COMPANY RESEARCH | Company Update

March 3, 2016

OUTPERFORM

(from NEUTRAL)

Bangkok Life Assurance

(BLA TB)

Share Price: Bt40.00 Target Price: Bt47.00 (17.5%)

krungsri Securities

A member of MUFG a global financial group

Bring back to life

- **Stripping out extra reserve, FY16-18F earnings would post 13% on 3-year CAGR ; true potential is distorted by extra reserves**
- **A low interest rate environment would impact ROI gradually, while most legacy policies are hedged**
- **Upgrade to OUTPERFORM with a revised TP of Bt47/sh (from Bt55/sh); trading at 24% discount to mean P/BV multiple**

Cut FY16-17F earnings by 17-44% because of extra reserves

We raised premium income by 9-15% for FY16-17F following strong 4Q15 results and BLA's strategy to grow market share. We forecast premium income to grow 13% this year, vs BLA's guidance of 23%. We revised down FY16-17F net profit by 17-44% due to lower ROI assumption and Bt2bn extra reserve following a declining bond yields, down 50 bps YTD to 2.0%. BLA is filing a petition to the OIC to use less stringent discount rates. If BLA is able to adopt a higher discount rate than the current risk free rate, extra reserves would be mostly eliminated. Stripping out this extra reserve, BLA should post 3% net profit growth in FY16F and 17-20% growth in FY17-18F.

Strong strategy to cope with low bond yields

BLA has reduced its duration gap from 7.4 years in 2Q12 to 1.4 years in 4Q15 to weather the low-yield environment. Most its legacy policies are fully hedged which minimizes their exposure to the current low rates. Meanwhile, the low rates would have gradual impact on BLA as only new premiums or about 23% of their total investment portfolio (vs. 26% for peers) are invested at current yields. BLA's CAR is at 310%, which is much higher than the minimum requirement of 140% and allows them to invest more in risky assets to deliver committed returns.

Upgrade to OUTPERFORM but reduce our TP price to Bt47/sh

BLA's share price has fallen 27% YTD because of fears the lower bond yields would hurt profits. BLA is trading at 24% discount to its long-term 5-year P/BV multiple. This led us to upgrade BLA to OUTPERFORM, despite trimming TP to Bt47/sh (from Bt55/sh). Our TP is based on 2.75x P/BV with a normalized ROE at 15% in FY16F. The mentioned multiple is a notch below their 5-year historical mean of 2.9x. There is upside risk to earnings if BLA decides to adopt the fair value option to smooth out earnings starting from 1Q16F.

Financial Summary (Btm)

Year to Dec	2014	2015	2016F	2017F	2018F
Net premium income	51,172	44,175	50,027	58,087	67,306
Net profit	2,662	4,108	2,671	5,054	5,909
EPS (Bt)	1.8	2.4	1.6	3.0	3.5
EPS growth (%)	(49.5)	32.5	(35.0)	89.2	16.9
P/E (x)	21.9	16.5	25.4	13.4	11.5
BVPS (Bt)	15.1	15.9	17.1	19.3	21.9
P/B (x)	2.7	2.5	2.3	2.1	1.8
DPS (Bt)	0.51	0.51	0.39	0.74	0.87
Div Yield	1.3	1.3	1.0	1.9	2.2
ROE (%)	11.1	15.6	9.5	16.4	16.9
ROA (%)	1.4	1.8	1.0	1.7	1.7

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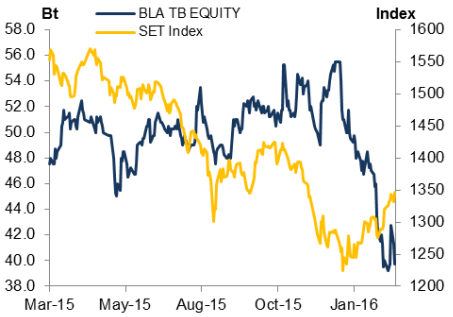
Key Data

12-mth High/Low (Bt)	56.25 / 38.75
Market Cap (Btm/US$m)	68,169.4 / 1,914.6
3m Avg. Turnover (Btm/US$m)	76.4 / 2.1
Free Float (%)	53.0
Issued Shares (m shares)	1,704
Major Shareholders:	
- STATE STREET BANK AN	24.3
- WATTANASOPHONPANICH	13.1
- BBL ASSET MANAGEMENT	10.0

Share Price Performance



	YTD	1Mth	3Mth	12Mth
Absolute (%)	(27.9)	(16.2)	(24.5)	(20.0)
Relative to index (%)	(33.9)	(22.5)	(26.5)	(6.3)

Krungsri Securities vs Market

	Positive	Neutral	Negative
Market Recommend	4	5	3

	Krungsri	Market	% +/-
Target Price (Bt)	47.0	50.9	(7.6)
'15 Net Profit (Btm)	2,671	4,503	(40.7)
'16 Net Profit (Btm)	5,054	5,842	(13.5)

