28 January 2010

Thailand | Insurance

Bangkok Life Assurance

SET | Reuters | Bloomberg
BLA | BLA.BK | BLA TB

CG Rating 2008
n.a. | n.a.

BUY
(unchanged)
Price (26 January 2010)
Bt22.50

12-month target price
Bt26 (+16%)

Company Update

Still some upside to go –TP raised to Bt26

Impressive share price run and more room to go; maintain BUY
BLA's stock price has shot up by 67% since the IPO in Sep '09 and outperformed the market by 33% for the YTD, but we believe it still has room left for further appreciation. Based on the assumption of a faster economic recovery, higher investment yield and reduced regulatory pressure we have therefore raised our target price to Bt26 (the upper end of our previous TP range was Bt22).

Rainsing premium growth forecast for 2010 to 25%
To reflect the more favourable economic backdrop, our in-house forecast for real GDP growth was recently raised to 3.9% for 2010. We are also targeting 15% net premium growth YoY at the industry level. Our view that BLA is poised to exceed the insurance industry's average growth rate is unchanged. This is based on the company's superior bancassurance channel with first year and renewal year premium growth projected at 30% and 22% YoY respectively.

New rules on capital in 2011 should have little impact
We maintain our view that some form of risk-based capital requirement rules will be implemented by the industry regulator next year. However, we doubt that BLA will be hampered by a lower growth ceiling that could result from an increase in the capital required to back up a unit of risk. A delay in the industry's adoption of the IAS 39 accounting standard until 2013 should also ease the pressure on reported profits.

New TP of Bt26 implies a 16% upside and 20% total return
To better reflect the characteristic life insurance product as a super-long life financial product, we have changed our valuation basis to the embedded value method. Assuming a P/EV rating of 1.6x (based on a 20% discount for Thailand's PER to the MSCI Asia ex-Japan multiple), we valued BLA at Bt26. Potential risk factors include: 1) more stringent regulatory rules regarding capital/solvency risk; and 2) increased competition from rival insurers backed by other leading domestic banks.

CONSOLIDATED FINANCIAL SUMMARY

Year	2006	2007	2008	2009F	2010F	2011F
Net written premiums	10,434	12,296	14,732	19,135	23,856	29,752
NWP growth (%)	12.9	17.8	19.8	29.9	24.7	24.7
Net profit (Bt, m)	652	770	752	1,172	1,622	2,181
Net profit growth (%)	66.1	18.0	(2.4)	55.9	38.4	34.5
EPS (Bt)	0.65	0.77	0.75	1.10	1.35	1.82
EPS growth (%)	66.1	18.0	(2.4)	46.1	23.0	34.5
EV per share (Bt)	n.a.	10.3	n.a.	14.3	16.0	19.4
BVPS (Bt)	3.3	3.1	3.0	6.8	7.2	8.6
DPS (Bt)	0.25	1.00	0.29	0.41	0.55	0.74
Yield (%)	n.a.	n.a.	n.a.	1.8	2.4	3.3

Note : use average price for historical PER, PBV, Yield

SHARE SUMMARY

Price:	
52-week high	Bt23.30
52-week low	Bt13.50
52-week average	Bt16.72

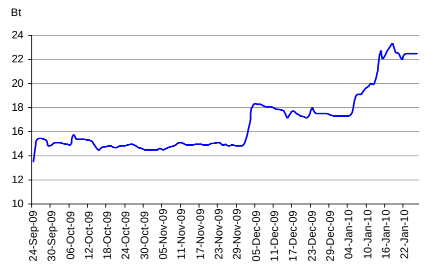
Stock data:	
Issued shares:	1,200.0m
Par value:	Bt1.0
Market capitalization:	Bt27.0bn
Market capitalization:	US$816.9m
Avg. Daily Turnover:	Bt103.2m
Avg. Daily Turnover:	US$3.0m
Foreign Limit:	25.0%
Foreign Ownership:	25.0%
Free Float:	31.1%
NVDR:	5.69%
Beta (3 years)	-0.01X

