Deserving a premium valuation

LPI is a general insurance player with key presence in Malaysia as well as in Singapore and Cambodia. Its superior and disciplined underwriting expertise, lucrative margins and a high-yielding investment portfolio should continue to protect the group against potential industry headwinds and detariffication challenges. We initiate coverage on LPI with a BUY rating and a PT of RM21.40.

Maintaining key competitiveness, leading position in fire insurance

LPI Capital Bhd ("LPI") is the top fire insurer in Malaysia. LPI's entrenched position, strong in-house agency force and established relationship with bancassurance partners, independent brokers and global partners are its key competitive advantages, helping it to gain market share over the years and to withstand industry headwinds.

Impact of detariffication (fire and motor insurance) to be manageable

In our view, the impact of detariffication (of motor and fire insurance) is likely to be manageable for LPI as it has a much lower exposure to the higher claims ratio motor segment (i.e. lower underwriting profit), which represented 23% of its FY16 gross-written premium (vs. fire policies at 41%). We believe that a price war post-detariffication is highly unlikely due to: i) no free-floating of premiums, i.e. deviation of tariffs are still being controlled by BNM; ii) high motor claims ratio does not justify significant reduction in premium rates; and iii) risk-based capital framework does not justify an aggressive price competition.

Disciplined underwriting, superior margins, higher-than peer ROE

LPI is run by a management team which has undertaken astute strategies to enable the general insurance player to generate superior underwriting margin of 31.4% vs. peers at 11% (for the past five years). This was through disciplined risk-underwriting, focusing on the relatively profitable fire segment and lower management expenses ratio. Having Public Bank as the main bancassurance partner and investment portfolio gains from Public Bank shares have also bode well for LPI's higher-than peer ROE.

Initiate coverage with a BUY rating, price target at RM21.40

We initiate coverage of LPI with a **BUY** recommendation and a price target of **RM21.40** (upside 14%) based on a premium 3.27x 2018E P/BV given its leadership, superior margins, strong bancassurance partner and superior FY17-19E ROE of 15%. Currently, LPI is trading at 3.1x 2017E P/BV against the industry average of 2.1x, while its FY17-19E dividend yields are at 4.0-4.3%, attractive vis-à-vis its peers at 2.8%.

Earnings & Valuation Summary

FYE 31 Dec (RMm)	2015A	2016A	2017E	2018E	2019E
Gross written premiums	1,250.8	1,278.3	1,322.4	1,383.6	1,457.4
Net earned premiums	706.9	767.3	813.0	853.0	902.1
Underwriting profit	229.8	271.6	279.5	298.9	322.4
Pretax profit	393.1	518.9	388.8	406.0	435.0
Net profit	321.0	437.2	303.3	316.7	339.3
EPS (sen)	96.7	131.7	91.4	95.4	102.2
PER (x)	19.4	14.3	20.6	19.7	18.4
Core net profit	248.2	291.6	303.3	316.7	339.3
Core EPS (sen)	74.8	87.8	91.4	95.4	102.2
Core EPS growth (%)	12.4	17.5	4.0	4.4	7.1
Core PER (x)	25.1	21.4	20.6	19.7	18.4
Net DPS (sen)	70.0	80.0	75.0	75.0	80.0
Dividend Yield (%)	3.7	4.3	4.0	4.0	4.3
P/BV (x)	3.6	3.4	3.1	2.9	2.7
ROE (%)	14.6	16.3	15.7	15.1	15.0
Chg in EPS (%)			-	-	-
Affin/Consensus (x)			1.0	1.0	1.0

Source: Company, Affin Hwang, Bloomberg

Initiation of Coverage

LPI Capital

LPI MK

Sector: Insurance

RM18.78 @ 17 May 2017

BUY

Upside: 14%

Price Target: RM21.40

Previous Target: N/A

Price Performance

	1M	3M	12M
Absolute	+9.3%	+7.3%	+22.1%
Rel to KLCI	+6.7%	+3.2%	+12.3%

Stock Data

Issued shares (m)	322.0
Mkt cap (RMm)/(US$m)	6,234.7/1,441.9
Avg daily vol - 6mth (m)	0.1
52-wk range (RM)	15.26-18.96
Est free float	49.4%
BV per share (RM)	5.23
P/BV (x)	3.59
Net cash/(debt) (RMm)	275.4
ROE (2017E)	15.7%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

Consolidated Teh Holdings	42.7%
Sompo Holdings Inc	8.5%
Retirement Benefits Fund	4.7%

Source: Affin, Bloomberg

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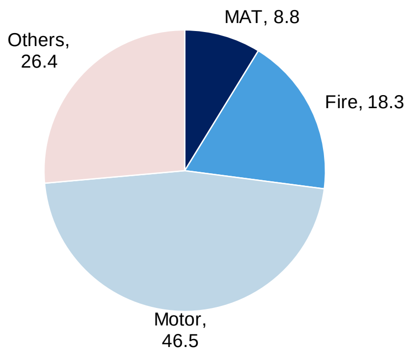
LPI Capital: Key differentiating factors

More profitable policy underwriting vs. the industry

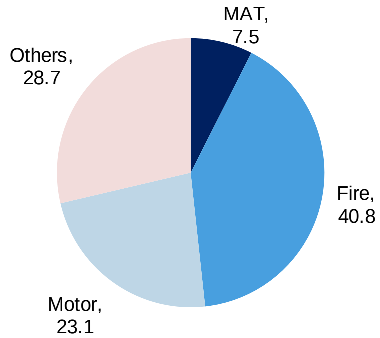
LPI has an advantage vis-à-vis other general insurance and general takaful industry players in terms of the portfolio mix of underwritten policies. Based on Fig 1, the industry players have on average 18.3% of gross-written premium ("GWP") concentrated in the more profitable fire policies whereas for LPI, the bulk of its GWP mix, 40.8%, is concentrated in this segment (which generally have higher returns due to lower claims, as seen in Fig 3).

Fig 1: Industry GWP mix 2016



Source: Bank Negara Malaysia, Affin Hwang

Fig 2: LPI GWP mix 2016

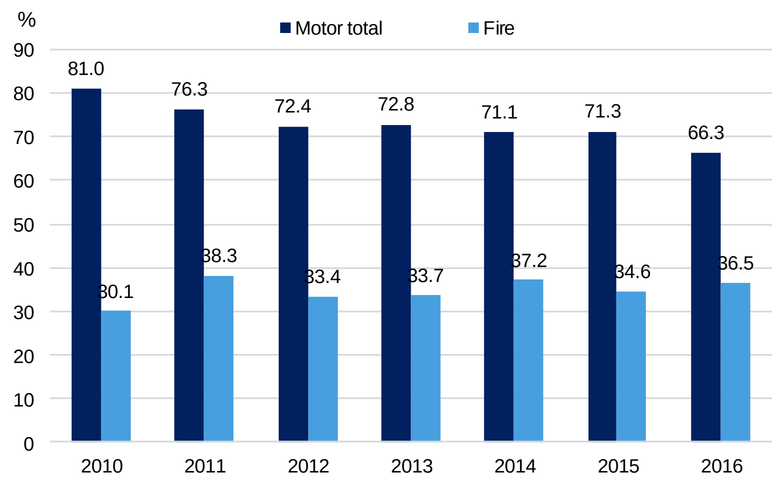


Source: Company, Affin Hwang

LPI also has a significantly lower exposure to the higher-claims-ratio motor segment, at 23.1% of its GWP vis-à-vis industry players at 46.5%. As individual insurer's claims and commissions ratios are generally indifferent to the industry average with management having little control over these costs, LPI's focus on the more profitable fire portfolio allowed LPI to generate an overall higher underwriting profit margin relative to its peers.

Fig 3 below shows the difference between the industry claims ratio for motor vs. fire insurance. The claims ratio for fire insurance has remained relatively steady at around 35-37% in 2014-2016. Though motor insurance claim is still 30ppts above fire insurance claims, it is however on a declining trend.

