midf RESEARCH

**10 July 2018 | 2QFY18 Results Review**

# LPI Capital Berhad

***New Challenge Emerging***

***Maintain* NEUTRAL**

***Unchanged* Target Price(TP): RM16.70**

## INVESTMENT HIGHLIGHTS

- **Results came in below expectations**
- **Operating revenue was mostly flat from last year**
- **We adjusted our earnings estimates for FY18, while maintaining our FY19's**
- **NEUTRAL with unchanged TP of RM16.70**

**Below expectation.** LPI Capital reported 2QFY18 net profit of RM65.7m, posting a decline of -3.4%yoy. Core profit grew marginally by +0.8%yoy to RM66.1m. For 1HFY18, core net profit grew +2.9%yoy to RM139.8m. Despite the improvement, earnings came in below ours and consensus expectations, accounting for 41.9% and 38.6% of full year estimates.

**Growth was challenged by business environment…** The group reported operating revenue of RM734.0m in 1HFY18, climbing up by +4.8%yoy. Accordingly, gross earned premium followed suit with parallel growth of +4.6%yoy to RM685.4m. It is worth noting that operating revenue climbed below our growth estimate of +10.3%yoy for 1HFY18. This could be due to more intense competition post liberalisation, putting pressure to premium growth.

**…but motor insurance was still the driver.** In 2QFY18, the growth of overall premium was largely driven by motor class. It grew by +12.1%yoy, outperforming fire segment which recorded only a +3.1%yoy growth. Motor and fire classes represent 31.1% and 43.5% of overall net earned premium respectively. We believe improvement on the group's overall earnings is possible given the group's strong business presence in both segments.

**However, investors should be warry of higher claim expenses.** LPI's net claims incurred were recorded +9.3%yoy higher in 2QFY18 to RM92.2m. This was attributable to higher motor and miscellaneous insurance claims by +13.9%yoy and +42.6%yoy respectively. Overall, this translated to loss/claims ratio of 41.0% for the group, which was +1.3ppts yoy higher from the same period last year. Moving forward, we believe that the risk of volatile loss ratio is likely to be minimized. This is following the group's selective risk underwriting for its motor class following the phased liberalisation.

**Resulting to higher combined ratio.** The group's combined ratio recorded a net increase of +1.9ppts yoy, from 67.5% in 2QFY18. This was due to the surge in the group's overall claim expenses, which translated to a -1.9ppts yoy drop in the group's 2QFY18 underwriting margin. However, in 1HFY18, we noted that combined ratio remained flat at 67.1% from last year.

| RETURN STATS | |
|---|---|
| Price (9 July 2018) | RM17.00 |
| Target Price | RM16.70 |
| Expected Share Price Return | -1.8% |
| Expected Dividend Yield | 4.1% |
| **Expected Total Return** | **+2.2%** |

| STOCK INFO | |
|---|---|
| KLCI | 1,672.63 |
| Bursa / Bloomberg | 8621 / LPI MK |
| Board / Sector | Main / Finance |
| Syariah Compliant | No |
| Issued shares (mil) | 398.4 |
| Par Value (RM) | 1.00 |
| Market cap. (RM'm) | 6,772.5 |
| Price over NA | 3.41x |
| 52-wk price Range | RM14.53– RM17.50 |
| Beta (against KLCI) | 0.47x |
| 3-mth Avg Daily Vol | 0.06m |
| 3-mth Avg Daily Value | RM1.02m |
| Major Shareholders (%) | |
| Consolidated The Hldgs | 42.74 |
| Sompo Holdings Inc | 8.54 |
| Hong Piow Teh | 1.41 |

**Underwriting surplus grew** at an average of +2.3%yoy in 2QFY18. The growth was driven by Fire and MAT segments, climbing up by +10.4%yoy and +10.9%yoy respectively. This was moderated by motor and miscellaneous due to higher net claims incurred in the quarter.

**The group declared 26 sen dividend.** The group announced 26 sen dividend, to be payable on 1st August 2018. This represented 75.0% of the group's net profit. Comparatively, 1HFY17 interim dividend payout ratio was 62.5% or 27 sen.

