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Balanced risk-reward profile seen for Syarikat Takaful Malaysia

Syarikat Takaful Malaysia Keluarga Bhd (Sept 10, RM5.82)

Initiate coverage with hold and a target price (TP) of RM6.30: We see a limited share price upside from the current level, with the stock having already performed exceptionally well over the past 12 months, generating returns in excess of 50% for investors. The stock's risk-reward profile is also balanced, in our opinion, given its good business positioning to ride the Islamic finance wave and positive structural industry dynamics but defused by downward normalising growth and the unfavourable upcoming Malaysian Financial Reporting Standards 17 (MFRS 17) accounting change. We initiate coverage of Syarikat Takaful Malaysia Keluarga Bhd (STMB) with a "hold" rating and a Gordon Growth Model-based TP of RM6.30 based on 3.69 times financial year 2020 (FY20) price-to-book ratio.

STMB has been a pioneer in the field of Islamic insurance for over three decades in Malaysia, making it one of the leaders in this space (it ranks first in family takaful, while for general, it is placed second among competitors). The group was established in 1984 and is now the sole pure listed takaful operator on Bursa Malaysia. It runs the family and general takaful businesses, along with a small overseas operation in Indonesia.

Syarikat Takaful Malaysia Keluarga Bhd's peer comparison

STOCK	MKT CAP (RM MIL)	PRICE (RM)	TARGET (RM)	RATING	FYE	P/E (X) FY19	P/E (X) FY20	P/B (X) FY19	P/B (X) FY20	ROE (%) FY20	YIELD (%) FY20
Allianz Malaysia	2,581	14.60	-	N rated	Dec	9.9	9.5	1.4	1.3	11.5	3.0
LPI Capital	6,231	15.64	-	N rated	Dec	18.1	17.1	2.9	2.8	15.2	4.7
Tune Protect	462	0.62	-	N rated	Dec	7.6	7.1	0.8	0.8	11.3	6.3
STMB	4,820	5.83	6.30	Hold	Dec	13.6	12.6	4.0	3.4	29.3	3.3
Simple average						12.3	11.6	2.3	2.1	16.8	4.4

Sources: Hong Leong Investment Bank Research, Bloomberg

Through a wide network of bancatakaful partners, STMB rides on robust Islamic banking growth (about 15 percentage points [ppts] faster than its conventional counterparts), with Bank Negara Malaysia aiming to expand the scope of Islamic financing activities and reach 40% of total bank market share by 2020 (currently 34%). Looking at the low insurance penetration rate, favourable demographics and the huge domestic protection gap, we believe structural long-term growth prospects for the group remain bright. STMB is also well positioned to capture these market opportunities, considering that it is one of the top two takaful operators in Malaysia (with a proven track record and business scale).

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However, in a fully fledged liberalised market, we expect price-based rivalry to be more prevalent, hurting STMB's profitability in the process. As for its family bancatakaful business, credit-related product growth should taper off and normalise from the third quarter of FY19, given that the contribution from Bank Rakyat on a full-year basis has come to a tail end, coupled with a high base effect. We also believe STMB would be more negatively affected by the adoption of the MFRS 17 since single premium products make up a large 90% plus of its family takaful business. Furthermore, STMB's surplus position for the general takaful fund has been thinning over the past two years.

For FY18 to FY21, we anticipate STMB's earnings to grow by a slower 11% compound annual growth rate (CAGR), versus 24% in FY15 to FY18, on the back of: i) a normalising 8% premium growth per annum; ii) a lower general takaful wakalah fee growth at a 6% CAGR (FY18 to FY21) versus 19% (FY15 to FY18) to build back the depleted surplus fund position; and iii) a conservative stance on claim assumptions where we have pencilled in a gradual uptick in the net claims ratio of 44.6% for FY19 to 45.6% for FY21. However, these would be partially mitigated by a more benign management expense ratio of 17.3% for FY19 to FY21 (1ppt to 2ppts lower than FY15 to FY18's) to reflect more stringent cost control and digital innovation. *— Hong Leong Investment Bank Research, Sept 10*