TISCO's forecast vs. consensus

EPS (Bt)	TISCO	Consensus	% Diff.
2010F	1.35	1.23	10.2
2011F	1.82	1.42	28.4

Major Shareholders (27/11/09)	
Nippon Life Insurance Co	20.8%
Wattanasophonpanich Co Ltd	13.3%
Bangkok Bank	7.7%
Bangkok Insurance	5.3%
Chatri Sophonpanich	3.8%

PRICE / PRICE RELATIVE



Source: Reuters

Performance (%)	-1m	-3m	-12m
BLA	27.84	52.03	n.a.
SET	(3.51)	(1.80)	60.66

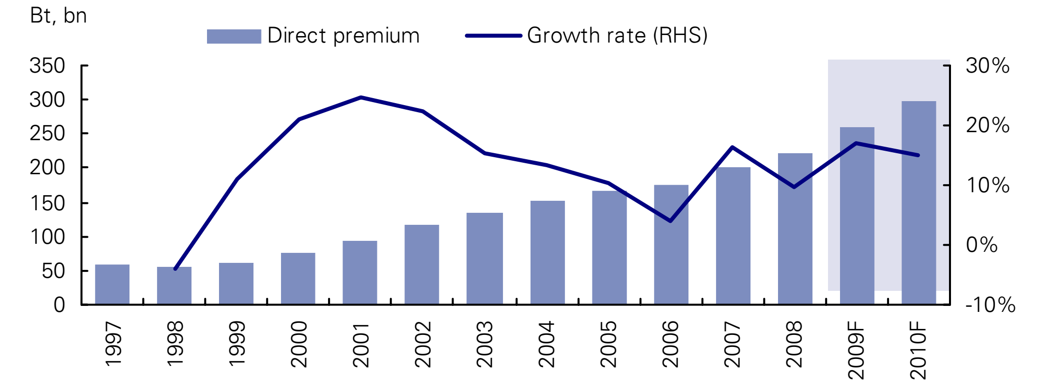
Miti Chinvaravatana
(66) 2633 6469
miti@tisco.co.th

Expecting another year of outperformance

Sector overview: we prefer life to non-life insurers
We are upgrading our target price for BLA also in the light of our preference for life over non-life insurers. In our view fundamentals for life insurance companies are more robust on both a short and long-term horizon because:

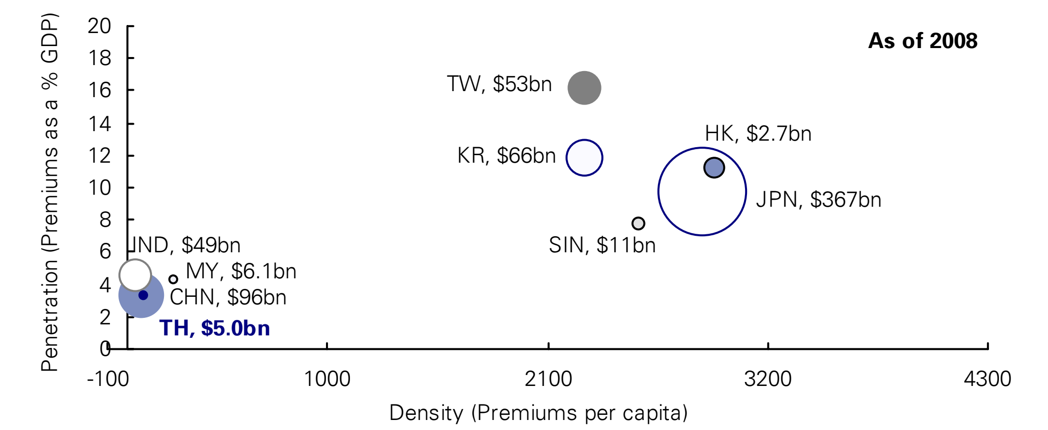
1. The performance of life insurers is more sensitive to a recovery in GDP growth.
2. Long-term trends such as an increase in the personal savings rate per capita are supportive of life insurance dynamics. Also some government policies support L/T savings-related instruments e.g. tax benefits in the form of increased tax deductibility have been introduced for life insurance policies, LTF and RMF funds etc.
3. Non-life insurers with greater exposure to short-duration equity investments can benefit more from rising equity markets but only in the short run.