**Impact to earnings.** Given that earnings came in below our expectation, we revise downwards our estimate for FY18. Accordingly, we lower our FY18 operating revenue growth forecast to +7.8%yoy, taking into account potential contraction in premiums. Following this, our core net profits assumption shrank by -9.2% from our previous estimate. At this juncture, we are maintaining our forecasts in FY19, due to our assumption of more stable operating environment next year while remaining conservative on revenue growth.

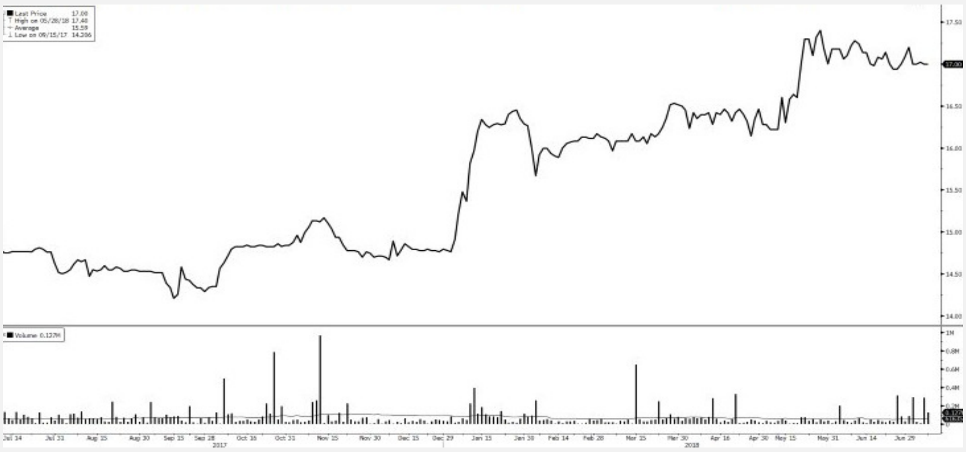
**Recommendation.** We opine that the group will be able to improve its performance primarily due to its strong presence, in fire and motor insurance segments. While we remain optimistic, we believe the industry's headwinds post liberalisation will continue to be a challenge which will put pressure on further growth. Taking that into account, we are maintaining our **NEUTRAL** call on the stock with an unchanged TP at **RM16.70** pegging the **EPS** to **PER** of **19x**. We opine the group will be able to continue strengthen its market share in the general insurance market, supported by the group's standing as the country's largest property underwriter. This will likely provide strong revenue base for the group moving forward.

## INVESTMENT STATISTICS

| FYE Dec | FY15 | FY16 | FY17 | FY18F | FY19F |
|---|---|---|---|---|---|
| **Operating Revenue** | 1284.6 | 1378.9 | 1470.6 | 1584.7 | 1663.2 |
| **Net earned premiums (RM'm)** | 706.9 | 767.3 | 850.2 | 873.3 | 946.8 |
| **Operating profit (RM'm)** | 391.1 | 516.5 | 401.3 | 508.0 | 558.6 |
| **Pre-tax profit** | 393.1 | 518.9 | 403.7 | 509.0 | 559.7 |
| **Core net profit** | 244.8 | 289.2 | 310.8 | 305.0 | 358.0 |
| **Vs. consensus estimate (RM'm)** | | | | 358.0 | 379.6 |
| **Core EPS (sen)** | 61.4 | 72.6 | 78.0 | 76.6 | 89.9 |
| **Recurring EPS growth (%)** | 11.7 | 18.1 | 7.5 | -1.9 | 16.8 |
| **PER (x)** | 27.7 | 23.4 | 21.8 | 22.2 | 19.0 |
| **Net Dividend (sen)** | 70.0 | 80.0 | 72.0 | 75.0 | 70.0 |
| **Net Dividend Yield (%)** | 4.1 | 4.7 | 4.2 | 4.4 | 4.1 |
| **BVPS (RM)** | 4.4 | 4.6 | 4.8 | 4.9 | 5.3 |
| **PBV (x)** | 3.9 | 3.7 | 3.5 | 3.5 | 3.2 |
| **ROE (%)** | 14.1 | 15.6 | 16.2 | 15.4 | 16.9 |
| **ROA (%)** | 6.8 | 7.8 | 8.1 | 7.6 | 8.5 |