Krungsri's earnings revision

	2016F	2017F
Earnings revision (%)	(43.5)	(17.3)

Source: Bloomberg, Krungsri Securities

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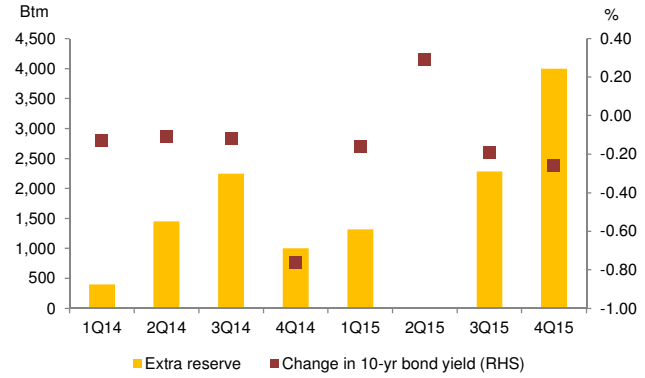
Stringent accounting rules distort BLA's true potential

Current low-yield environment will pressure performance

We cut FY16F earnings by 44% and FY17F earnings by 17% mainly because of the requirement to book extra reserves as a result of lower bond yields. Lower bond yield causes a mismatch between assets and liabilities value which result in extra reserves. We also introduce FY18F numbers. BLA estimates a 10bps drop in the average bond yield would result in Bt1,000m extra reserve. YTD, Thailand's 10-year bond yield has fallen by 50 bps, which would pressure BLA's 1Q16 performance.

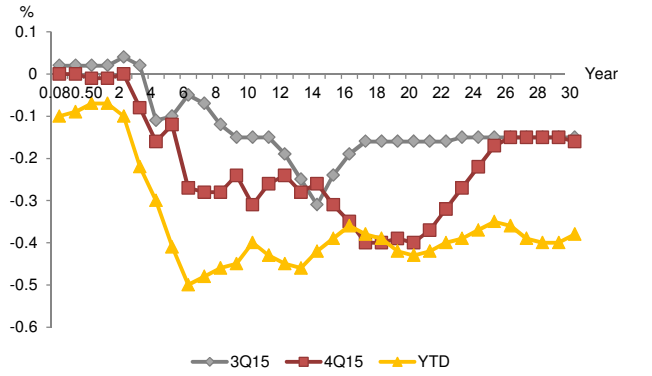
To recap, when Thailand's 10-year government bond yield dropped by 112 bps in 2014, BLA had to book Bt5,098m extra reserve. And they booked Bt6,284m extra reserve in FY15 when bond yields fell by 32 bps during the year.

Extra reserve and changes in bond yield



Source: Company data and Thai Bond Market Association (ThaiBMA)

Changes in Thailand's government bond yield



Source: ThaiBMA

Earnings revision

	2016			2017		
	New	Old	%Ch	New	Old	%Ch
Net premium (Btm)	50,737	46,823	8.4	58,912	51,360	14.7
Investment income (Btm)	10,803	11,809	-8.5	12,719	13,540	-6.1
Life reserve (Btm)	36,519	33,713	8.3	40,080	36,465	9.9
Net income (Btm)	2,671	4,726	-43.5	5,054	6,109	-17.3

Source: Krungsri Securities

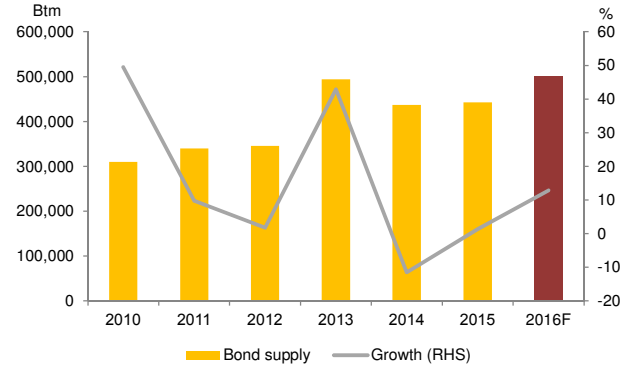
Key assumptions

	2016F	2017F	2018F
Premium growth (%)	13.2	16.1	15.9
Norm reserve to premium (%)	69	69	69
Total reserve to premium (%)	73	69	69
Extra life reserve (Btm)	2,000	0	0
ROI (%)	4.3	4.4	4.5