Figure 1. L/T trend supports sustainable 5-year Cagr of 15%



Sources: Thai Life Assurance Association (TLAA), TISCO Research

Figure 2. Low penetration rate in both absolute and relative terms



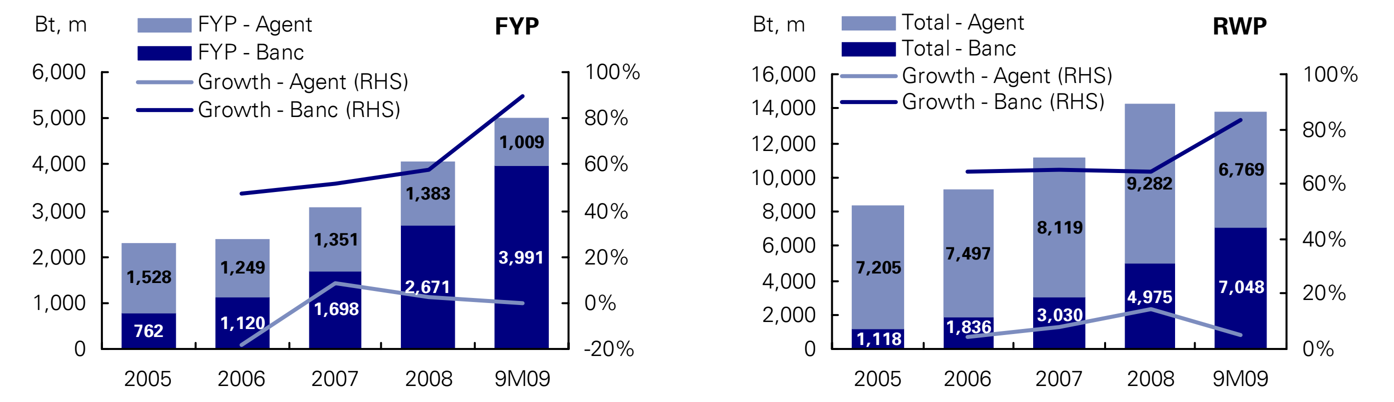
Sources : Swiss Re, TISCO Research

25% premium growth is anticipated this year
Life insurers had a stellar year in 2009. At the industry level, premium growth was 16.8% YoY for 11M09 and we expect 2009 growth to end above 17% given the strong momentum. In the light of last year's rapid pace and our forecast of 3.9% GDP growth for 2010, we have raised our projection for growth in gross premiums written by BLA from 16% to 25%. This rate is also applicable to net premiums written, since a cede rate of c.150bp is minimal.

BLA pared down its drive for premium growth after registering 60% YoY growth in 1Q09 and as of 11M09 its premium growth was 30%. This rate should be applicable for the whole year and we estimate its premiums totalled Bt19bn. For 2010, we project a net premium growth rate of 25% YoY to Bt24bn. We anticipate a continued out-performance for first year premiums (FYP) with growth forecast at 30% YoY. This is comparable to the pace in 2008 but well below last year's estimated 50% growth rate. In absolute terms this amounts to FYP of Bt8bn. The remaining Bt16bn of our forecast is for Renewal Year Premiums (RWP). This implies an expected growth rate for RWP of 22%.

We anticipate another large contribution from the bancassurance channel with management guidance suggesting very strong growth in the range of 50% YoY. On the other hand, we think that the agent channel growth rate is likely to be closer in line to the industry rate of 10-15%. Assuming that a 50% growth rate for the bancassurance channel is achievable, then our projection of 30% growth for FYP in 2010F appears to be conservative. Considered together with BLA's expectation that 75-80% of premiums will come from this channel, the FYP growth rate could be 40% or higher.

Figure 3. Bancassurance is now the growth engine for both FYP and RWP



Sources: BLA, TISCO Research

Sources: BLA, TISCO Research

Higher level of provisioning is normal given business growth
The most volatile expense in 2009 was the "increase in premium reserve" which rose from the 50% level in 2008 to 64% in 3Q09. This reflects an additional provisioning requirement for the savings component of BLA's endowment policies. This high 64% reserve level made the 3Q09 P&L look rather ugly, with an underwriting margin of -6%. However, we regard this as a cosmetic exercise since it is a non-cash item and the reserve capital can be employed for investment returns.