Fig 3: Industry claims ratio for motor and fire insurance



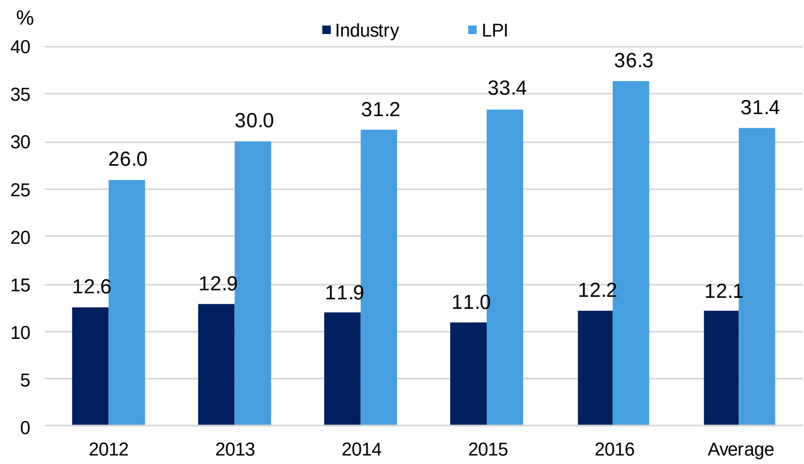
Source: Bank Negara Malaysia

LPI's lower retention ratio (<60%) reflects underwriting conservativeness

LPI's second advantage vs. peers is its considerably lower retention ratio of below 60% against the industry average (>90%). While reinsurance schemes reduce its net premiums earned, it also lowers the claims amount and ensure overall claims exposure for risk events are controlled within certain operating limits.

Such conservative and disciplined underwriting, together with lower management expenses ratio (20.4% vs industry average 22.1%) contributes to the superior underwriting profitability of LPI, which saw an average underwriting margin of 31.4% vs peers at 11.1% for the past five years. This effectively means that for every RM100 of premiums earned, LPI is making RM20 more, or effectively, almost triple that of its peers in terms of underwriting profit.

Fig 4: LPI underwriting margin vs industry peers



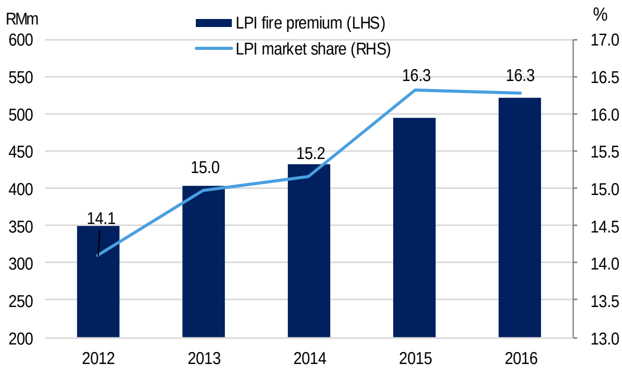
Source: Company, Bank Negara Malaysia, Affin Hwang

Growing market share in fire insurance despite conservative approach

Despite being conservative in its business practices, LPI has also displayed its ability over the years to outgrow the industry and gain market share at the expense of competitors. As a testimony, LPI remains the leading fire insurer in Malaysia with 16.3% of market share in 2016 by GWP, compared to a market share of 14.1% in 2012 (Fig 5).

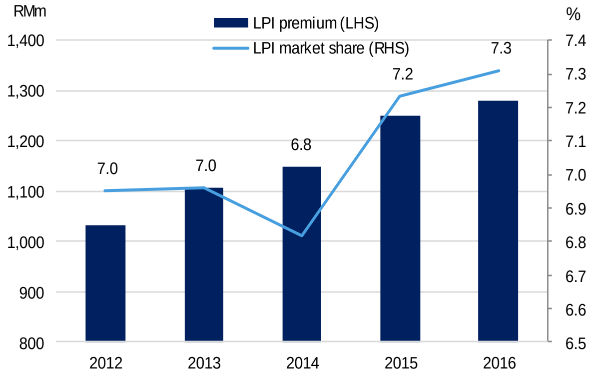
Meanwhile, on an overall gross written premium comparison, LPI is the sixth largest among industry players with a share of 7.3% as in Fig 6. This market share has also been inching up throughout the years, from a market share of 7.0% in 2012 (Fig 6).

Fig 5: LPI market share in fire insurance



Source: Bank Negara Malaysia, Company, Affin Hwang

Fig 6: LPI overall market share



Source: Bank Negara Malaysia, Company, Affin Hwang

Entrenched position in the fire insurance supply chain

For fire insurance, larger commercial and industrial portfolios are usually controlled by in-house corporate agents and/or independent brokers while small medium enterprises, smaller commercial and residential portfolios are controlled by the agents and banks.

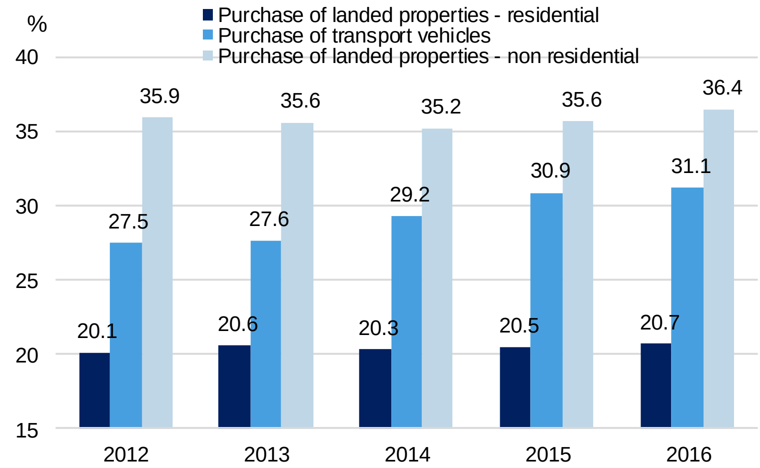
Over the years, LPI has firmly entrenched itself in the fire insurance supply chain by building up an extensive distribution network and enjoy strong relationships with the stakeholders. Not only does it have a strong in-house fire agency force and bancassurance partner, it also enjoys a strong relationship with the independent brokers who control a large portfolio of fire premiums and global partners who would refer large fire industrial and commercial policies to LPI. Being the leading fire insurance player, LPI also further differentiates itself by providing efficient front-end IT systems and value-added loss control and risk improvement services to the clients. We believe these competitive advantages would be crucial especially when industry competition is expected to intensify post-detariffication.

Distribution strength through tie-ups

LPI has continued to leverage on tie-ups with various parties such as agencies (45% of portfolio contribution), banks (25% of portfolio) and joint-management board of condominiums. LPI has also signed partnership agreements with other global companies (such as Fubon Financial, RSA Insurance Group, other multi-nationals), which have customers operating in Malaysia. One of its key bancasurrance partner is Public Bank, and they share a common major shareholder via Consolidated Teh Holdings Sdn Bhd (controlled by Tan Sri Teh Hong Piow). Currently, Public Bank has 259 branches in Malaysia and 130 overseas, serving approximately 10m customers.

We note that Public Bank has a significant and growing market share in selected segments such as purchase of residential and non-residential properties as well as transport vehicles. These would allow LPI to ride on Public Bank's strong pipeline of residential and non-residential mortgages to grow market share in the fire insurance segment. Currently, we understand that approximately 65% of its residential fire portfolio and 33% of its commercial fire portfolio are generated from Public Bank. While Its motor insurance segment may also benefit from Public Bank's hire purchase financing growth, we note that the motor insurance space is still largely dominated by agents and franchises.