Source: Krungsri Securities

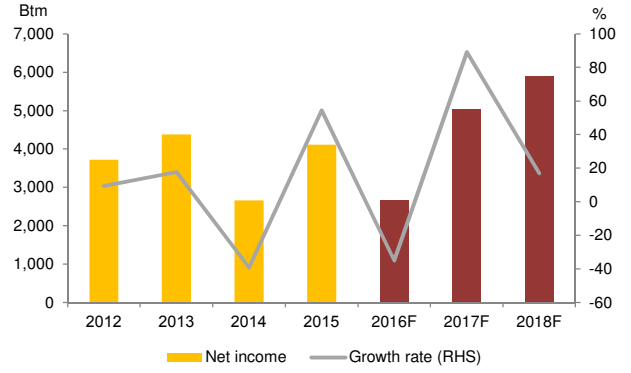
Looking forward, our house view is that bond yields will improve gradually in 2H16, premised on a recovery in oil prices pushing up inflation rate. This would also push up long-term bond yields. At the same time, the larger supply of bonds this year would help to limit downside for bond yield to drop further. The PDMO (Public Debt Management Office) expects bond supply to increase by 13% to Bt500bn this year following flat growth in 2014 and 2015.

New bond issues in Thailand (by year)



Source: Public Debt Management Office (PDMO)

BLA's earnings forecast with extra reserve



Source: Company data and Krungsri Securities

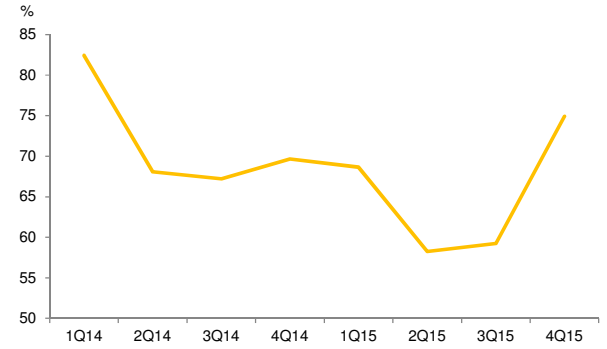
But core operations are intact

We forecast BLA's earnings will contract by 36% in FY16F, but mainly because of the extra reserve in 1Q16 (c.Bt4,000m). If bond yields do not drop further, earnings should normalize the rest of the year. Overall, BLA's core operations are intact, and we forecast earnings will surge 89% in FY17F and grow by 17% in FY18F.

BLA disagrees with the current accounting method, which distorts their true performance. A drop in interest rate would raise the present value of the company's liabilities because of a lower discount rate. Meanwhile, the value of assets should also increase because the lower interest rate. However, under Thailand accounting standards, 80-90% of BLA's assets classified as held-to-maturity cannot be marked to market. This causes total liabilities to increase more than assets, and BLA has to set aside extra reserve to accommodate this.

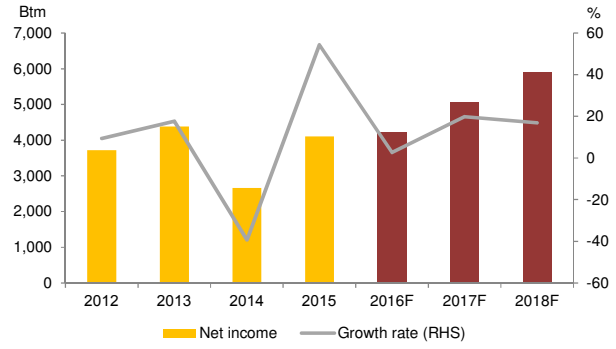
If we ignore the stringent accounting rule, BLA would report a much lower life policy reserve to premium ratio. If we exclude extra reserve charges, including extra reserves to cover lower bond yields, and a reversal of reserves because of changes in actuarial assumptions for riders and return on investments, BLA's life policy reserve for the past eight quarters would be about 69% of premiums received. If we apply this ratio in our earnings model, earnings would grow by 2.6% in FY16F, 19.8% in FY17F, and 16.9% in FY18F.

BLA's normal life reserve to premium ratio



Source: Company data and Krungsri Securities

BLA's earnings forecast without extra reserve



Source: Company data and Krungsri Securities

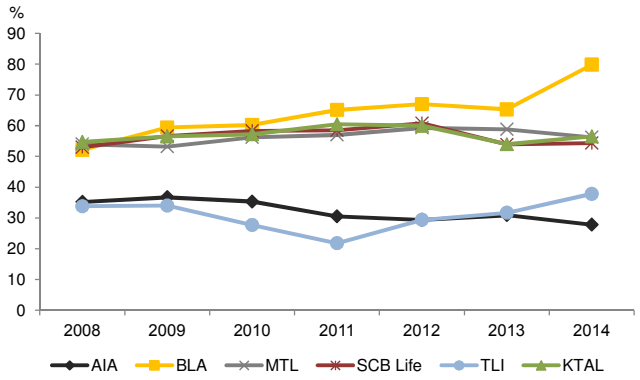
Going behind the scenes

In this section, we highlight the visible and physical impact of BLA's stringent accounting policy on their earnings.