Our expectation of sustainably high earnings growth (a Cagr of 25% for 2010-12F), is another cause of the high level of reserves that we have forecast. As to when this 60%+ reserve margin will decline, this would happen only in the unlikely case that BLA stops selling endowment products through the bancassurance channel.

For profitability, focus on Investment-Net loss spread
Though insurers tend to focus on the Investment-Operating expense spread, we prefer to look at the Investment-Net loss spread (inclusive of both underwriting and operating expenses) to directly determine near-term accounting profitability.

We forecast an underwriting loss of Bt600m for 2010 which in terms of underwriting margin is -2.5%. This implies some deterioration from our 2009F forecast of -1.8%. The setting aside of premium reserves and high acquisition costs are again behind our forecast of the underwriting loss. Including corporate operating expenses, we expect the net loss to widen to Bt1.8bn in 2010F from Bt1.5bn in 2009F. But as long as premium growth is visible and returns from investments are adequate, we would not be too worried by this. Note that in terms of total net loss margin to net written premium (NWP), the projected net loss for 2010F is almost constant at -7.7% despite the bigger underwriting loss. We assume that increased economies of scale will reduce the expenses margin as NWP growth gains traction.

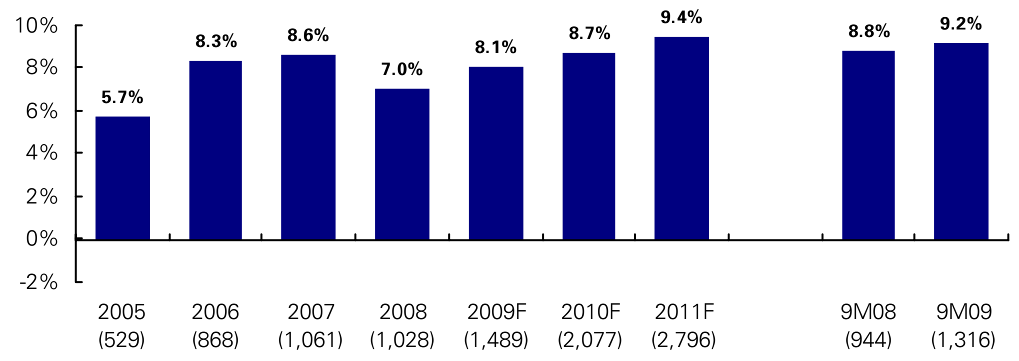
Higher returns on investments are anticipated
Our in-house forecast for a 1% rise in the Bank of Thailand's policy rate to 2.25% this year with a flattening yield curve (though both ends should shift up), should be more

accommodating for BLA's investment portfolio. Though yield flattening is not the most ideal condition, the rising back end will allow for higher returns on investments.

We estimate the company's RoI will expand by about 30bp to 5.6% or roughly Bt4bn. Subtracting net expenses of Bt1.8bn, we arrived at an estimate of Bt2bn for EBT, which is 35% higher YoY. This implies an Investment-Net Expense gap of +8.7% to net premiums and we further expect spread improvement of about 70bps YoY going into 2011, as the size of BLA's investment asset base expands at a faster pace than its underwriting loss.

Our net profit growth rate forecast for 2010 is 38% YoY leading to a total sum of Bt1.6bn. This rate is higher than our EBT growth rate since BLA is entitled to 25% tax rate for the next 3 years due to its newly listed status.

Figure 4. Investment-Net loss spread (absolute amount in brackets)



Sources: BLA, TISCO Research

2009F result summary

Our 2009F net profit forecast of Bt1.17bn is below the consensus estimate of Bt1.3bn due to higher premium reserves (effectively 59% of net premiums written for 2009F), lower investment income due to dividend seasonality and the back loading of unamortisable expenses (e.g. bonuses) in the final quarter. We estimate the Investment-Net loss spread to be about Bt1.5bn or 7.8% of NWP, up from 7% in 2008 because of a turnaround (from negative to positive) in realised gains from securities. Our net profit forecast represents an increase of 56% YoY (basic EPS growth 46% YoY).