*Source: Company, MIDFR*

**DAILY PRICE CHART**



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*Source: Bloomberg, MIDFR*

**2QFY18 RESULTS SUMMARY**

| FYE Dec (RM'm) | Quarterly Results | | | | | Cumulative | | |
|---|---|---|---|---|---|---|---|---|
| | 2Q18 | 2Q17 | 1Q18 | YoY | QoQ | 6M18 | 6M17 | YoY |
| **Operating revenue** | **353.0** | **352.7** | **381.0** | **0.1%** | **-7.3%** | **734.0** | **700.4** | **4.8%** |
| Gross earned premiums | 335.6 | 336.7 | 349.7 | -0.3% | -4.0% | 685.4 | 655.0 | 4.6% |
| **Net earned premiums** | **225.1** | **212.5** | **216.4** | **6.0%** | **4.0%** | **441.5** | **391.6** | **12.7%** |
| Investment income | 17.4 | 16.0 | 31.3 | 9.0% | -44.3% | 48.7 | 45.4 | 7.2% |
| Realised gains and losses | 0.0 | 2.5 | -0.1 | N.A | -101.4% | -0.1 | 2.8 | -102.4% |
| Fair value gains and losses | -0.4 | 0.0 | -1.0 | N.A | N.A | -1.4 | 0.0 | #DIV/0! |
| Commission income | 25.6 | 26.7 | 31.1 | -4.3% | -17.8% | 56.7 | 57.1 | -0.7% |
| **Other income** | **43.7** | **46.4** | **61.3** | **-5.8%** | **-28.7%** | **108.8** | **107.3** | **1.3%** |
| Gross claims paid | -102.2 | -124.6 | -139.9 | -18.0% | -26.9% | -242.1 | -225.8 | 7.2% |
| Claims ceded to reinsurers | 26.1 | 49.5 | 47.2 | -47.3% | -44.8% | 73.2 | 78.8 | -7.0% |
| Gross change to contract liabilities | -110.9 | 9.7 | 4.9 | -1243.4% | -2368.6% | -106.0 | -5.6 | 1790.8% |
| Change in contract liabilities ceded | 94.8 | -18.9 | -14.1 | -602.0% | -772.9% | 80.7 | -3.0 | -2748.2% |
| **Net claims incurred** | **-92.2** | **-84.4** | **-101.9** | **9.3%** | **-9.5%** | **-194.1** | **-155.7** | **24.6%** |
| Commission expenses | -39.3 | -38.4 | -39.0 | 2.4% | 0.9% | -78.3 | -73.8 | 6.0% |
| Management expenses | -50.2 | -47.4 | -48.6 | 5.9% | 3.4% | -98.8 | -92.9 | 6.4% |
| **Other expenses** | **-90.3** | **-85.8** | **-87.6** | **5.2%** | **3.1%** | **-179.2** | **-166.7** | **7.5%** |
| **Operating profit** | **86.3** | **88.7** | **90.7** | **-2.7%** | **-4.8%** | **177.0** | **176.5** | **0.3%** |
| Share of associates and JV | 0.6 | 0.5 | 0.9 | 10.1% | -37.9% | 1.5 | 1.5 | -3.5% |
| **Profit before tax** | **86.9** | **89.2** | **91.6** | **-2.6%** | **-5.1%** | **178.5** | **178.0** | **0.2%** |
| Taxation | -21.1 | -21.2 | -19.1 | -0.1% | 10.8% | -40.2 | -39.4 | 2.1% |
| **Net profit** | **65.7** | **68.1** | **72.5** | **-3.4%** | **-9.3%** | **138.2** | **138.6** | **-0.3%** |
| **Core net profit** | **66.1** | **65.6** | **73.6** | **0.8%** | **-10.2%** | **139.8** | **135.8** | **2.9%** |
| Core EPS | 16.6 | 16.5 | 22.2 | 0.8% | -25.1% | 35.1 | 34.1 | 2.9% |

