinsurer, Virginia Surety due to a prolonged arbitration process. Allianz General has made a provision of RM9m in 1Q17 and is expecting a further RM10-15m in provisions for the same account in the coming quarters. Management remains hopeful that the arbitration process may be concluded and that the company could be awarded a favourable outcome by end-2017.

Excluding the likely RM25m in one-off provision for 2017E, the business-as-usual (BAU) underwriting profit for the general insurance segment would likely show a recovery in profitability.

Fig 17: Allianz General Insurance: Key earnings forecast assumptions

General insurance	2012	2013	2014	2015	2016	2017E	2018E	2019E
GWP growth (%)	14.4	18.2	7.9	2.2	(4.5)	4.0	4.8	6.9
Retention ratio (%)	69.5	78.3	71.8	80.3	83.7	84.0	84.0	84.0
Net claims incurred ratio (%)	59.3	60.2	59.3	60.7	61.9	61.0	61.0	61.0
Net commissions ratio (%)	8.7	10.2	10.4	11.5	11.1	11.5	11.5	11.5
Management expenses ratio (%)	20.0	18.1	17.5	16.9	17.4	19.5	17.5	17.0
Combined ratio (%)	88.0	88.5	87.1	89.0	90.4	92.0	90.0	89.5
Underwriting profit (RM m)	130.6	156.5	200.0	188.4	166.9	145.6	190.8	214.0
PBT (RM m)	220.8	264.2	325.7	331.3	329.4	310.0	361.9	396.1
ROE (%)	18.7	19.5	19.8	16.6	14.4	12.3	12.9	12.7

Source: Company, Affin Hwang forecasts

Life insurance as the key earnings driver, in our view

We believe the life industry is likely to grow at a much stronger rate than the general industry. For Allianz Life, we are expecting a higher mid-single digit growth for its GWP for 2017-19E (6.4-7.0%).

Meanwhile, we also note that the new business margins have improved in recent years since the introduction of a higher-margin death-protection investment-linked product. With the repricing of its medical policy products and the gradual increase in contribution from the higher-margin products, we believe life-insurance segment margins are likely to be stronger in the coming years.

For 2017E, in view of the positive equity and fixed income market, we expect a significant jump in investment income. These higher returns, however, are mostly attributable to policyholders and would correspondingly be reflected in a higher liability charges. The net positive impact for Allianz Life is likely to be much smaller.

Fig 18: Allianz Life Insurance earnings forecast assumptions

Life insurance	2012	2013	2014	2015	2016	2017E	2018E	2019E
Recurring premium growth (%)	15.4	12.8	9.7	9.6	5.7	6.0	6.5	7.0
Single premium growth (%)	6.7	110.7	39.9	(6.0)	15.9	8.0	7.0	7.0
GWP growth (%)	14.5	22.2	14.6	6.5	7.6	6.4	6.6	7.0
NEP/ GEP (%)	94.3	93.7	92.6	91.6	92.8	92.0	92.0	92.0
Claims and reserves/ NEP (%)	80.1	77.1	80.5	79.9	82.1	99.0	83.0	83.5
Net commissions/ NEP (%)	22.8	20.2	18.5	19.3	18.8	19.0	19.0	19.0
Management expenses/ NEP (%)	9.0	9.6	9.1	9.1	10.1	9.5	9.2	9.0
Investment income (RM m)	235.8	202.3	256.1	280.9	368.1	754.0	460.4	507.8
PBT (RM m)	84.5	84.1	105.6	117.2	137.2	161.9	185.1	205.2
ROE (%)	10.3	9.0	10.3	10.8	10.6	11.4	11.6	11.5

Source: Company, Affin Hwang forecasts

Overall, group future remains bright

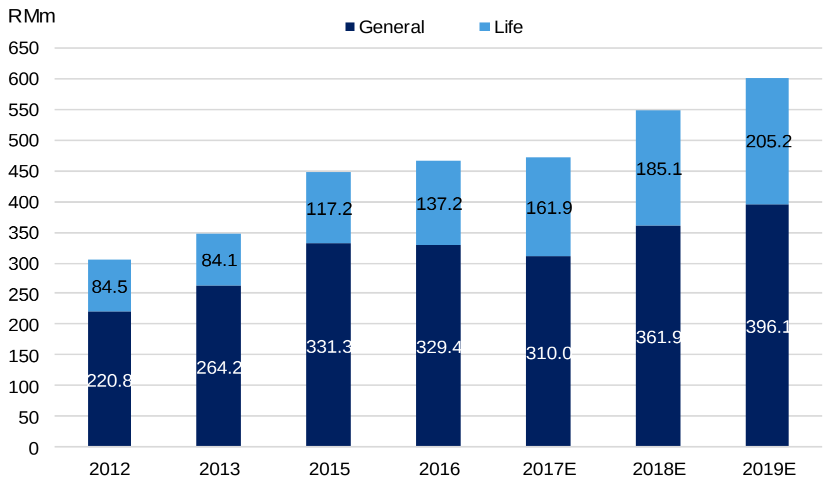
Overall, we expect better years ahead for AllianzM. We look for premium growth to rebound from 2016 levels and remain resilient in the coming years. Meanwhile, we expect net profit to accelerate, underpinned by the recovery in its general insurance operations and maturing of its life-insurance operations. The life-insurance operations are also expected to contribute a higher portion (33-34%) of the group's PBT over our forecast period of 2017-19E, vs. their historical PBT contribution of 24-29%. Finally, we look for overall group ROE to be relatively stable (at 11.3-11.6%) despite the expansion of its book value.