Our forecasts for notable balance sheet items include:

1. Bt65bn in investments inclusive of cash and loans covering the Bt53bn policy reserve at a 120% ratio.

2. Bt1bn in unrealised gains on securities.

Regulatory issues: risk-based capital and accounting standards

Our Nov '09 view of the impending (2011) change in the regulatory landscape still stands. RBC will be implemented but insurers under our coverage already hold sufficient capital to allow them to write premiums at multiples over our 2010F targets. Some smaller insurers are likely to have to raise capital but we do not think that the competitive landscape will change much for the leading players. In the case of BLA, its direct competitors are insurers with parent banks and they too have abundant capital.

The delay in applying the IAS-39 accounting standard until 2013 will have no impact on calculations of solvency and thus the ability to expand premiums. The likelihood of increased earnings and/or shareholder's equity volatility would be deferred until adoption. One minor concern is BLA's net liabilities duration (about five years). Given that it is not symmetrically 'hedged' by equal asset duration, there will be some negative pressure on its stated accounts during the interest down cycle when IAS-39 is implemented.

Valuation – Switching to Embedded Value

Rationale

We have switched our valuation method for life insurers from the P/BV multiple to Embedded Value (EV) method, as this is more in line with a life insurance policy's characteristic of a super-long financial product. The easiest way to consider EV is to compare it with life insurance's DCF.

We acknowledge that bottom line net profit is the most tangible metric especially for investors with an outlook shorter than the 20+ years of a typical insurance policy, but insurers with high growth will experience artificially low earnings due to the so-called 'New Business Strain.' That is to say even though profitable business (at the NPV level) is being written, underwriting profit on an accounting basis will appear worse than the economic reality during the first year, because acquisition costs are 100% expensed (solvency will also take an immediate but revertible hit). For example, BLA's break-even NPV on an 'average' policy occurs in the third year.

Summary of EV methodology

Two main schools of EV valuation apply for insurers: Appraisal Value and P/EV multiple. The underlying logic is fundamentally the same, but we prefer the market-based logic of the latter since the 'new business multiple' component of Appraisal Value requires making arbitrary terminal growth assumptions that are impossible to verify in such a high-growth industry.

Embedded value is divided into the Adjusted Net Asset Value (ANAV) and Present Value of Future Profits (PVFP).

ANAV = Equity + Adjustments

Future profit is essentially statutory profit (i.e. for the existing business ***only)*** less the required increase in regulatory capital to maintain solvency.

PVFP = ∑ PV(Statutory profit adjusted for 'frictional' increase in regulatory capital)

In theory, BLA deserves a multiple of at least 2.0x if one applies the regional multiple deserving of a 25% NWP growth rate and assuming an unchanged new business margin. (At the extreme, the likes of China's Ping An trades on an EV of nearly 2.6x with EV growth of 20%). However, assigning a 2.0x multiple would be to ignore the 'cheapness' of Thai equities compared with typical regional stocks.

Hence we assumed a 20% discount (i.e. the SET index's PER discount to the MSCI Asia ex-Japan multiple) and applied a 1.6x P/EV multiple to BLA as the company's EV could reach Bt23/share by 2012 if it can achieve 25% NWP growth p.a. for the next three years. In our view this is not unrealistic given that it recorded NWP growth of 30% in 11M09 despite some extremely unfavourable macro factors.

Valuation

We derived a 2010F EV estimate of Bt19bn or Bt16/share. Multiplying this by 1.6x, we arrive at our target price of Bt26.

Figure 5. Embedded Value

	2009	2010F
Balance sheet equity	7,234	8,609
Cost of solvency capital	(1,824)	(2,421)
Minor intangibles removal	(17)	(13)
ANAV	5,393	6,175
PV(Statutory profits)*	9,407	12,967
Value of tax-relief	n.a.	n.a.
PVFP	9,407	12,967
EV	14,800	19,142
EV per share		16
P/EV multiple		1.6
Company value per share		25.5
Rounding adjustments		0.5
Target price		**26**

Note: * Adjusted for frictional cost of solvency capital
Sources: TISCO Research

Risk factors

These fall into two categories. On the operating side, lower bond yields (particularly on longer-term maturities), which would reduce investment yields. Also, stepped-up competition from rival insurance firms backed by the leading domestic banks, and a sharp rise in inflation. On the regulatory side, the main risk is if stricter than expected RBC rules are applied in 2011. In addition the early adoption of IFRS accounting standards could affect the industry. The primary impact would be the IAS-39 requirement of a mark-to-market valuation of its investment portfolio. A lower yield curve could have a negative impact given BLA's net liabilities duration. Expanding credit spreads could also have a negative impact on embedded value.