According to the OIC (Office of the Insurance Commission), between 2008 and 2014, life reserve expenses accounted for 46.1-47.8% of net premiums earned at the Top 5 life insurance players: American International Assurance (AIA), Krungthai AXA (KTAL), Mueng Thai Life Assurance (MTL), SCB Life Assurance (SCB Life), and Thai Life Assurance (TLI). And, they were 53.9-58.6% for the top 3 bancasurance players - MTL, SCB Life and KTAL.

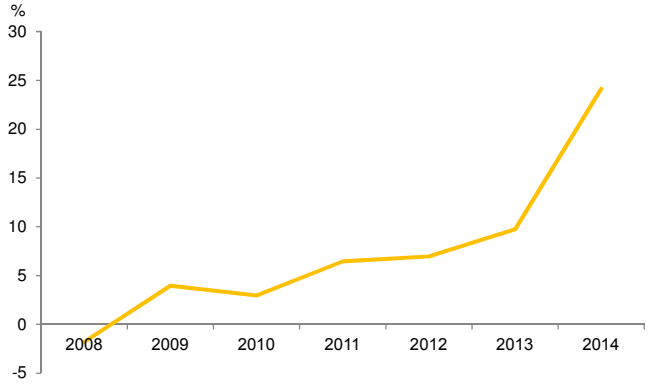
BLA's ratios were between 52.1% and 67.0% from FY08 to FY13 and peaked in FY14 at 79.8%. We suspect the spike was mostly due to its stringent accounting policy; when average bond yield tumbled in FY14, BLA was forced to book Bt5,098m extra reserve. If other life players had adopted the same policy, they would also see a spike in their ratios. Although BLA's product mix leans towards endowment policies, this alone would not have created the large difference in ratios between BLA and other players. In 2014, the gap between BLA's reserve ratio and the average for bancasurance players had widened to 24%. To conclude, if BLA had adopted a less aggressive reserve calculation methodology, their reported net income would have been much better.

Life policy reserve to net earned premium



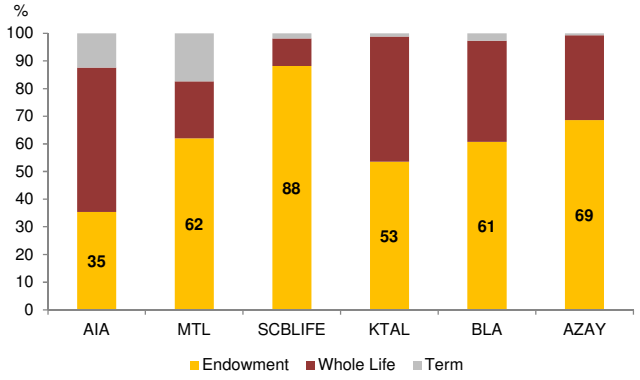
Source: Thailand Life Assurance Association (TLAA)

BLA's reserve ratio over average bancasurance players



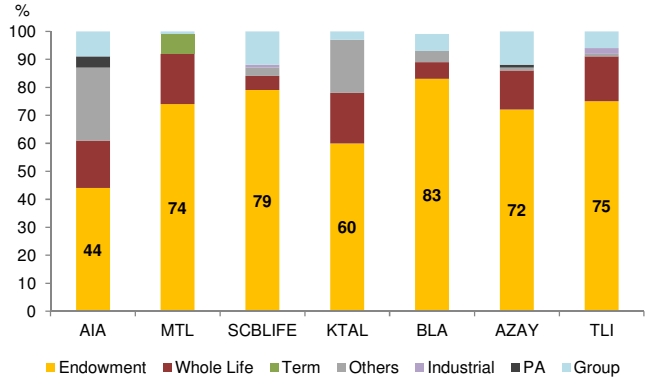
Source: TLAA and Krungsri Securities

Policy mix by number of policy in FY14



Source: Thailand Life Assurance Association (TLAA)