*Source: Bloomberg, MIDFR*

| | 2Q18 | 2Q17 | 1Q18 | +/- ppts | +/- ppts | 6M18 | 6M17 | +/- ppts |
|---|---|---|---|---|---|---|---|---|
| Claims ratio | 41.0% | 39.7% | 47.1% | 1.3 | -6.1 | 44.0% | 39.8% | 4.2 |
| Management expense ratio | 22.3% | 22.3% | 22.5% | 0.0 | -0.1 | 23.0% | 23.0% | 0.0 |
| Commission ratio | 6.1% | 5.5% | 3.6% | 0.6 | 2.5 | 4.3% | 2.8% | 1.5 |
| **Combined ratio** | **69.4%** | **67.5%** | **73.2%** | **1.9** | **-3.8** | 67.1% | 67.1% | 0.0 |
| Retention ratio | 67.1% | 63.1% | 61.9% | 4.0 | 5.2 | 64.4% | 59.8% | 4.6 |
| Underwriting margin | 30.6% | 32.5% | 26.8% | -1.9 | 3.8 | 32.9% | 32.9% | 0.0 |

| Segmental breakdown | | | | | |
|---|---|---|---|---|---|
| | 2Q18 | 2Q17 | 1Q18 | YoY | QoQ |
| **Net earned premiums (RM'm)** | | | | | |
| Fire | 98.0 | 95.0 | 91.9 | 3.1% | 6.6% |
| Motor | 69.9 | 62.4 | 66.7 | 12.1% | 4.9% |
| Marine, aviation & transit | 4.6 | 5.6 | 5.0 | -18.3% | -8.3% |
| Miscellaneous | 52.7 | 49.4 | 52.8 | 6.5% | -0.3% |
| **Net claims incurred (RM'm)** | | | | | |
| Fire | -9.2 | -15.3 | -17.4 | -40.2% | -47.5% |
| Motor | -53.5 | -47.0 | -56.5 | 13.9% | -5.2% |
| Marine, aviation & transit | -0.9 | -2.0 | -0.7 | -55.4% | 24.7% |
| Miscellaneous | -28.6 | -20.1 | -27.2 | 42.6% | 5.3% |
| **Net claims incurred (%)** | | | | | |
| Fire | 9.3% | 16.1% | 19.0% | -6.8 | -9.6 |
| Motor | 76.6% | 75.3% | 84.8% | 1.2 | -8.2 |
| Marine, aviation & transit | 19.0% | 34.9% | 14.0% | -15.8 | 5.0 |
| Miscellaneous | 54.4% | 40.6% | 51.5% | 13.8 | 2.9 |
| **Net commission (RM'm)** | | | | | |
| Fire | -5.9 | -4.6 | -5.2 | 28.1% | 14.1% |
| Motor | -6.0 | -4.9 | -6.1 | 22.8% | -2.6% |
| Marine, aviation & transit | 0.1 | -0.2 | 0.8 | -165.5% | -83.1% |
| Miscellaneous | -2.0 | -2.0 | 2.7 | -1.0% | -173.6% |
| **Underwriting surplus* (RM'm)** | | | | | |
| Fire | 82.9 | 75.1 | 69.3 | 10.4% | 19.6% |
| Motor | 10.4 | 10.5 | 4.0 | -0.9% | 159.8% |
| Marine, aviation & transit | 3.8 | 3.5 | 5.1 | 10.9% | -24.5% |
| Miscellaneous | 22.0 | 27.4 | 28.3 | -19.5% | -22.1% |

*Source: Bloomberg, MIDFR*

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| MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS | |
|---|---|
| **STOCK RECOMMENDATIONS** | |
| BUY | Total return is expected to be >10% over the next 12 months. |
| TRADING BUY | Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow. |
| NEUTRAL | Total return is expected to be between -10% and +10% over the next 12 months. |
| SELL | Total return is expected to be <-10% over the next 12 months. |
| TRADING SELL | Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow. |
| **SECTOR RECOMMENDATIONS** | |
| POSITIVE | The sector is expected to outperform the overall market over the next 12 months. |
| NEUTRAL | The sector is to perform in line with the overall market over the next 12 months. |
| NEGATIVE | The sector is expected to underperform the overall market over the next 12 months. |