CONSOLIDATED INCOME STATEMENT (Bt, m)

	Year Ended December 31,				
	2007	2008	2009F	2010F	2011F
Net premiums written	12,296	14,732	19,135	23,856	29,752
Net investment income	1,985	2,430	2,773	3,834	4,893
Gains on investments in securities	131	(359)	229	50	50
Other income	15	26	21	30	35
Total revenue	14,427	16,829	22,158	27,770	34,730
Life policy reserve increase	6,230	7,670	11,292	14,314	17,851
Benefit payments	4,278	4,926	5,449	6,975	8,773
Commissions	1,787	1,985	2,383	2,743	3,421
Other underwriting expenses	188	262	363	412	504
Personnel expenses	426	490	560	621	681
Premises and equipment expenses	101	108	120	122	124
Other operating expenses	356	360	449	504	577
Total expenses	13,366	15,801	20,617	25,692	31,933
Income tax	291	277	370	457	615
Extraordinary items	0	0	0	0	0
Net profit	**770**	**752**	**1,172**	**1,622**	**2,181**

KEY FINANCIAL RATIOS (%)

	Year Ended December 31,				
	2007	2008	2009F	2010F	2011F
Premium receivable (days)	29.7	27.1	23.5	22.4	21.3
Gross profit margin (%)	14.5	14.5	12.5	10.7	10.5
Net profit margin (%)	5.3	4.5	5.3	5.8	6.3
Return on investment (%)	5.8	4.9	5.7	5.7	5.7
Cost to insurance income ratio (%)	23.1	21.8	20.2	18.4	17.8
Underwriting profit margin (%)	(1.5)	(0.8)	(1.8)	(2.5)	(2.7)
Investment-net expense margin (%)	8.6	7.0	8.1	8.7	9.4
Return on equity (%)	24.2	49.5	22.9	20.5	23.1
Return on asset (%)	1.9	3.1	2.0	2.1	2.3
Asset turnover (x)	0.4	0.7	0.4	0.4	0.4
Policy reserve to equity ratio (x)	11.1	13.9	7.4	7.8	8.3
Policy reserve to asset ratio (%)	0.8	0.8	0.8	0.8	0.8
Book value per share (Bt)	3.1	3.0	6.0	7.2	8.6
Earnings per share (Bt)	0.8	0.8	1.0	1.4	1.8

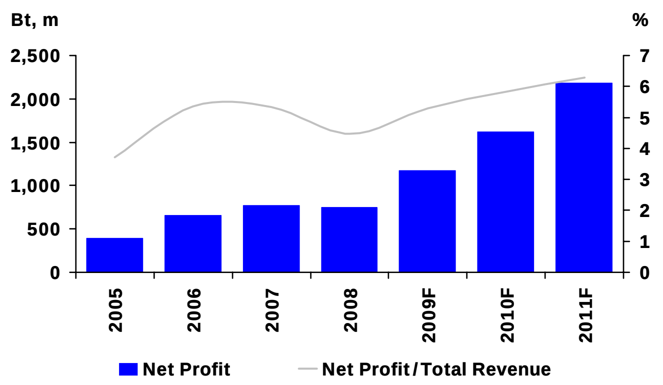
CONSOLIDATED QUARTERLY RESULTS (Bt, m)