Fig 19: Allianz Malaysia earnings and ratios (2012-19E)

Group	2012	2013	2014	2015	2016	2017E	2018E	2019E
GWP growth (%)	14.5	19.9	10.9	4.1	1.2	5.2	5.7	6.9
Retention ratio (%)	80.8	85.7	81.3	85.7	88.2	88.1	88.1	88.1
Net claims incurred ratio (%)	70.4	69.1	70.4	70.5	72.6	81.2	72.8	73.0
Net commissions ratio (%)	16.2	15.5	14.6	15.5	15.2	15.5	15.5	15.5
Management expenses ratio (%)	14.6	14.0	13.4	13.3	13.9	14.2	13.1	12.7
PBT (RM m)	297.8	339.2	423.5	438.2	454.6	471.9	547.0	601.3
Net profit (RM m)	207.6	237.9	295.9	308.9	312.1	326.5	378.8	416.2
Core net profit (RMm)	207.6	237.9	295.9	308.9	312.1	351.5	378.8	416.2
ROE (%)	11.9	12.3	13.7	12.6	11.3	11.6	11.4	11.3

Source: Company, Affin Hwang forecasts

Fig 20: AllianzM segment PBT breakdown: 2/3 from General insurance, 1/3 from Life insurance



Source: Company, Affin Hwang forecasts

Limited impact from change in bancassurance partner

Allianz General's current bancassurance partner, CIMB Group Holdings Berhad ("CIMB") has entered into a strategic partnership with Sompo Japan Nipponkoa Holdings in July 2016, effectively spelling the non-renewal of the current bancassurance agreement with Allianz General which expires in August 2017.

While this would affect Allianz General's distribution of products, we note that GWP of products distributed through the bancassurance channel generally only comprises around 7-9% of the total GWP. As part of the measures to mitigate the impact, AllianzM also inked a new 15-year partnership with Standard Chartered early this year to distribute its general-insurance products in Hong Kong, Singapore, Malaysia, Indonesia and China. Moreover, we understand that the new bancassurance agreement is more comprehensive in terms of product range compared to the existing bancassurance agreement, which only distributes Allianz General's motor and fire products (due to CIMB's commitment with other insurers). As such, we believe the impact of the change in bancassurance partner, if any, should be relatively minimal.

Still keen on takaful acquisition

AllianzM previously announced that it has entered into negotiations to acquire HSBC Amanah Takaful (Malaysia) Berhad. This however, has been discontinued, due to an inability to agree on the pricing. We understand that the company is still exploring the possibility of a potential acquisition of a takaful operator in order to gain exposure into the Shariah segment, in particular family takaful. Management has, however, stressed that they would not overpay in order to gain entry into this business.

Digital initiatives likely only to contribute over the longer term

As highlighted in an earlier section of this report, AllianzM has been active in undertaking various digital initiatives and has increased its investment in digital assets. However, in the near term, we do not expect significant incremental growth at the top and bottom lines from the digital initiatives. Such effects are likely to be only felt over the longer run.

Premature to estimate IFRS17 impact

After almost 10 years in the making, a new international IFRS standard for insurance contracts, IFRS 17 was formally published on 18 May 2017. The new standard replaces IFRS 4 Insurance Contracts and is expected to improve comparability between companies, contracts and industries, and enhance disclosure to enable investors, analysts and other stakeholders to make informed decisions. There will be material change in the recognition and presentation of insurance companies' revenue, reserving of contract liabilities and consequently the profits and equity recognition as well as the companies' financial reporting processes, actuarial models etc. The impact is also expected to be more significant for insurance companies with longer-term liabilities (ie, life insurance) compared to those with shorter-term liabilities (ie, general insurance).

IFRS 17 however, is only effective from 1 January 2021 and there could still be potential delays in the implementation timeline, considering the complexity of the standards and the time and resources required for the implementation. At this juncture, it is too premature to assess the impact of the new standard and there would not be any impact on AllianzM's financial statements for at least another 4 financial years.

1Q17 financial results review

1Q17 results – affected by seasonal factor and provision

AllianzM delivered a commendable set of results for 1Q17. While core net profit grew 2.7% yoy, headline net profit however was 8.2% lower yoy as it made a RM9m provision for insurance receivables from a reinsurer, Virginia Surety due to a prolonged arbitration process. As guided in earlier sections, a further RM10-15m in provisions can be expected for the same account in the coming quarters. A favourable arbitration outcome, however, could reverse these provisions. Net profit also appeared to be weak qoq due to the seasonally stronger 4Q16 for the life-insurance segment.

For segmental performance, general insurance GWP rebounded from a lacklustre 2016. There are minimal changes in its key insurance ratios, except for the higher expense ratio due to the provisions as highlighted above and higher investment levels in digital assets.