Fig 7: Public Bank's estimated market share in selected loan segments



Source: Public Bank, Affin Hwang

A higher-yielding investment portfolio to supplement underwriting profits

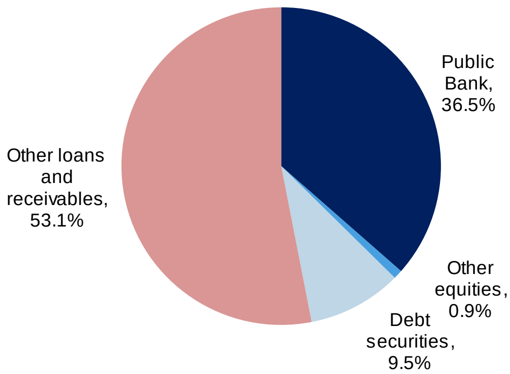
For most general insurance players, underwriting profit remains the key driver to pre-tax profits, while investment income (including fair value gains/losses and realized gains and losses) does not contribute a significant portion. This is due to most general insurance players' conservative and non-risk taking stance on their investment portfolio, whereby 90% is comprised of government securities and high quality corporate bonds. On the other hand, LPI's investment portfolio (Fig 8) has a higher proportion of equities, representing 37.2% of the portfolio, while investment in fixed deposits, fixed-income securities, and loans/receivables made up the balance 47.1%, 10.2% and 5.5%.

LPI's investment portfolio exposure to equities is mainly through its investment in Public Bank (PBK MK, BUY, RM 23.25) shares (since 1999). As of Mar-2017, we estimate that the value of its Public Bank investment stood at RM876.8 million, representing approximately 36.5% of its investment portfolio. We note that such high percentage however is not by design but rather a reflection of how much Public Bank shares' value has appreciated over the years.

Public Bank's adjusted value (for dividends and corporate exercises) have soared by more than 23 times, translating into a compounded annual growth rate (CAGR) of 20.6% over a 17-year period. Such returns dwarf that of a 10-year MGS or the benchmark FBMKLCI Index which would have only yielded a 4.6% and a 6.2% CAGR respectively over the same period.

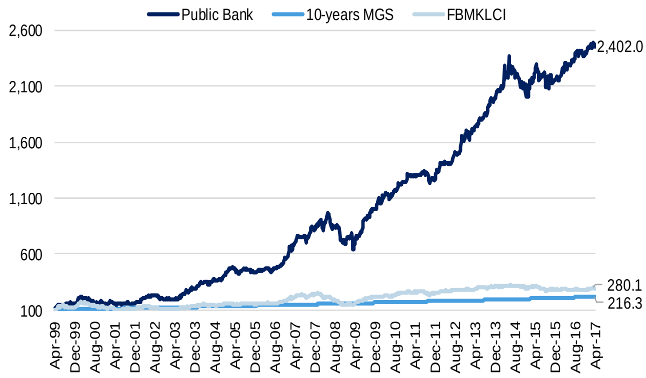
While such marked-to-market returns are not reflected in its profit or loss (due to its designation as available-for-sale), it has been recognized through other comprehensive income and has contributed to the increase in LPI's book value.

Fig 8: Breakdown of LPI's investment portfolio



Source: Company, Affin Hwang

Fig 9: Comparison of ROIs since 1999 (%)



Source: Bloomberg,, Affin Hwang

We note that Public Bank stands out amongst its banking peers by having the best asset quality (GIL ratio 0.5%, LLC at 102.7% in 2016), lowest CIR at 32.3% (2016), the largest market share in domestic retail lending and has the largest private unit trust arm (Public Mutual). While investment in equities typically carry higher risks than that of bonds, we believe that the investment in Public Bank will likely yield better returns in the medium to long term compared to an investment in bonds.

Lucrative reward to shareholders through decent dividends

LPI has always been committed to delivering shareholders' returns and uphold strong corporate governance standards and disclosures. While LPI does not have a formal dividend policy, it has always been rewarding shareholders with decent dividends from its excess cash pile. The payout ratio in the last 5 years (since FY12) has ranged from 61-86%. For FY17-19E, we are pencilling in a payout ratio of 78-82%, which should translate into a dividend yield of 4.0%-4.3%.

Its strong corporate governance standards and disclosures are also recognized through various corporate governance awards, the most recent being winner of 3 categories, including overall and industry categories, in Malaysia-ASEAN Corporate Governance 2016 awards held by the Minority Shareholder Watchdog Group.

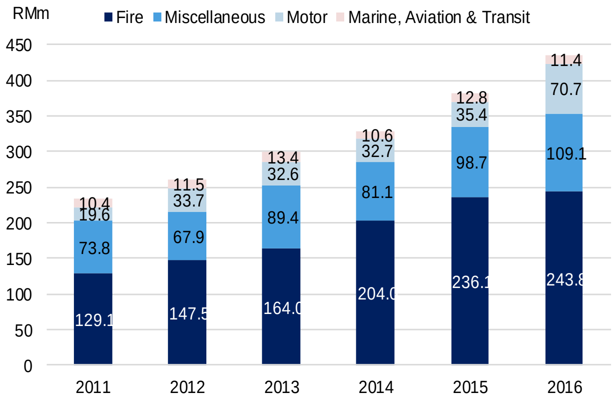
Financial forecasts and outlook

Fire insurance the key driver, offers the highest underwriting profit

Based on LPI's latest segmental breakdown as at Mar17, fire insurance contributed the bulk of the GWP at 42.5% while contributing circa 55% (the highest amount) of LPI's total underwriting surplus before management expenses ('Underwriting Surplus"). This was followed by the motor segment which contributed 18% of the Underwriting Surplus, others at 24% and the marine/aviation/transportation ("MAT") the least at 3%.

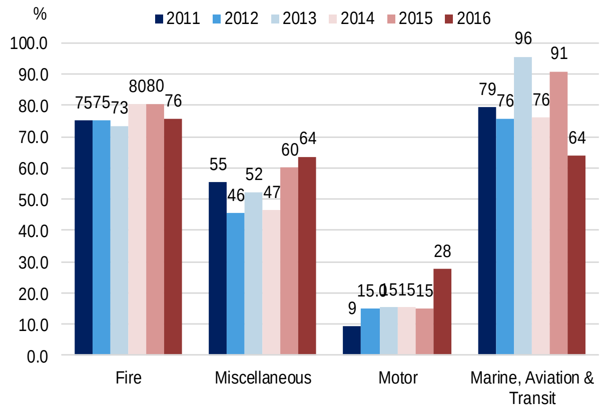
Looking at the past five financial years (from FY11-16), the fire segment has been generating a relatively consistent percentage contribution of circa 55-56% to total Underwriting Surplus (except for FY14 and FY15 at 61-62%) as in Fig 10. In terms of underwriting surplus margins (Fig 11), the fire segment's underwriting margin remains the most profitable at around 75-81% among others.

Fig 10: LPI's underwriting surplus by segment (RMm)



Source: Company, Affin Hwang

Fig 11: LPI's surplus margin by segment (%)



Source: Company, Affin Hwang

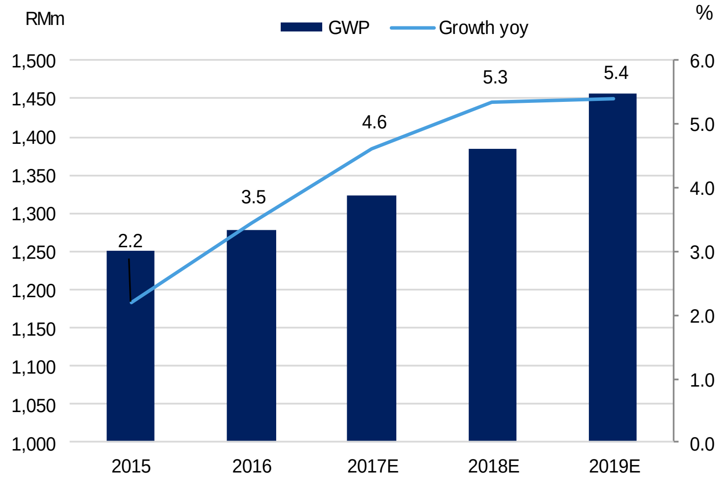
Core profit forecasts at +4.0-4.4% yoy FY17-18E, +7.1% yoy FY19E

For FY17-19E, we are currently forecasting a normalized net profit growth of +4% yoy for FY17E, +4.4% yoy in FY18E and +7.1% yoy in FY19E. On a headline basis, our FY17E pre-tax profit is however forecast to dip by 25% yoy as we did not factor in any significant realized equity investment gains vis-à-vis FY16 (which saw a RM150m gain largely from the sale of Public Bank Berhad's shares).