	3Q08	4Q08	1Q09	2Q09	3Q09
Net premiums written	4,129	4,033	4,722	4,701	4,872
Net investment income	648	613	635	688	742
Gains on investments in securities	(60)	(311)	125	41	58
Other income	15	5	7	6	6
Total revenue	4,732	4,340	5,490	5,435	5,677
Life policy reserve increase	2,391	1,975	2,434	2,822	3,133
Benefit payments	1,288	1,444	1,201	1,363	1,399
Commissions	471	544	671	603	553
Other underwriting expenses	72	56	127	66	86
Personnel expenses	128	121	136	139	135
Premises and equipment expenses	28	28	29	29	30
Other operating expenses	96	90	118	107	106
Total expenses	4,473	4,257	4,717	5,129	5,441
Income tax	84	8	217	73	22
Extraordinary items	0	0	0	0	0
Net profit	**176**	**75**	**556**	**233**	**214**
Net profit margin (%)	3.7	1.7	10.1	4.3	3.8
Return on investment (%)	0.0	5.5	5.5	5.7	5.5
Underwriting profit margin (%)	(2.2)	0.4	6.1	(3.2)	(6.1)

CONSOLIDATED BALANCE SHEET (Bt, m)

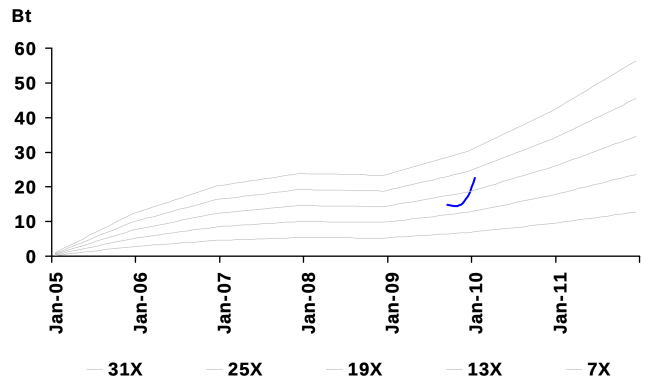
	As of December 31,				
	2007	2008	2009F	2010F	2011F
Bonds	24,167	28,449	36,188	45,976	57,947
Notes	3,668	4,058	7,238	9,195	11,589
Stocks	3,516	3,594	4,825	6,130	7,726
Debentures	7,422	7,423	10,253	13,027	16,418
Total investment in securities	40,009	44,858	60,313	76,627	96,578
Allowance for doubtful accounts	(3)	(3)	(3)	(3)	(3)
Loans net allowance	1,499	1,798	2,030	2,292	2,590
Cash and deposits	760	2,382	2,983	3,499	3,951
Other assets	2,142	2,443	2,614	3,125	3,681
Total assets	**44,410**	**51,482**	**67,940**	**85,543**	**106,800**
Life policy reserve	34,222	41,892	53,183	67,497	85,348
Unpaid policy benefits	3,311	3,984	4,537	6,412	8,108
Other	3,797	2,587	2,986	3,025	3,068
Total liabilities	**41,330**	**48,463**	**60,706**	**76,934**	**96,525**
Surplus on revaluation of investments	1,129	316	1,000	1,200	1,300
Total shareholder's equity	**3,080**	**3,019**	**7,234**	**8,609**	**10,276**