Meanwhile, the life-insurance segment delivered another strong quarter with GWP growing 5.6% yoy. Annualised new premiums continued to grow at a strong pace of 27.4% yoy, while segmental PBT was 40.2% higher yoy. While the lapse ratio has seemingly surged to 13.7%, this is not a cause for concern as management guided that it is due to certain policies reaching the end of their payment stage. This can be corroborated by the 13th month persistency ratio, which has remained strong at around 85.5%.

Fig 21: Results comparison

FYE 31 Dec (RMm)	1Q17	QoQ % chg	YoY % chg	2015	2016	YoY % chg	Comment
Gross written premium	1,116.0	*7.8*	*4.1*	4,132.7	4,182.6	*1.2*	GWP yoy growth supported by growth in both general (2.6%) and life (5.6%) segments.
Net earned premium	956.8	*(0.8)*	*3.0*	3,504.3	3,690.5	*5.3*	
Net claims incurred	(823.8)	*51.0*	*5.5*	(2,469.7)	(2,677.9)	*8.4*	Net claims surged mainly due to higher investment income from life investment-linked insurance policyholders
Net commission expenses	(151.8)	*2.1*	*7.8*	(543.1)	(560.8)	*3.3*	
Other expenses	(155.7)	*3.1*	*28.8*	(494.1)	(546.1)	*10.5*	
Realised gains	33.4	*>100*	*9.3*	48.3	60.9	*26.0*	
Other investment gains	249.9	*>100*	*26.1*	392.5	488.0	*24.3*	Higher investment income qoq due to stronger capital market performance
PBT	**108.7**	*(10.2)*	*(5.5)*	**438.2**	**454.6**	*3.7*	
Tax	(41.5)	*33.7*	*(0.8)*	(129.4)	(142.5)	*10.1*	
Net profit	**67.2**	*(25.3)*	*(8.2)*	**308.9**	**312.1**	*1.1*	Net profit affected by provisions for one reinsurance account of RM9m. Core net profit came in at around 22% of our forecasts. Seasonally 4Q is the strongest quarter.
Core net profit	**78.1**	*(8.9)*	*2.7*	**309.2**	**315.1**	*1.9*	
EPS (sen)	38.7	*(27.0)*	*(10.5)*	184.2	184.0	*(0.1)*	
Diluted EPS (sen)	19.4	*(26.2)*	*(8.2)*	86.0	90.8	*5.6*	
DPS (sen)	0.0	*n.m.*	*n.m.*	0.0	0.0	*n.m.*	No dividend declared as expected

Source: Affin Hwang, Company

Fig 22: Insurance segmental ratio and key data

General	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17
Retention ratio (%)	82.3	83.2	83.5	72.7	82.3	98.2	85.2
Net claim incurred ratio (%)	64.1	58.2	61.1	62.5	62.6	61.3	59.7
Net commission ratio (%)	11.5	11.4	12.2	10.4	10.1	11.8	12.6
Management expenses ratio (%)	15.7	18.4	15.3	16.8	18.7	18.9	20.3
Combined ratio (%)	91.3	88.0	88.6	89.7	91.4	92.0	92.6

Life	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17
Recurring premium (%)	81.9	85.6	76.7	80.5	83.0	83.2	77.2
New premium (%)	18.1	14.4	23.3	19.5	17.0	16.8	22.8
Annualised new premiums	98.5	106.8	86.5	88.2	93.7	124.1	110.2
Net investment results (LF+SHF)	(1.2)	74.8	119.8	80.5	89.8	(15.7)	85.4
*Expense ratio (LF+SHF)	9.8	9.9	10.4	10.8	11.1	9.9	12.3
*Local investment yied (LF+SHF)	2.4	3.8	6.2	6.2	7.7	3.8	5.8
*Lapse ratio (total company)	9.1	9.5	9.4	10.6	11.2	9.5	13.7
*Persistency (13th month by purpose)	81.1	81.4	83.1	83.5	84.1	81.4	85.5

*Source: Affin Hwang, Company   *Note: Cummulative*

Valuation attractive; initiate with a BUY rating

Initiate with a BUY call and SOTP-based target price of RM16.30

We initiate coverage on AlianzM with a **BUY** rating and a 12-month **target price** of **RM16.30**. As AllianzM is a composite insurer, we employ a Sum-of-the-Parts (SOTP) valuation methodology to value the stock.

For general insurance, we apply a 2018E P/BV target multiple of 1.73x (2018E segment ROE: 12.9%, cost of equity: 8.5% and g of 2.5%). Despite its larger size, we apply a lower target multiple than we use to value its peers, LPI Capital (3.27x) and Tune Protect (2.03x), given its lower ROE and slower expected growth.

For the life-insurance business, we apply a P/EV (embedded value) target multiple of 1x on our 2018E EV of RM1,850m, which we believe is fair based on its robust 45% yoy new-business-value (NBV) growth from RM108.1m in 2015 to RM157.0m in 2016, partly due to strong sales of a new higher-margin investment-linked product. Moving forward, we believe the strong ANP growth (27.4% yoy in 1Q17) and contribution from higher-margin products will be the key drivers for AllianzM's EV.