Other assumptions (on GWP and claims ratio) which we have modelled into our forecasts are discussed below:

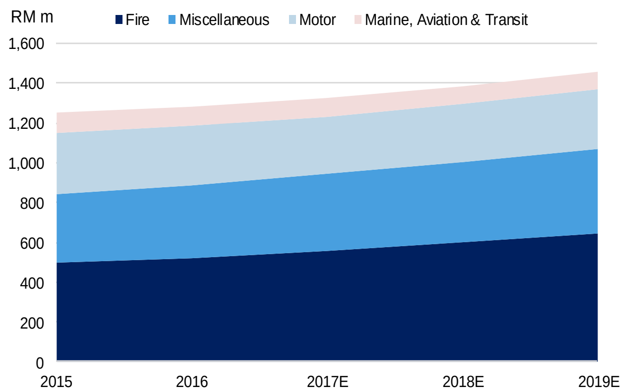
- A modest 3.5% GWP growth in FY17E subsequently rising to 4.6% in FY18E and 5.3% in FY19E. This is underpinned by a much stronger growth of 7-8% yoy in the fire segment, miscellaneous at 5% yoy, motor at -2% to 2% yoy and marine/aviation/transit at -5% to flat for FY17-19E.

Fig 12: GWP mix based on FY17-19E forecast (RMm)



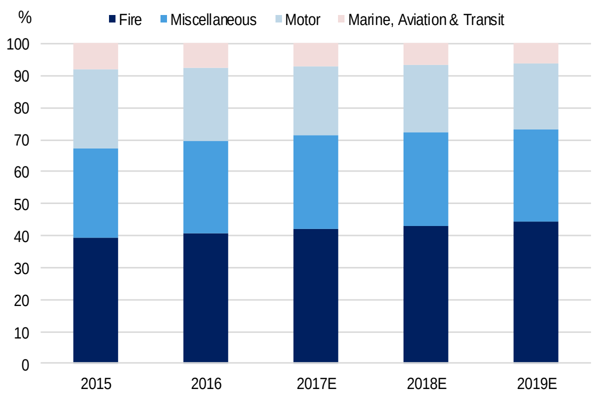
Source: Company, Affin Hwang estimates

Fig 13: Gross written premium forecast and growth



Source: Company, Affin Hwang estimates

Fig 14: GWP mix based on FY17-19E forecast (%)

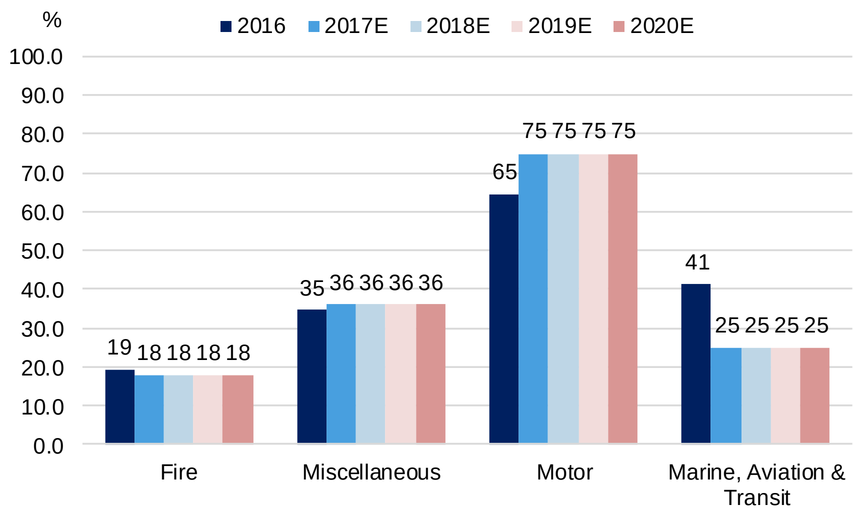


Source: Company, Affin Hwang estimates

In our view, our assumptions for growth (in FY17-19E) remain conservative as the historical growth rates have been stronger for these segments. In our view, the detariffication of fire and motor insurance, would create more price competition among industry players arising from the risk-based pricing and there may be a period of demand-supply adjustments before the industry reaches a new price equilibrium.

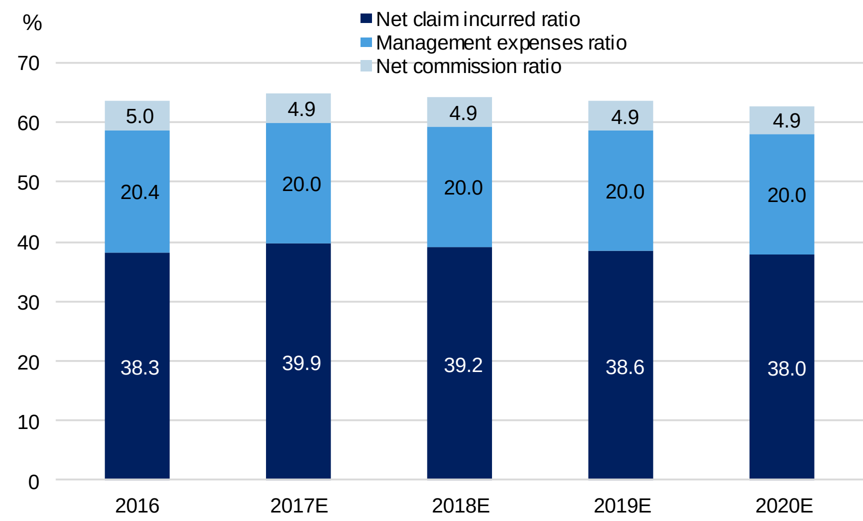
- We do not expect significant changes to the retention ratio, claims incurred ratio, commission ratio and management expenses ratio in our forecast. We however note that claims incurred ratio is likely to inch up in 2017 as the 2016 motor claims were boosted by one-off release of MMIP reserves. Our forecasts for LPI's FY17-19E claims ratio are laid out in Fig 15.

Fig 15: Claim ratio (by product segment) FY17-20E forecasts



Source: Company, Affin Hwang forecasts

Fig 16: Overall combined ratio FY17-20E forecasts



Source: Company, Affin Hwang forecasts

How LPI may position its strategies in FY17-19E?

Given its entrenched market position in the fire insurance, LPI may continue to leverage on its distribution channels and expand geographical coverage. According to management, it plans to grow its agency force by 10% p.a., which is the most straightforward mode of expansion and target markets are the new commercial/residential properties.

Though overseas contribution (Singapore and Cambodia) remains minimal (less than 2% of net profit), we believe that the growth rate in Cambodia will be more robust compared to Malaysia arising from the rapidly expanding economy and FDIs. Meanwhile, expectation of GWP growth in Singapore is expected to decline on the back of intense competition.

For engineering risk policies, LPI has been appointed as the main insurer for MRT2 and could possibly benefit from the rolling-out of other key infrastructure projects. Nonetheless, due to LPI's conservative business practices and the relatively large project risk involved, management generally maintains a minimal retention ratio of 5-20%. Hence, the net premiums earned and underwriting surplus are not significant on absolute terms.