Policy mix by premium classification in FY14

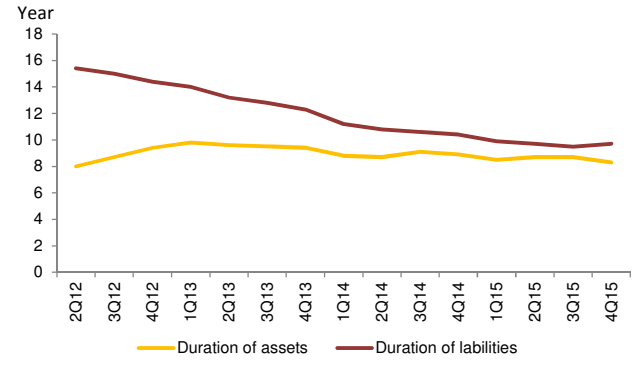


Source: Krungsri Securities compilation

Solid fundamentals to cope with low-yield environment

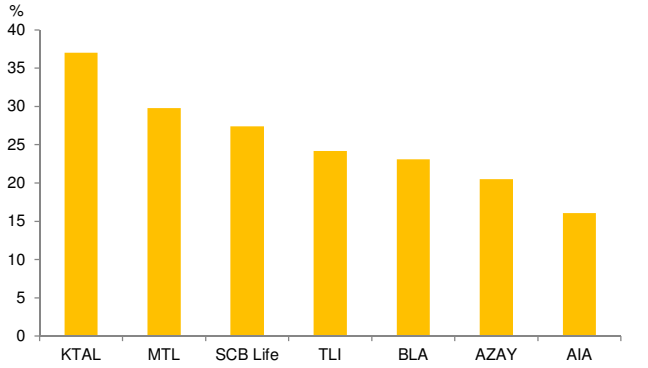
The entire insurance industry, including BLA, will be affected by the current low-yield environment. However, BLA is stronger than it was five years ago to cope with the low rates. Its duration gap has fallen from a peak of 7.4 years in 2Q12 to only 1.4 years in 4Q15. Thus, the economic value should not change much. In addition, BLA indicated they currently do not have legacy policies that are committed to returns they cannot deliver. Meanwhile, the negative effects of low interest rates would affect BLA gradually as only new premiums received or 23.1% of their total investment portfolio (vs. 25.8% industry average) is invested at current yields.

BLA's duration gap has narrowed



Source: Company data

New premium to total investment in 2014



Source: Office of Insurance Commission (OIC)

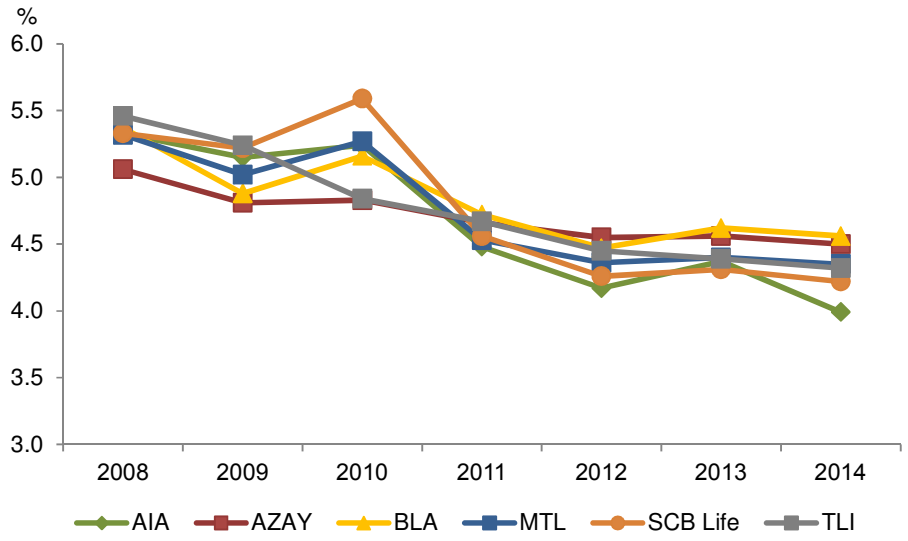
We are confident BLA would be able to deliver commitments for new policies that are on the shelf. The management indicated the maximum yield or IRR offered by their insurance products is only about 3%. The average ROI of major life insurance players was 4.3% over FY12-14, and the negative effect of low interest rate should slowly impact on ROI for the following reasons:

1. The new premiums received annually are forecast to account for 25.8% of the total investment portfolio of major life players in Thailand, but only 23.1% for BLA.

2. Given current CAR levels, there is room for life players to invest more aggressively to lift yields. At end 3Q15, SCBLIFE had the lowest CAR of 248% among life insurers, and that still exceeded the minimum requirement of 140%. There is room to invest in more high-risk high-return assets. Our analysis indicates risky assets (i.e. equities) account for about 7-8% of total portfolio for all Thai insurers, i.e. the risk is similar.

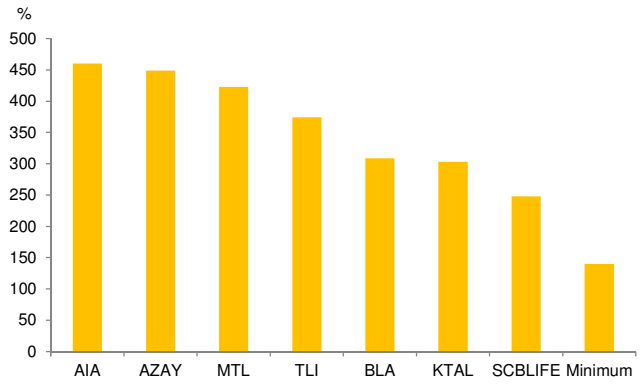
3. At worst, life insurers would reduce committed returns on new policies if they expect long-term yields to drop.