While the embedded value is susceptible to vagaries in actuarial assumptions, we believe that embedded value remains the best valuation measure to capture the nature and value of Allianz Life's long-term business (please refer below for further details on embedded values). We also note that the embedded value has yet to take into account future new premiums and the NBV that can be generated.

Fig 23: AllianzM: SOTP valuation

	Book/ embedded value (RM m)	Target multiple (x)	Value (RM m)
General insurance	2,186.6	1.73	3,782.9
Life insurance	1,850.0	1.00	1,850.0
Total SOTP value	**4,036.6**		**5,632.9**
SOTP per share (RM)			**32.30**
Outstanding shares (m)			*174.2*
Diluted SOTP per share (RM)			**16.30**
Outstanding shares + ICPS (m)			*346.2*

Source: Affin Hwang estimates and forecasts; note: fully-diluted share count assumes full conversion of irredeemable convertible preference shares

An undervalued life business

We believe that there remains a general lack of understanding and appreciation on the valuation of AllianzM's life insurance business. Based on AllianzM's enlarged market capitalisation of RM4.47 billion (with the assumption of the conversion of ICPS), this would translate into a fully-diluted P/BV multiple of 1.4x. At its current valuation, we do not believe that the market has accorded much value to Allianz Life and it remains significantly undervalued.

We believe this could be due to a lack of understanding and information available on:

i) the **embedded value (EV)** of the life insurance company. The aim of EV accounting is to capture the present value of all future shareholders' cashflows that are expected to emerge from the life insurer's existing balance sheet, which can be further divided into two categories, i.e. adjusted net asset value and the value of in-force business. Adjusted net asset value incorporates the realisable market value of statutory capital and any free surplus held in the company. Meanwhile, the value of in-force business is the assessment of the present value of all existing policies that are expected to accrue to shareholders over the policies' future lifetime. In other words, it only values the policies that have been sold and remain in-force for the company.

It is arguably a conservative estimate as it does not take into account the value of future business, which could be generated by the firm (AllianzM) through new policy underwriting. We believe, however, that EV is a much better measure of a life insurer's value as it at least examines the value of in-force policies throughout its duration/life-cycle, which could span decades. Increased investor awareness and understanding of the EV method could potentially lead to a re-rating of Allianz Life and, hence, AllianzM, in our view.

ii) the **limited number of listed life insurers** in Malaysia as well as the tendency for investors to use short-term financial measures, ie, ROE or P/BV to evaluate long-term life insurance operations. Such measures are grossly inadequate to capture the value of long-term business such as life insurance, whereby most of the policies sold are multi-year policies in which the premiums are not fully paid or earned in the year in which they were sold. We believe that the EV method remains a more appropriate valuation method to fully reflect the value of life insurance operations.

Undervalued by 21% based on enlarged market cap; upside potential 26.6%

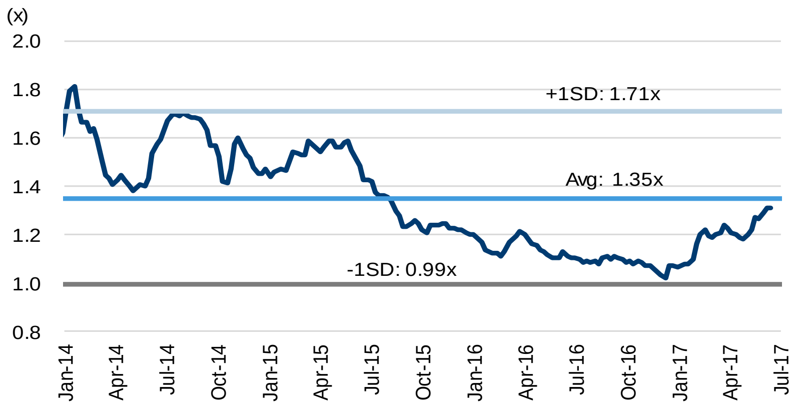
Our 12-month **target price** of **RM16.30**, based on a fully-diluted share count, implies a 1.61x 2018E P/BV multiple, which is slightly less than 1-SD above its past-3-year average P/BV. Comparatively, we believe that the 2017E and 2018E P/BV multiples remain undervalued at 1.41x and 1.28x, respectively, even after the share price run-up of 28.5% since early January 2017.

Assuming that all of the outstanding AllianzM 172.5m irredeemable convertible preference shares (ICPS) are converted into AllianzM shares today, its market cap would increase by RM2.22bn, resulting in an enlarged market cap of RM4.465bn, or c.79.3% of our SOTP valuation of RM5.63bn.

At the current enlarged market cap of RM4.465bn, this could imply that the market has only captured c.37% of Allianz's life-insurance business value. We believe that the mispricing of the security is largely caused by a lack of investor understanding of the life-insurance arm's valuation. Besides, we also note that the EV of the life business is not published as compared to other more developed markets (ie, Hong Kong), while AllianzM's low stock liquidity (free float: 20.76%) may also have contributed to the inefficient price discovery.

We believe that these catalysts could be potential share-price drivers: i) increased investor understanding of life-insurance company valuations and embedded values; ii) higher share liquidity iii) higher household-income levels; and iv) improved economic outlook.