While there are also growth opportunities in other lines of businesses such as personal accident, medical insurance etc., we do not expect any significant change in the premium mix in the short term as the incremental growth from these markets may still be insignificant relative to LPI's mainstream focus (fire and motor). Policies such as medical insurance are also already dominated by life insurance players and margins may be thin due to the high medical inflation costs.

Slower auto sales of key alliance partner may dampen motor GWP

On the other hand, LPI's motor segment may likely take a backseat in 2017 in terms of GWP growth due to potentially declining vehicle sales of its main sourcing partner (Tan Chong Motor). Hence, we have pencilled-in the negative impact on LPI's motor insurance premium growth.

Impact of motor and fire insurance detariffication

Impact of detariffication to be manageable for LPI

We believe that the impact of detariffication, if any, is likely to be manageable for LPI as the it has much lower exposure to the higher claims ratio motor segment (i.e. lower underwriting profit), which accounted for 23% of its FY16 gross-written premium (vs. fire policies at 41%). While fire insurance policies are likely to be impacted under the framework as well, we believe that LPI's established fire agency force, strong relationship with its bancassurance partner, independent brokers and global partners are likely to mitigate any significant negative impact and support its growth and underwriting profit in the segment.

No significant negative impact from detariffication on the industry

We believe that a price war post-detariffication is a potential threat, but 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 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

As shown in Fig 3, motor segment has the highest claims ratio among all segments as it is plagued by high claims from compulsory third-party claims, high accident rates and high incidence of fraud and car theft. In recent years, high vehicle parts replacement costs, medical costs and court compensation costs also added further pressure to 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 move, coupled with poor profitability, may not be well-received by its shareholders.

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

1Q17 financial results review

1Q17 results – affected by seasonal factors

LPI's 1Q17's core net profit of RM70.6m represented 23.3% of our FY17 forecast as a result of seasonally lower net earned premium ("NEP"), which, in our view, is not a concern owing to seasonal factors whereby policies written in 1Q results are being progressively recognised over the year. The lower NEP meanwhile, has inevitably brought down LPI's 1Q17 underwriting margin to 31.9% vs. the average of 35.4% in FY16 and our FY17E underwriting margin assumption of 35.2%. Nonetheless, margins were partially supported by a lower-than-expected motor claims ratio of 62.4% due to the release of MMIP reserves, which helped to sustain LPI's overall 1Q17 claims ratio at 39.8% vs 1Q16 at 43.1%. We anticipate some normalization in terms of the overall claims ratio, especially in the motor segment which may gravitate towards our assumption of 75% due to the absence of release of MMIP reserves.

Fig 17: Results comparison

FYE 31 Dec (RMm)	1QFY17	QoQ % chg	YoY % chg	FY15	FY16	YoY % chg	Comment
Gross written premium	415.7	*56.3*	*3.5*	1250.8	1278.3	*2.2*	GWP yoy growth supported by fire (+10.2%) but mitigated by motor (-2.1%) and MAT (-29.0%)
Net earned premium	179.1	*(14.8)*	*15.2*	706.9	767.3	*8.5*	Strong growth yoy supported by fire NEP (+39.8%). Overall seasonally weaker as expected due to timing of recognition.
Net claims incurred	(71.4)	*3.7*	*6.4*	(289.9)	(294.2)	*1.5*	
Net commission expenses	(5.1)	*(64.3)*	*>100*	(34.1)	(38.1)	*11.9*	
Other expenses	(45.5)	*20.6*	*9.4*	(153.1)	(163.4)	*6.7*	
Underwriting profit	**57.2**	***(36.1)***	***18.6***	**229.8**	**271.6**	***18.2***	
Underwriting margin (%)	*31.9*	*(10.6)*	*0.9*	*32.5*	*35.4*	*8.9*	Underwriting margin lower qoq due to seasonality. Claims ratio held up well despite absence of release in reserves by MMIP.
Realised gains	0.3	*<100*	*n.m.*	76.2	150.3	*97.3*	
Other investment gains	30.3	*80.5*	*(8.0)*	85.1	94.6	*11.2*	Higher investment income qoq due to receipt of dividends. Dividend income lower yoy due to partial disposal of Public Bank shares in 2016 but was mitigated by increased interest income
Share of results of associates	1.0	*48.2*	*(5.7)*	2.3	2.4	*3.5*	
PBT	**88.8**	*(16.9)*	*8.0*	**393.1**	**518.9**	*32.0*	
Tax	(18.2)	*(28.3)*	*8.6*	(72.1)	(81.7)	*13.4*	
Net profit	**70.6**	*(13.4)*	*7.9*	**321.0**	**437.2**	*36.2*	In-line with expectations due to seasonality
Core net profit	**70.8**	*(13.6)*	*5.0*	**248.2**	**291.6**	*17.5*	
EPS (sen)	21.3	*(13.4)*	*7.9*	96.7	131.7	*36.2*	
DPS (sen)	0.0	*n.m.*	*n.m.*	70.0	80.0	*n.m.*	No dividend declared

Source: Affin Hwang, Company data

Valuations and Recommendation

Initiate with a BUY, Price target at RM21.40 (at 3.27x 2018E P/BV)

We initiate coverage on LPI with a **BUY** recommendation and a target price of **RM21.40** based on a 3.27x 2018E P/BV. This represents an upside of 14% over LPI's current price of RM18.78.

Fig 18: Gordon Growth model key assumptions

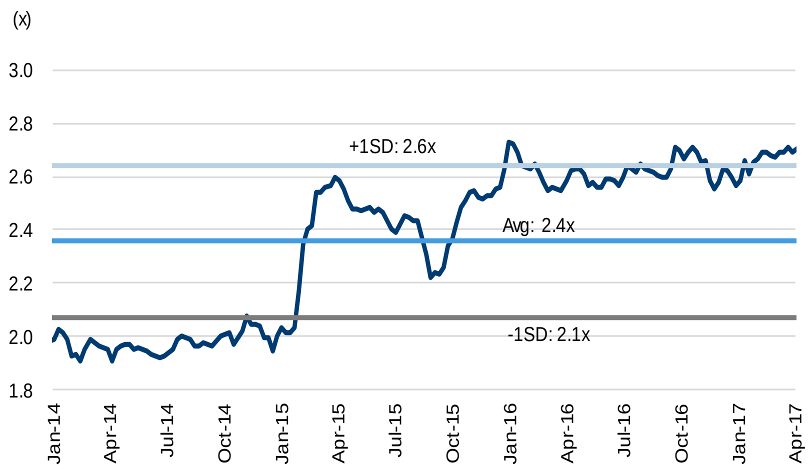
Assumptions	FY18E
Return on equity, ROE	15.1%
Growth, g	5.0%
Cost of equity, Ke	8.1%
P/BV	3.27

*P/BV = (ROE-g)/(Ke-g)

Source: Bloomberg, Affin Hwang forecasts

Though in recent years it has been trading in a range of 1.9x to 2.6x P/BV, we note that LPI's core ROE has been on an uptrend for the past few years, rising from 13.5% in 2014 to 16.3% in 2016. Therefore, we believe that applying historical P/BV averages will not justify how LPI could improve its profitability in the coming years based on its competitive advantage and key strengths.

Fig 19: Historical P/B multiple



Source: Bloomberg

ROE generation expected to remain robust at 15%

With decent growth in premiums, stable combined ratio and mid to long term support from favourable demographics, we expect LPI's ROE to remain strong at around 15% for the next few years. This is also partly aided by an efficient capital structure with its generous dividend distribution to the shareholders.

A well-deserved premium valuation due to bancassurance tie-up

We believe that LPI's premium is well-derserved due to its niche portfolio as the leading fire-insurer in Malaysia, tie-up with a strong bancassurance partner, superior profitability (ROE) and corporate governance standards. Moreover, the

FY17E dividend yield of approximately 4.0% could appeal to shareholders who favour consistent income.
In the past, P/BV multiples transacted for insurance M&A deals ranged from 1.4 to 4.5 times, with the average around 2.5 times. However, a closer look would reveal that deals which included a strong bancassurance partner like CIMB Aviva (20-years exclusive distributorship through CIMB Bank) or AmMet Life (20-years exclusive distributorship through AMMB's banking subsidiaries) were transacted at a 3 to 3.1 times P/B multiple, which is a significant premium compared to other deals without such arrangement (Fig 20).