Net profit



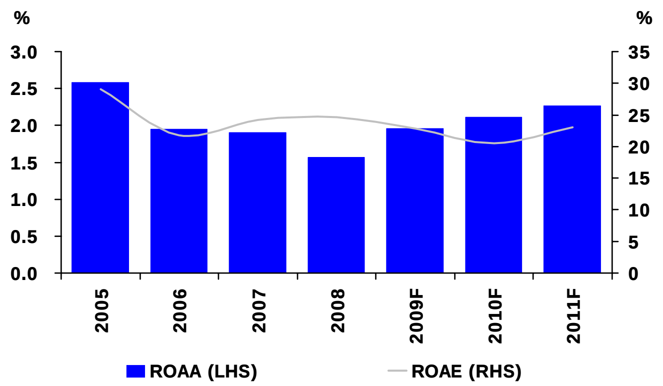
Sources : Company data, TISCO Research

PE Band



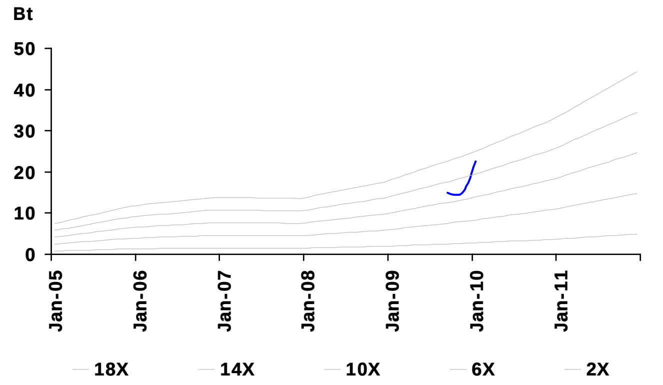
Sources : Company data, TISCO Research

ROAA, ROAE



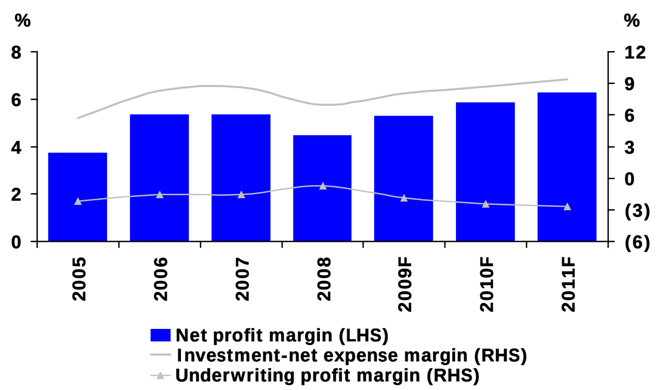
Sources : Company data, TISCO Research

PE (forward) Band



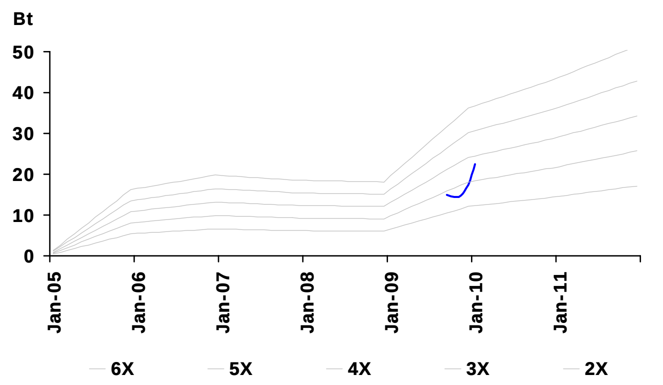
Sources : Company data, TISCO Research

Underwriting profitability



Sources : Company data, TISCO Research

PBV Band



Sources : Company data, TISCO Research

TISCO Securities Company Limited

www.tiscosec.com

Bangkok
48/8 TISCO Tower 4th Floor, North Sathorn Road, Bangkok 10500, Thailand
Tel : 662 633 6999 Fax : 662 633 6490, 662 633 6660

Esplanade Branch
99 Esplanade Shopping Center, Room 202-2, 2nd Floor, Ratchadapisek Road, Din Daeng, Bangkok 10400
Tel : 662 641 3251, 662 641 3252 Fax : 662 641 3253

Chiang Mai
275/4, 2nd Floor, Chang Phuak Road, Chang Phuak, Muang District, Chiang Mai 50300
Tel. 0 5322 4722 Fax. 0 5322 4711

Nakhon Pathom
386, 388 Petchkasem Road, Prapatone, Muang District, Nakhon Pathom 73000
Tel: 0 3421 1812 Fax: 0 3425 1676

Nakhon Ratchasima
Tesco Lotus Korat, 719/5 Mittraphap Road, Naimuang, Muang District, Nakhon Ratchasima 30000
Tel: 0 4425 7752 Fax: 0 4425 3752

Udon Thani
227/21 2nd Floor, Udondussadee Road, Muang District, Udon Thani 41000
Tel: 0 4224 6888 Fax: 0 4224 5793

บรรษัทภิบาลแห่งชาติ
National CG Committee

Corporate Governance Report of Thai Listed Companies 2008

Score Range	Level	Description
90 - 100	5	Excellent
80 - 89	4	Very Good
70 - 79	3	Good
60 - 69	2	Satisfactory
50 - 59	1	Pass
< 50 or not rated	n.a.	n.a.

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