Fig 24: Historical P/BV multiple



Source: Bloomberg, Affin Hwang forecasts

Fig 25: Peer comparison

Company	Bloomberg Code	Rating	Price (RM)	TP (RM)	Mkt Cap (RMm)	Mkt Cap (US$m)	Year end	PE (x) CY17E	PE (x) CY18E	EPS growth (%) CY17E	EPS growth (%) CY18E	P/B (x)	ROE (%) CY17E	ROE (%) CY18E	Div. Yield (%) CY17E	Div. Yield (%) CY18E
Allianz Malaysia Bhd*	ALLZ MK	BUY	12.90	16.30	4,467	1,032.0	Dec	13.6	11.7	4.6	16.0	1.4	10.8	11.4	0.7	0.8
LPI Capital Berhad	LPI MK	BUY	18.90	21.40	6,275	1,449.7	Dec	20.7	19.8	4.0	4.4	3.1	15.7	15.1	4.0	4.0
Tune Protect Group Bhd	TIH MK	BUY	1.26	1.57	947	211.3	Dec	13.8	12.8	-14.4	8.6	1.8	13.4	13.5	4.0	4.4
Syarikat Takaful Malaysia	STMB MK	N/R	4.20	Not rated	3,457	793.5	Dec	17.6	16.2	11.1	9.2	4.4	24.9	23.0	2.6	2.7
Sector average					**16,110**	**3,487**		**16.4**	**15.1**	**1.3**	**9.6**	**2.7**	**16.2**	**15.7**	**2.8**	**3.0**

*Source: Bloomberg, Affin Hwang forecasts *Note: Includes Irredeemable convertible preference shares; prices as of close on 3 July 2017*

Key risks

Key downside risks to our call would include:

i) The high percentage of lower-income group households in Malaysia remains a dampener to the insurance industry growth. In 2014, approximately 24% of households had income below RM3,000/month, while 31% of total households earned between RM3,000-5,000/month;

ii) Stronger-than-expected competition from detariffication;

iii) Claims ratio may rise higher than our assumption in the event of an unexpected economic downturn and due to theft/ fraud cases;

iv) Adverse experience, or variance in assumptions in embedded-value calculations.

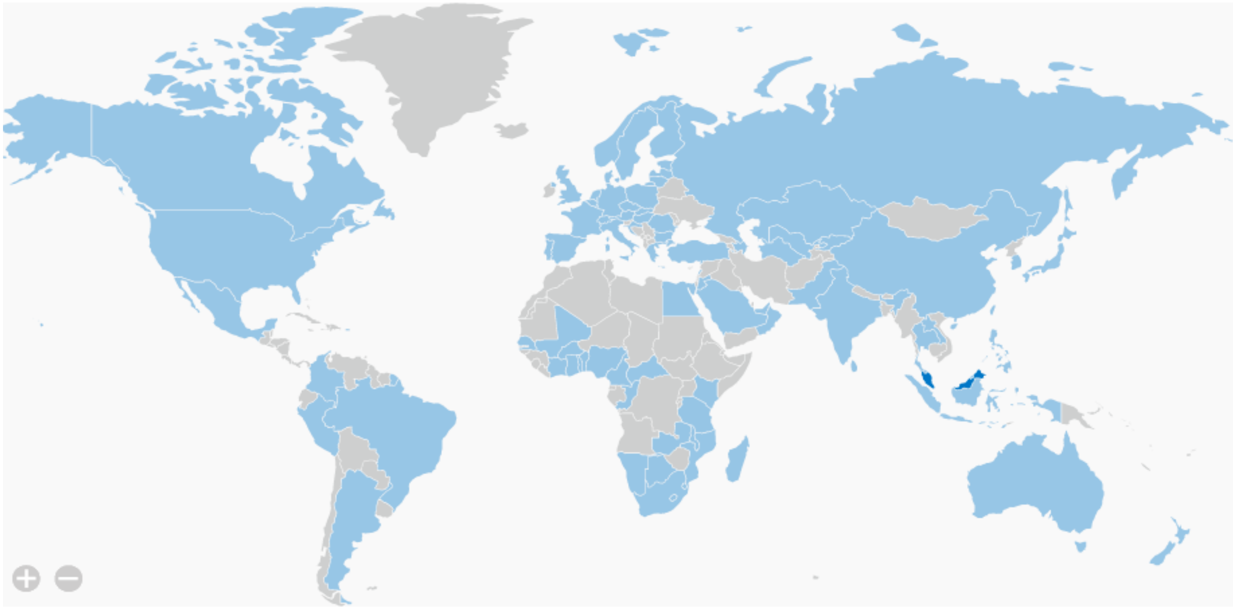
Appendix I

Company profile

AllianzM is part of the Allianz Group which is headquartered in Munich, Germany. Founded in 1890, Allianz Group has grown to be the market leader in the German market as well as having a strong international presence, with over 140,000 employees worldwide and serving more than 86 million customers in around 70 countries. It currently ranks among the top-3 Property and Casualty insurers globally, top-5 in Life/Health business globally and top-5 asset managers globally. (Source: Allianz SE)

Allianz officially stepped foot in Malaysia in 2001 when it became the controlling shareholder of Allianz General Insurance Malaysia Berhad ("AGIM"). In 2007, the general insurance business of AGIM was transferred to its wholly-owned subsidiary, Allianz General Insurance Company (Malaysia) Berhad ("Allianz General"). Following the completion of the transfer of general insurance business, Allianz General changed its name to Allianz Malaysia Berhad. AllianzM is an investment holding company that also owns 100% of Allianz Life Insurance Malaysia Berhad ("Allianz Life"), Allianz General and Bright Mission Berhad.