Such premium is understandable as acquirers are willing to pay more to enjoy the significant market presence build via the bank branches and also to tap the bank's existing and prospective customers. In Public Bank, LPI benefits from one of the largest banking network in the country and an established franchise with strong foothold in the retail segment. While we understand that the bancassurance agreement between LPI and Public Bank is not exclusive, we believe investors should still appreciate the agreement due to their long standing relationship and common major shareholdings. Therefore, with a strong bancassurance partner we believe that our 3.3 times forward P/BV target is justifiable.

Fig 20: Major insurance mergers and acquisitions in recent years

Announced	Acquiree	Acquirer	Seller	Consideration/ implied consideration RMm	P/B times
2011	Berjaya Sompo Insurance Bhd	Sompo Holdings Inc	Berjaya Corp Bhd	1,240.00	3.3
2012	AmGeneral Insurance Bhd (formerly known as Kurnia Insurans Malaysia Berhad)	AMMB Holdings Bhd	KSK Group Bhd	1,550.00	2.0
2012	Pacific & Orient Insurance Co Bhd	Sanlam Ltd	Pacific & Orient Bhd	551.02	2.5
2013	AmMetLife Insurance Bhd, AmMetLife Takaful Bhd	AmBank M Bhd	Friends Life Group Ltd	816.67	1.7
2013	CIMB Aviva Assurance Bhd, CIMB Aviva Takaful Berhad	Sun Life Financial Inc, Khazanah Nasional Bhd	Aviva PLC, CIMB Group Holdings Bhd	1,800.00	3.0
2013	Gibraltar BSN Life (formerly known as Uni Asia Life Assurance Bhd)	Prudential Financial Inc, Bank Simpanan Nasional Bhd	United Overseas Bank Ltd, DRB-Hicom Bhd	518.00	1.4
2013	AmMetLife Insurance Bhd (formerly known as AmLife Insurance Berhad)	MetLife Inc	AMMB Holdings Bhd	1,624.00	3.1
2014	Liberty Insurance Bhd (formerly known as Uni.Asia General Insurance Berhad)	Liberty Mutual Holding Co Inc	United Overseas Bank Ltd, DRB-Hicom Bhd	549.93	1.6
2014	Multi-Purpose Insurans Bhd	Generali Asia	MPHB Capital Berhad	726.13	2.4
2016	MAA Takaful Berhad	Zurich Insurance Company Ltd	MAA Group Bhd, Solidarity Group	525.00	4.5
Average					2.5

Source: Bloomberg, Affin Hwang

Fig 21: Peer comparison

	Bloomberg Code	Rating	Price (RM)	TP (RM)	Mkt Cap (RMm)	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	N/R	12.72	N/R	2,211	Dec	11.7	10.7	13.6	5.1	1.4	11.6	10.9	0.8	0.9
LPI Capital Berhad	LPI MK	BUY	18.78	21.40	6,235	Dec	19.7	18.4	4.0	4.4	3.1	15.7	15.1	4.0	4.0
Tune Protect Group Bhd	TIH MK	N/R	1.44	N/R	1,083	Dec	14.6	13.3	-14.4	8.6	2.1	13.4	13.5	3.5	3.8
Syarikat Takaful Malaysia	STMB MK	N/R	3.99	N/R	3,284	Dec	15.3	14.0	11.1	9.2	4.2	24.9	23.0	2.8	2.9
Sector average					**13,776**		**15.3**	**14.1**	**3.6**	**6.8**	**2.7**	**16.4**	**15.6**	**2.8**	**2.9**

Source: Bloomberg, Affin Hwang forecasts

Note:
** Includes dilution of irredeemable convertible preference shares*

Key risks

Key downside risks would include:

i) Weaker-than-expected GWP growth;
ii) Price war triggered by the upcoming detariffication;
iii) Significant decline in the value of LPI's Public Bank's shareholdings

Appendices

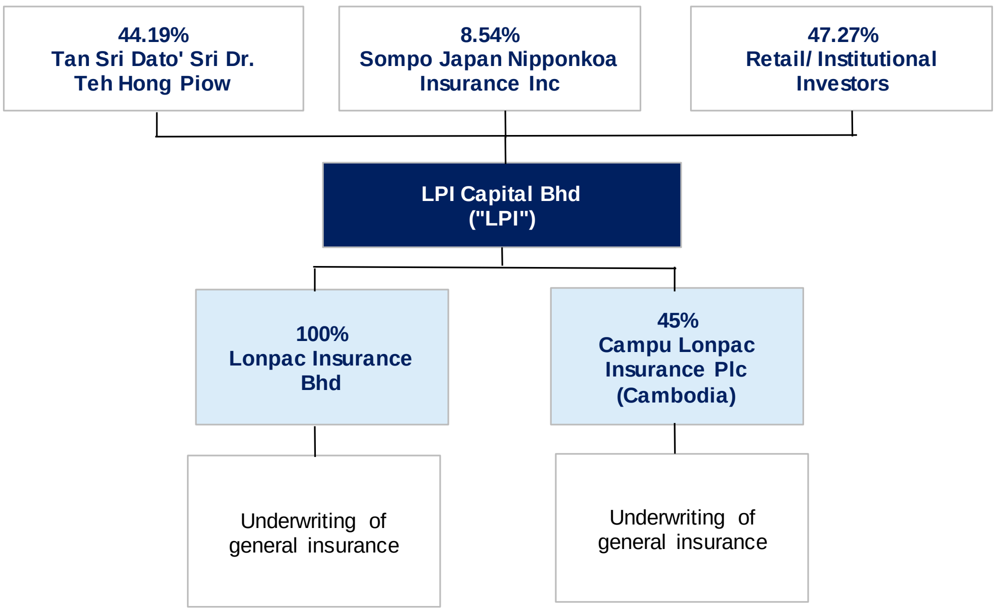
Appendix 1: Company profile

LPI Capital Bhd ("LPI") is a Malaysian-based investment holding company which provides general insurance principally through its wholly-owned subsidiary, Lonpac Insurance Bhd ("Lonpac"). Formerly known as London & Pacific Insurance Company Bhd, LPI was established back in 24 May 1962 as a private limited company and was registered as an approved insurer on 9 April 1963 under the Malaysian Insurance Act 1963. It was publicly listed on 8 January 1993 on the Second Board of the Malaysian stock exchange before being transferred to the Main Market of Bursa Malaysia Securities Berhad on 17 January 1997. LPI's insurance business was transferred to Lonpac through a rationalisation exercise conducted on 1 May 1999. (Source: Company)

Besides Malaysia, Lonpac also has presence in Singapore and Cambodia via its sole Singapore branch and Campu Lonpac Insurance Plc ("Campu Lonpac") respectively. Campu Lonpac is a joint venture between LPI (45%) and Public Bank Berhad ("Public Bank") (4%) and Public Bank's wholly-owned subsidiary, Cambodian Public Bank Plc (51%).

Malaysia operations remain the key revenue and earnings drivers as overseas contributions are minimal with the highly competitive Singapore insurance operations and the relatively small albeit fast growing Cambodia operations.