ROI of each life player



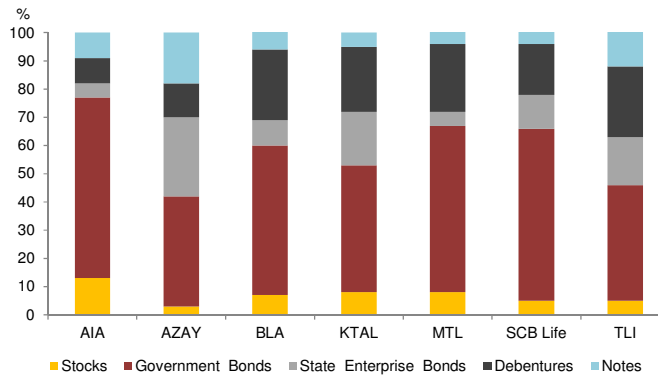
Source: Office of Insurance Commission (OIC)

CAR of major life insurance player as of 3Q15



Source: Krungsri Securities compilation

Investment portfolio mix



Source: Office of Insurance Commission (OIC)

Upgrade to OUTPERFORM with a new TP of Bt47/sh

BLA's share price has fallen by 27% YTD mainly because of concerns the extra reserve charge would hurt 1Q16 earnings. However, we believe the drop is excessive because their conservative accounting policy merely distorted earnings, and operations are intact. The lower bond yields would also have limited impact on the economic value of BLA's assets and liabilities.

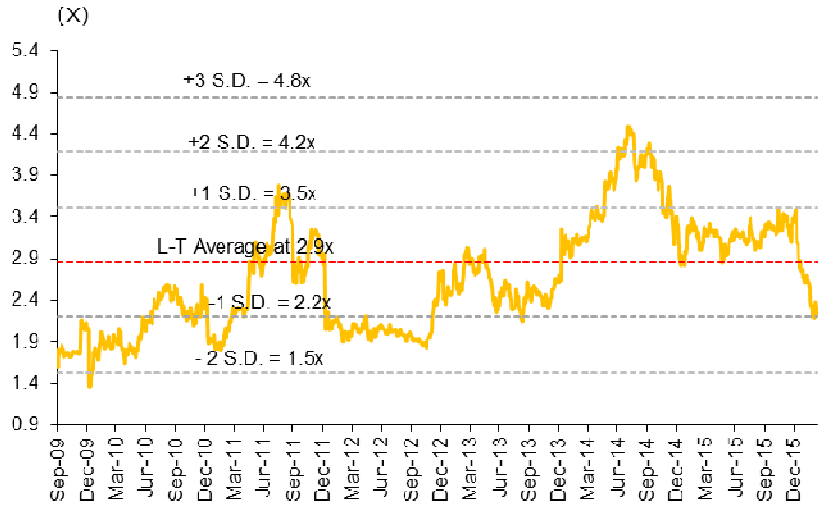
Hence, we upgrade BLA to OUTPERFORM from NEUTRAL. However, we trimmed TP to Bt47/sh (vs Bt55/sh previously) based on 2.75x P/BV multiple, which is lower than its long-term average of 2.9x. This is reasonable because overall yields in the market are not favorable for life insurers. We will upgrade our target multiple if: i) BLA's agency channel shows a significant improvement, ii) overall yields in the market rise, and iii) BLA adopts a less-stringent accounting policy, which would benefit earnings.

BLA has two options they can adopt to smooth out earnings and reflect their full business potential:

1. A new accounting rule that would allow them to mark held-to-maturity investments to market value. This would result in a revaluation gain if bond yields drop further, since most of BLA's investments is in fixed income assets. This gain would be booked on the income statement and would offset a higher life reserve amount. According to BLA, they can implement this in 1Q16 but there is no firm decision yet.

2. BLA and other life insurance companies are filing a petition to the OIC to allow them to use less stringent discount rates (from risk-free rate to a rate which is between the risk-free rate and return on investment) to calculate the present value of liabilities. This could reduce the amount of extra reserve booked in each quarter if bond yields continue to drop. The soonest this can be adopted is in 2Q16.