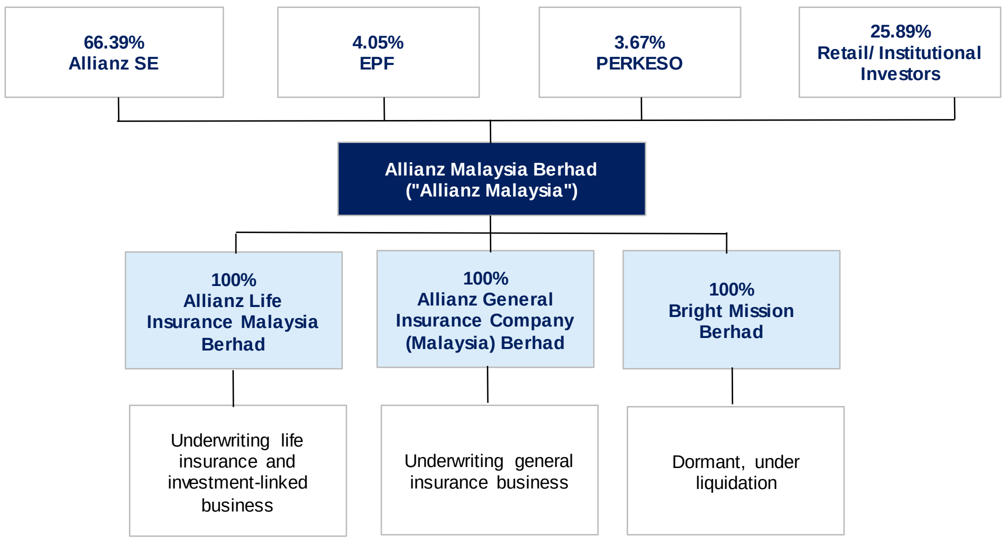
Fig 26: Allianz global capabilities



Source: Allianz SE

With 35 branches in major cities nationwide, Allianz General is one of the leading general insurers in Malaysia (with an approximate market share of 11.8% in the domestic general insurance market in 2016) and has a broad spectrum of services in motor insurance, personal lines, small to medium enterprise businesses and large industrial risks. Meanwhile, Allianz Life (with an approximate market share of 6.9% in the domestic life insurance market in 2016) offers a comprehensive range of life and health insurance as well as investment-linked products and is one of the fastest growing life insurers in Malaysia.

Fig 27: Allianz shareholding and corporate structure



*Source: Company *Note: Shareholdings as at 21 March 2017*

AllianzM also stands to benefit from the spillover effects of the Allianz Group's global marketing campaign and the strong Allianz branding worldwide. Known for its sporting and cultural marketing, these ongoing campaigns enhance the visibility as well as the familiarity of the Allianz brand, especially to the younger generation.

Fig 28: Sponsor for Formula E

Source: Company

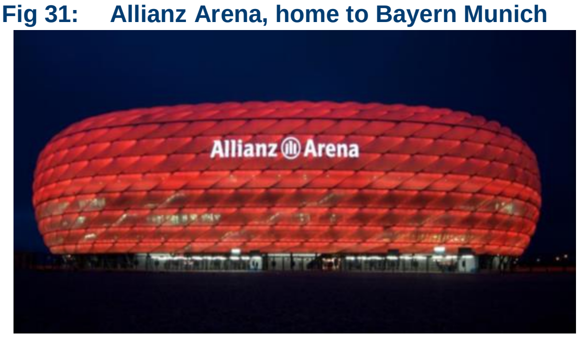
Fig 29: Partnership with pianist Lang Lang

Source: Company

Fig 30: Sponsor for Asian football confederations

Source: Company

Fig 31: Allianz Arena, home to Bayern Munich



Source: Company

Appendix II

LIFE Framework

The Life Insurance and Family Takaful Framework (LIFE framework), issued in November 2015, outlines a three-pronged strategy and reforms to support the long-term development of the life insurance and family takaful industry. The three key pillars of the framework include:

1) Gradual removal of limits on operating costs
2) Diversification of distribution channels
3) Strengthening market practices

Gradual removal of limits on operating costs

Main initiatives under this pillar would be the gradual removal of the existing limits on management expenses, commissions and agency related expenses. Such removal of limits would allow insurers better flexibility to manage costs and incentivize their agency forces, which is expected to improve new sales growth and, hence, GWP growth.

These limits will likely be removed in phases on different products (see Fig 32) with certain conditions. For pure-protection products, limits will be removed subject to the offering of products by insurers via direct channels as detailed below, while a Minimum Allocation Rate is introduced concurrent with removal of limits for investment-linked products to safeguard consumers' interests.

Diversification of distribution channels

Life insurers and takaful operators are required to offer term insurance/takaful through at least one direct channel (premises of an insurer/takaful operator or an online platform) from 1 January 2017, followed by critical-illness and medical and health plans from 1 January 2018. These are expected to lower the distribution cost of products and potentially increase the take-up rate of insurance although such effects may not be significant in the short term as consumers may still prefer to deal with agents.