Fig 22: LPI shareholding and corporate structure



Source: Company

Appendix 2: Motor and fire liberalisation framework (detariffication)

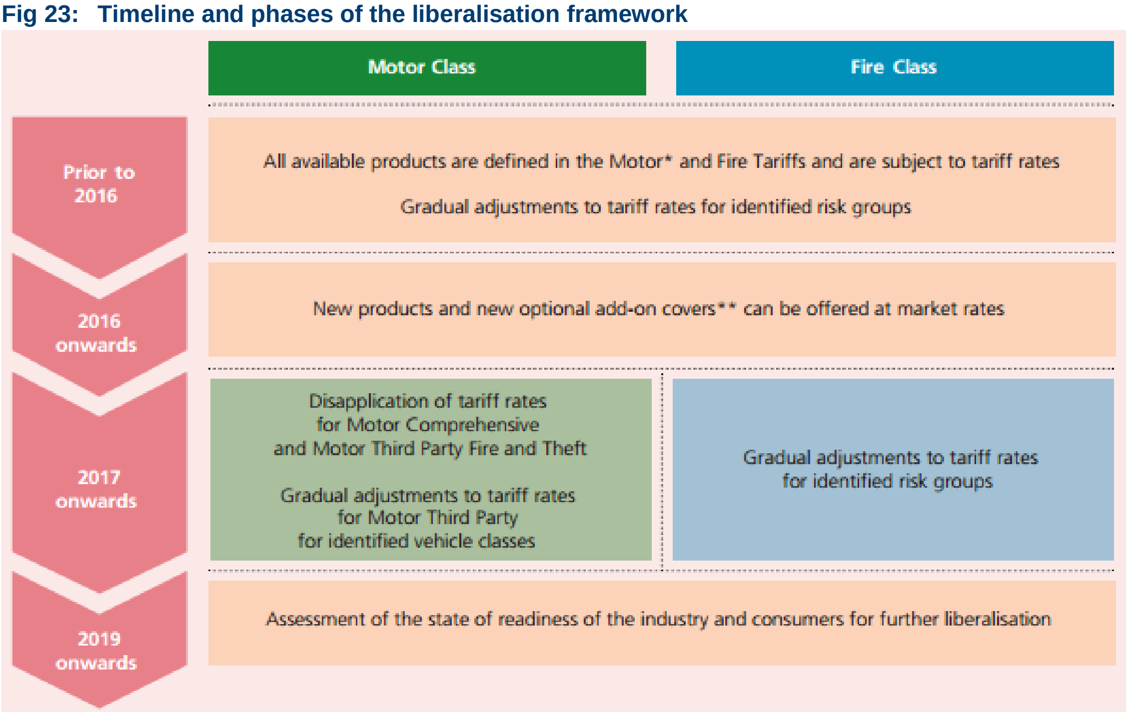
The need for a new model

Currently, insurance premiums for motor and fire insurance are regulated by tariffs. These tariffs essentially fix the premium rates which insurance companies can charge the consumers based on rudimentary factors such as car value (sum insured) and power of engine (cc). Such lack of price differentiation prevents effective industry competition and also prevent proper risk-pricing which often results in drivers of good behavior cross-subsiding reckless drivers.

A gradual liberalisation process

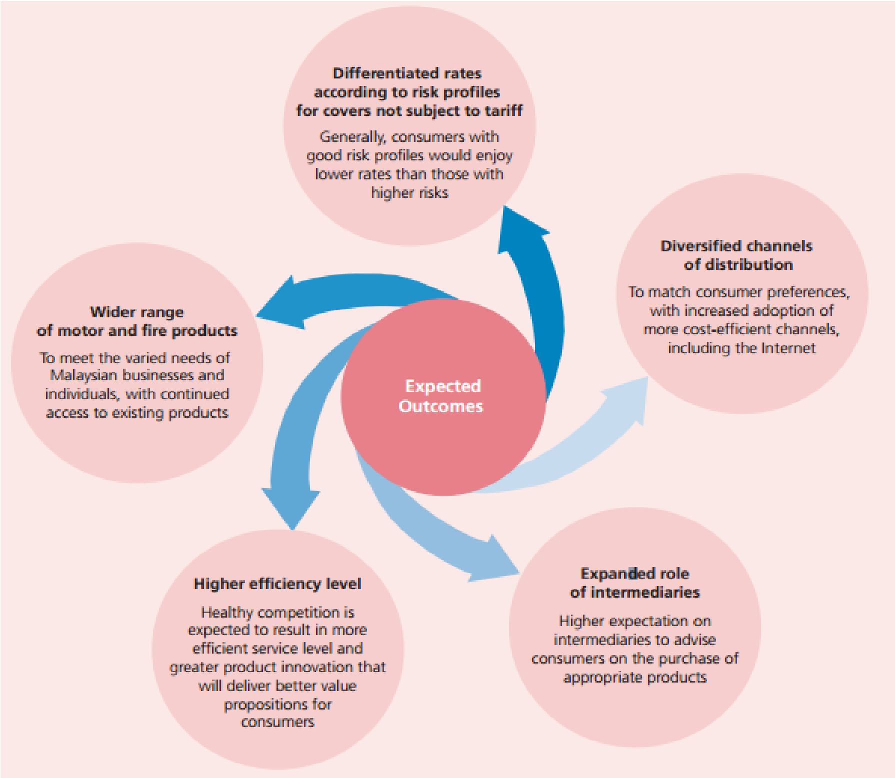
BNM first mooted the idea back in 2012 of industry liberalization by moving the tariff-based system to a risk-based system. It however has taken a gradual approach in order to prevent any risk of a system shock. The roadmap of the liberalization framework is as shown in Fig 23 below.

Fig 23: Timeline and phases of the liberalisation framework



Source: : Bank Negara Malaysia

Fig 24: Expected outcomes under the liberalisation framework



Source: Bank Negara Malaysia

The way forward – insurers to adopt more sophisticated risk-pricing model

Moving forward, the insurers will have to adopt a more sophiscticated risk-pricing model and policies would be priced based on risk factors such as age, occupation, purpose of use, location of residence etc. in addition to the usual car value and power of the engine. Accident records are also likely to be priced in beyond the current Non-Claims Discount. This would allow more equitable pricing and reduce the need of cross-subsiding between customer segments.

We note that under the framework, the third party policy segment will continue to be regulated by BNM with gradual adjustments over time, as insurers are currently paying out an average of RM2.26 in claims and related costs from 2010-2016 for every RM1 motor third party premium received. An immediate detariffication of motor third party premium rates could result in steep premium increases and the lower-income group in particular, will be largely affected.

Appendix 3: Key assumptions table

Fig 25: Key assumptions for fire segment

Fire	2015	2016	2017E	2018E	2019E	2020E
GWP growth (%)	14.3	5.4	7.0	7.0	8.0	8.0
NEP growth (%)	15.4	9.9	10.0	7.8	8.8	8.8
Retention ratio (%)	63.3	64.3	65.5	66.0	66.5	67.0
Net claims incurred ratio (%)	14.6	19.4	18.0	18.0	18.0	18.0
Net commissions ratio (%)	4.9	5.0	5.0	5.0	5.0	5.0
Underwriting surplus (%)	80.5	75.6	77.0	77.0	77.0	77.0

Source: : Company, Affin Hwang forecasts

Fig 26: Key assumptions for motor segment

Motor	2015	2016	2017E	2018E	2019E	2020E
GWP growth (%)	11.5	(4.1)	(2.0)	1.0	2.0	2.0
NEP growth (%)	11.4	8.6	(3.0)	1.0	2.0	2.0
Retention ratio (%)	81.7	80.8	80.0	80.0	80.0	80.0
Net claims incurred ratio (%)	76.8	64.5	75.0	75.0	75.0	75.0
Net commissions ratio (%)	8.2	7.8	8.0	8.0	8.0	8.0
Underwriting surplus (%)	15.0	27.6	17.0	17.0	17.0	17.0

Source: : Company, Affin Hwang forecasts

Fig 27: Key assumptions for MAT segment

MAT	2015	2016	2017E	2018E	2019E	2020E
GWP growth (%)	(4.9)	(4.2)	(5.0)	0.0	0.0	0.0
NEP growth (%)	0.7	26.4	(21.0)	0.0	0.0	0.0
Retention ratio (%)	13.7	18.0	15.0	15.0	15.0	15.0
Net claims incurred ratio (%)	22.0	41.2	25.0	25.0	25.0	25.0
Net commissions ratio (%)	(12.9)	(5.2)	(10.0)	(10.0)	(10.0)	(10.0)
Underwriting surplus (%)	90.9	64.0	85.0	85.0	85.0	85.0