PB band



Source: Bloomberg and Krungsri Securities

INCOME STATEMENT (Btm)	2014	2015	2016F	2017F	2018F
Insurance premium	**51,172**	**44,175**	**50,027**	**58,087**	**67,306**
Less Life policy reserve	40,818	29,874	36,519	40,080	46,441
% of life policy reserve	28.8%	21.3%	20.5%	20.5%	20.4%
Underwriting expenses	15,531	18,714	20,311	23,293	26,721
Profit from insurance	(5,177)	(4,412)	(6,803)	(5,286)	(5,856)
Revenue on investment	10,255	11,414	12,415	14,266	16,231
Others	48	64	50	58	67
Non-underwriting Income	**10,303**	**11,478**	**12,465**	**14,324**	**16,298**
Operating Expenses	1,881	2,054	2,174	2,512	2,814
Profit from operation	**3,245**	**5,013**	**3,489**	**6,526**	**7,629**
Obligation expenses	137	126	151	209	242
Pre-tax Profit	**3,108**	**4,887**	**3,338**	**6,317**	**7,386**
Income Tax	446	779	668	1,263	1,477
After Tax Profit	2,662	4,108	2,671	5,054	5,909
Equity Income	0	0	0	0	0
Minority Interest	0	0	0	0	0
Extraordinary Items	0	0	0	0	0
NET PROFIT	**2,662**	**4,108**	**2,671**	**5,054**	**5,909**
Normalized Profit	**2,662**	**4,108**	**2,671**	**5,054**	**5,909**
EPS (Bt)	1.8	2.4	1.6	3.0	3.5
Normalized EPS (Bt)	1.8	2.4	1.6	3.0	3.5

FINANCIAL RATIOS (Btm)	2014	2015	2016F	2017F	2018F
Growth Rate (%)					
Net premium written	31.9	(13.7)	13.2	16.1	15.9
Life policy reserves	61.0	(26.8)	22.2	9.8	15.9
Underwriting expenses	11.4	20.5	8.5	14.7	14.7
Net profit	(39.2)	54.3	(35.0)	89.2	16.9
Normalized profit growth	(39.2)	54.3	(35.0)	89.2	16.9
EPS	(49.5)	32.5	(35.0)	89.2	16.9
Normalized EPS	(49.5)	32.5	(35.0)	89.2	16.9
Dividend payout ratio	32.5	21.1	25.0	25.0	25.0
Total FYP	20.2	81.0	(28.5)	25.5	21.9
Total premium	12.8	32.6	(13.5)	13.2	16.1
Total investment assets	22.9	15.1	15.0	15.1	15.2
Total assets	25.5	15.8	12.4	15.4	15.3
Total equity	14.9	5.5	7.4	13.1	13.5
Operating Ratios (%)					
Profit on underwriting to net earned premium	(10.1)	(10.0)	(13.6)	(9.1)	(8.7)
Underwriting expenses to net earned premium	110.1	110.0	113.6	109.1	108.7
Accounting ROI	5.6	5.2	4.9	4.9	4.9
Net profit margin	4.3	7.4	4.3	7.0	7.1
ROE	11.1	15.6	9.5	16.4	16.9

BALANCE SHEET (Btm)	2014	2015	2016F	2017F	2018F
ASSETS:					
Liquid Items	**10,541**	**12,346**	**8,816**	**9,969**	**11,814**
cash & cash equivalents	5,708	7,102	2,000	2,000	2,500
accrued investment income	2,344	2,628	2,791	3,286	3,871
Securities under resale agreement	1,725	1,717	3,006	3,500	4,073
Investments	198,238	227,584	260,783	301,737	347,692
Net loans	**4,735**	**6,139**	**7,959**	**7,665**	**8,825**
Gross and accrued interest	4,735	6,139	7,959	7,665	8,825
Provisions for doubtful	0	0	0	0	0
Fixed assets - net	389	547	616	633	648
Other assets	1,687	2,959	2,372	3,786	4,374
Total assets	**215,590**	**249,576**	**280,546**	**323,790**	**373,353**
LIABILITIES:					
Liquid Items	**879**	**1,002**	**985**	**1,484**	**1,729**
securities sold under repurchase agreement	0	0	0	0	0
income tax payable	500	542	465	880	1,029
amount due to reinsurer	380	459	520	604	700
Life policy reserve	177,435	207,308	243,827	283,907	330,348
Other liabilities	2,685	4,825	4,970	5,119	5,273
Total liabilities	**190,013**	**222,585**	**251,558**	**291,013**	**336,144**
Minority interest	0	0	0	0	0
Shareholders' equity	**25,576**	**26,990**	**28,987**	**32,778**	**37,209**
Preferred capital	0	0	0	0	0
Paid-in capital	1,698	1,704	1,698	1,698	1,698
Share premium	2,988	3,220	3,220	3,220	3,220
Surplus/ Others	5,642	4,035	4,035	4,035	4,035
Retained earnings	15,248	18,031	20,034	23,824	28,256
Liabilities & equity	**215,590**	**249,575**	**280,546**	**323,790**	**373,353**