Other pillar initiatives include development of bancassurance/bancatakaful through alignment of the current commission limits with those of corporate agents, supporting the scaling up of agents to become financial advisers and introduction of online product aggregator.

Strengthening market practices

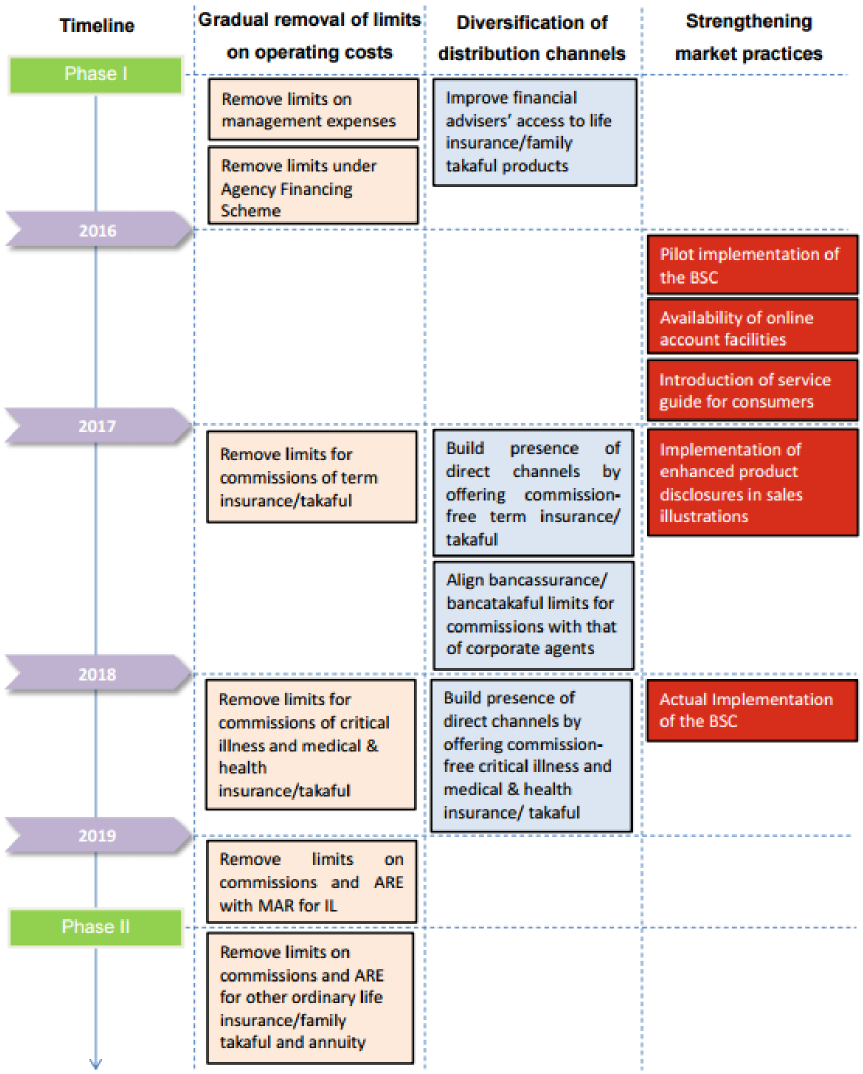
The key initiatives under this pillar would be the introduction of the balanced score card (BSC). It is designed to capture non-sales key performance indicators (KPIs) such as customer fact finding, volume of consumer complaints etc. in order to prevent mis-selling of products that were ill-suited to a policyholder's needs and financial circumstances. Agents whose performance exceeds the minimum requirements for non-sales KPIs will be eligible for higher commissions. A pilot run of the BSC has been in progress since 2H16 prior to its effective implementation in 2018.

Other pillar initiatives include strengthening of product disclosure standards and providing sales/marketing illustrations at the point of sale, providing online account facilities, and service guide to enhance consumer awareness of financial advisory services.

Gradual reform

Similar to the motor and fire liberalization framework, BNM advocates a gradual reform approach and expects such changes to support long-term sustainable development of the life insurance/family takaful industry in order to achieve the target of meeting a 75% penetration rate (policy to population) by 2020. The implementation timeline of the LIFE framework is summarized in Fig 32.

Fig 32: LIFE framework implementation timeline



Source: Bank Negara Malaysia

Allianz Malaysia - FINANCIAL SUMMARY

Profit & Loss Statement

FYE Dec (RMm)	2015	2016	2017E	2018E	2019E
Gross written premiums	4,132.7	4,182.6	4,399.7	4,651.9	4,974.2
Net earned premiums	**3,504.3**	**3,690.5**	**3,874.6**	**4,098.2**	**4,382.3**
Net claims incurred	(2,469.7)	(2,677.9)	(3,144.4)	(2,981.8)	(3,200.6)
Net commission expenses	(543.1)	(560.8)	(599.7)	(635.6)	(679.8)
Management expenses	(464.8)	(513.3)	(550.1)	(535.4)	(557.5)
Underwriting profit	**26.7**	**(61.4)**	**(419.6)**	**(54.6)**	**(55.5)**
Realised gains	48.3	60.9	0.0	0.0	0.0
Other investment gains	375.7	468.9	924.1	636.8	694.6
Other income	16.8	19.2	13.4	13.6	13.9
Other expenses	(29.4)	(32.8)	(46.0)	(48.9)	(51.7)
PBT	**438.2**	**454.6**	**471.9**	**547.0**	**601.3**
Tax	(129.4)	(142.5)	(145.4)	(168.1)	(185.1)
Net profit	308.9	312.1	326.5	378.8	416.2
Core net profit	**308.9**	**312.1**	**351.5**	**378.8**	**416.2**