Source: : Company, Affin Hwang forecasts

Fig 28: Key assumptions for miscellaneous segment

Miscellaneous	2015	2016	2017E	2018E	2019E	2020E
GWP growth (%)	3.9	5.0	5.0	5.0	5.0	5.0
NEP growth (%)	(5.8)	4.4	14.4	5.0	5.0	5.0
Retention ratio (%)	46.8	45.9	50.0	50.0	50.0	50.0
Net claims incurred ratio (%)	38.5	34.6	36.0	36.0	36.0	36.0
Net commissions ratio (%)	1.4	1.7	2.0	2.0	2.0	2.0
Underwriting surplus (%)	60.1	63.7	62.0	62.0	62.0	62.0

Source: : Company, Affin Hwang forecasts

Fig 29: Key assumptions for overall business

General insurance	2015	2016	2017E	2018E	2019E	2020E
GWP growth (%)	8.8	2.2	3.5	4.6	5.3	5.4
NEP growth (%)	8.1	8.5	6.0	4.9	5.7	5.8
Retention ratio (%)	58.6	59.5	60.8	61.0	61.3	61.6
Net claims incurred ratio (%)	41.0	38.3	39.9	39.2	38.6	38.0
Net commissions ratio (%)	4.8	5.0	4.9	4.9	4.9	4.9
Management expenses ratio (%)	20.8	20.4	20.0	20.0	20.0	20.0
Combined ratio (%)	66.6	63.7	64.8	64.1	63.5	62.8

Source: : Company, Affin Hwang forecasts

LPI Capital - FINANCIAL SUMMARY

Profit & Loss Statement

FYE Dec	2015	2016	2017E	2018E	2019E
Gross written premiums	1,250.8	1,278.3	1,322.4	1,383.6	1,457.4
Net earned premiums	**706.9**	**767.3**	**813.0**	**853.0**	**902.1**
Net claims incurred	(289.9)	(294.2)	(324.1)	(334.4)	(348.0)
Net commission expenses	(34.1)	(38.1)	(40.1)	(41.9)	(44.2)
Other expenses	(153.1)	(163.4)	(169.3)	(177.8)	(187.5)
Underwriting profit	**229.8**	**271.6**	**279.5**	**298.9**	**322.4**
Realised gains	76.2	150.3	-	-	-
Other investment gains	85.1	94.6	106.6	104.2	109.4
Associates' contribution	2.3	2.4	2.7	2.9	3.2
Finance costs	(0.4)	-	-	-	-
PBT	**393.1**	**518.9**	**388.8**	**406.0**	**435.0**
Tax	(72.1)	(81.7)	(85.5)	(89.3)	(95.7)
Net profit	321.0	437.2	303.3	316.7	339.3
Core net profit	**248.2**	**291.6**	**303.3**	**316.7**	**339.3**

Balance Sheet Statement

FYE Dec	2015	2016	2017E	2018E	2019E
Financial assets	1,705.1	2,389.6	2,233.9	2,356.8	2,494.8
Reinsurance assets	733.3	685.0	733.1	752.0	776.1
Other assets	1,186.9	581.4	879.6	920.3	967.2
Total assets	**3,625.3**	**3,656.1**	**3,846.6**	**4,029.1**	**4,238.1**
Insurance contract liab	1,654.0	1,609.5	1,663.9	1,694.8	1,735.6
Other liabilities	232.7	209.3	157.4	158.6	159.5
Total liab	**1,886.7**	**1,818.8**	**1,821.2**	**1,853.4**	**1,895.1**
Shareholders' Funds	**1,738.6**	**1,837.3**	**2,025.4**	**2,175.7**	**2,343.0**

Cash Flow Statement

FYE Dec	2015	2016	2017E	2018E	2019E
PBT	393.1	518.9	388.8	406.0	435.0
Non-cash adjustments	(155.2)	(236.3)	(100.2)	(97.8)	(103.1)
Working capital changes	101.7	(662.5)	254.2	(35.7)	(37.3)
Cash tax paid	(65.1)	(78.7)	(85.5)	(89.3)	(95.7)
Others	78.7	88.9	101.6	99.2	104.4
Cashflow from operation	**353.2**	**(369.8)**	**559.0**	**282.4**	**303.3**
Capex	(9.1)	(2.8)	(5.0)	(5.0)	(5.0)
Others	-	-	-	-	-
Cash flow from investing	**(9.1)**	**(2.8)**	**(5.0)**	**(5.0)**	**(5.0)**
Debt raised/(repaid)	(35.0)	-	-	-	-
Equity raised/(repaid)	-	-	-	-	-
Dividends paid	(188.1)	(249.0)	(265.6)	(249.0)	(265.6)
Others	(0.1)	-	-	-	-
Cash flow from financing	**(223.3)**	**(249.0)**	**(265.6)**	**(249.0)**	**(265.6)**
Free Cash Flow	**344.1**	**(372.6)**	**554.0**	**277.4**	**298.3**

Key Financial Ratios and Margins

FYE Dec	2015	2016	2017E	2018E	2019E
Growth					
Net written premium (%)	8.8	2.2	3.5	4.6	5.3
Gross written premium (%	8.8	2.2	3.5	4.6	5.3
Net earned premium (%)	8.1	8.5	6.0	4.9	5.7
Underwriting profit (%)	16.3	18.2	2.9	6.9	7.9
PBT (%)	14.9	32.0	(25.1)	4.4	7.1
Core net profit (%)	12.7	17.5	4.0	4.4	7.1
Profitability					
Net claims ratio (%)	41.0	38.3	39.9	39.2	38.6
Comms ratio (%)	4.8	5.0	4.9	4.9	4.9
Mgmt exp ratio (%)	20.8	20.4	20.0	20.0	20.0
Combined ratio (%)	66.6	63.7	64.8	64.1	63.5
Effective tax rate (%)	22.7	22.2	22.0	22.0	22.0
Core ROE (%)	14.6	16.3	15.7	15.1	15.0
Core ROA (%)	7.1	8.0	8.1	8.0	8.2
Liquidity					
Fin. assets over ins liab (x	1.9	2.6	2.4	2.5	2.6
Op. cash flow (RMm)	353.2	(369.8)	559.0	282.4	303.3
Free cashflow (RMm)	344.1	(372.6)	554.0	277.4	298.3
FCF/share (sen)	103.6	(112.2)	166.9	83.6	89.9
Investment statistics					
PER (X)	25.0	21.3	20.5	19.6	18.3
EPS (sen)	74.8	87.8	91.4	95.4	102.2
EPS growth rate (%)	12.4	17.5	4.0	4.4	7.1
BV/share (RM)	5.2	5.5	6.1	6.6	7.1
P/BV	3.6	3.4	3.1	2.9	2.6
Dividend payout (%)	72.4	60.7	82.1	78.6	78.3
NDPS (sen)	70.0	80.0	75.0	75.0	80.0
Net yield (%)	3.7	4.3	4.0	4.0	4.3

Segmental contribution (%)

FYE Dec	2015	2016	2017E	2018E	2019E
Net earned premium					
Fire	41.5	42.0	43.6	44.8	46.1
Motor	33.3	33.3	30.5	29.4	28.3
MAT	2.0	2.3	1.7	1.6	1.6
Miscellaneous	23.2	22.3	24.1	24.1	24.0
Underwriting surplus					
Fire	61.6	56.0	60.9	61.8	62.9
Motor	9.2	16.3	9.4	8.9	8.5
MAT	3.3	2.6	2.7	2.5	2.3
Miscellaneous	25.8	25.1	27.1	26.8	26.3

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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