Balance Sheet Statement

FYE Dec (RMm)	2015	2016	2017E	2018E	2019E
Financial assets	10,822.6	12,218.1	13,814.5	15,372.1	17,054.5
Reinsurance assets	1,129.3	980.9	1,074.7	1,123.7	1,179.2
Other assets	1,665.6	1,713.4	1,784.9	1,865.2	1,991.1
Total assets	**13,617.4**	**14,912.4**	**16,674.1**	**18,361.0**	**20,224.8**
Insurance contract liab	9,888.6	10,768.5	12,219.4	13,536.2	14,983.8
Other liabilities	1,107.5	1,264.4	1,286.7	1,323.6	1,377.0
Total liab	**10,996.1**	**12,032.9**	**13,506.1**	**14,859.9**	**16,360.8**
Shareholders' Funds	**2,621.3**	**2,879.5**	**3,168.0**	**3,501.1**	**3,864.1**

Cash Flow Statement

FYE Dec (RMm)	2015	2016	2017E	2018E	2019E
PBT	438.2	454.6	471.9	547.0	601.3
Working capital changes	(735.9)	(772.9)	(1,163.5)	(916.7)	(966.6)
Cash tax paid	(115.3)	(117.0)	(145.4)	(168.1)	(185.1)
Others	393.6	446.4	924.1	636.8	694.6
Cashflow from operation	**11.5**	**51.0**	**87.1**	**98.9**	**144.1**
Capex	(35.0)	(21.3)	(23.0)	(20.0)	(20.0)
Others	-	-	-	-	-
Cash flow from investing	**(35.0)**	**(21.3)**	**(23.0)**	**(20.0)**	**(20.0)**
Debt raised/ (repaid)	-	-	-	-	-
Equity raised/ (repaid)	-	-	-	-	-
Dividends paid	(19.1)	(24.8)	(38.1)	(45.7)	(53.3)
Cash flow from financing	**(21.4)**	**(26.0)**	**(38.1)**	**(45.7)**	**(53.3)**
Free Cash Flow	**(23.5)**	**29.6**	**64.1**	**78.9**	**124.1**

Key Financial Ratios and Margins

FYE Dec	2015	2016	2017E	2018E	2019E
Growth					
Gross written premium (%)	4.1	1.2	5.2	5.7	6.9
Gross earned premium (%)	2.2	2.3	5.2	5.7	6.9
Net earned premium (%)	7.7	5.3	5.0	5.8	6.9
Underwriting profit (%)	(48.8)	(329.7)	582.9	(87.0)	1.7
PBT (%)	3.5	3.7	3.8	15.9	9.9
Core net profit (%)	4.4	1.1	12.6	7.8	9.9
Profitability					
General insurance					
Net claims ratio (%)	60.7	61.9	61.0	61.0	61.0
Comms ratio (%)	11.5	11.1	11.5	11.5	11.5
Mgmt exp ratio (%)	16.9	17.4	19.5	17.5	17.0
Combined ratio (%)	89.0	90.4	92.0	90.0	89.5
ROE (%)					
General insurance	16.6	14.4	12.3	12.9	12.7
Life insurance	10.8	10.6	11.4	11.6	11.5
Group	12.6	11.3	10.8	11.4	11.3
Liquidity					
Fin. assets over ins liab (x)	1.2	1.2	1.2	1.2	1.2
FCF/share (sen)	34.5	(13.9)	17.1	36.8	45.3
Investment statistics					
PER (X)	14.4	14.2	13.6	11.7	10.6
Diluted EPS (sen)	89.4	90.8	95.0	110.2	121.1
EPS growth rate (%)	4.0	1.6	4.6	16.0	9.9
BV/share (RM)	7.6	8.3	9.2	10.1	11.2
P/BV	1.7	1.5	1.4	1.3	1.2
Dividend payout (%)	7.8	10.9	11.7	12.1	12.9
NDPS (sen)	5.0	6.5	9.0	10.0	12.0
ICPS DPS (sen)	6.0	7.8	10.8	12.0	14.4
Net yield (%)	0.4	0.5	0.7	0.8	0.9

Segmental contribution (%)

FYE Dec	2015	2016	2017E	2018E	2019E
Net earned premium					
General insurance	49.0	47.2	47.0	46.5	46.5
Life insurance	51.0	52.8	53.0	53.5	53.5
PBT					
General insurance	73.9	70.6	65.7	66.2	65.9
Life insurance	26.1	29.4	34.3	33.8	34.1

Source: Company, Affin Hwang forecasts

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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