RATIOS (%)	2014	2015	2016F	2017F	2018F
Normlized PE (x)	21.9	16.5	25.4	13.4	11.5
Normalized PE - at target price (x)	25.7	19.4	29.9	15.8	13.5
PE (x)	21.9	16.5	25.4	13.4	11.5
PE - at target price (x)	25.7	19.4	29.9	15.8	13.5
P/PPP (x)	18.0	13.5	19.5	10.4	8.9
P/PPP - at target price (x)	21.1	15.9	22.9	12.2	10.5
P/BV (x)	2.7	2.5	2.3	2.1	1.8
P/BV - at target price (x)	3.1	3.0	2.8	2.4	2.1
Dividend yield (%)	1.3	1.3	1.0	1.9	2.2
Market cap / total premium (x)	1.3	1.5	1.4	1.2	1.0
Market cap / life policy reserve (x)	0.4	0.3	0.3	0.2	0.2
(Bt)					
Normalized EPS	1.8	2.4	1.6	3.0	3.5
EPS	1.8	2.4	1.6	3.0	3.5
DPS	0.5	0.5	0.4	0.7	0.9
PPP/Share	2.2	3.0	2.1	3.8	4.5
BV/Share	15.1	15.9	17.1	19.3	21.9

BAFS	BCP	BTS	CPN	EGCO	GRAMMY	HANA	INTUCH	IRPC	IVL
KBANK	KKP	KTB	MINT	PSL	PTT	PTTEP	PTTGC	SAMART	SAMTEL
SAT	SC	SCB	SE-ED	SIM	SPALI	TISCO	TMB	TOP	

To recognize well performers, the list of companies attaining "Good", "Very Good" and "Excellent" levels of recognition without regulatory notation (from January 1, 2013 to October 22, 2014) is publicized.

AAV	ACAP	ADVANC	ANAN	AOT	ASIMAR	ASK	ASP	BANPU	BAY
BBL	BECL	BIGC	BKI	BLA	BMCL	BROOK	CENTEL	CFRESH	CIMBT
CK	CNT	CPF	CSL	DELTA	DRT	DTAC	DTC	EASTW	EE
ERW	GBX	GC	GFPT	GUNKUL	HEMRAJ	HMPRO	ICC	KCE	KSL
LANNA	LH	LHBANK	LOXLEY	LPN	MACO	MC	MCOT	NBC	NCH
NINE	NKI	NMG	NSI	OCC	OFM	PAP	PE	PG	PHOL
PJW	PM	PPS	PR	PRANDA	PS	PT	QH	RATCH	ROBINS
RS	S&J	SAMCO	SCC	SINGER	SIS	SITHAI	SNC	SNP	SPI
SSF	SSI	SSSC	STA	SVI	TCAP	TF	THAI	THANI	THCOM
TIP	TIPCO	TK	TKT	TNITY	TNL	TOG	TRC	TRUE	TSTE
TSTH	TTA	TTW	TVO	UAC	VGI	VNT	WACOAL		

2S	AF	AH	AHC	AIT	AJ	AKP	AKR	AMANAH	AMARIN
AMATA	AP	APCO	APCS	AQUA	ARIP	AS	ASIA	AYUD	BEAUTY
BEC	BFIT	BH	BJC	BJCHI	BOL	BTNC	BWG	CCET	CGD
CGS	CHOW	CI	CKP	CM	CMR	CSC	CSP	CSS	DCC
DEMCO	DNA	EA	ESSO	FE	FORTH	FPI	GENCO	GL	GLOBAL
GLOW	GOLD	HOTPOT	HTC	HTECH	HYDRO	IFS	IHL	INET	IRC
IRCP	ITD	KBS	KGI	KKC	KTC	L&E	LRH	LST	MAJOR
MAKRO	MATCH	MBK	MBKET	MEGA	MFC	MFEC	MJD	MODERN	MONO
MOONG	MPG	MTI	NC	NTV	NUSA	NWR	NYT	OGC	OISHI
PACE	PATO	PB	PDI	PICO	PPM	PPP	PREB	PRG	PRIN
PTG	QLT	QTC	RCL	SABINA	SALEE	SCBLIF	SCCC	SCG	SEAFCO
SEAOIL	SFP	SIAM	SIRI	SKR	SMG	SMK	SMPC	SMT	SOLAR
SPC	SPCG	SPPT	SST	STANLY	STEC	STPI	SUC	SWC	SYMC
SYNEX	SYNTEC	TASCO	TBSP	TEAM	TFD	TFI	THANA	THIP	THREL
TIC	TICON	TIW	TKS	TLUXE	TMI	TMT	TNDT	TPC	TPCORP
TRT	TRU	TSC	TTCL	TUF	TVD	TWFP	UMI	UP	UPF
UPOIC	UT	UV	UWC	VIH	WAVE	WHA	WIN	WINNER	YUASA
ZMICO									

Score Range	Number of Logos	Description
90-100		Excellent
80-89		Very Good
70-79		Good
60-69		Satisfactory
50-59		Pass
Below 50	No logo given	N/A

Disclaimer

The disclosure of the survey result of the Thai Institute of Directors Association (IOD) regarding corporate governance is made pursuant to the policy of the Office of the Securities and Exchange Commission. The survey of the IOD is based on the information of a company listed on the Stock Exchange of Thailand, and the Market of Alternative Investment disclosed to the public and able to be accessed by a general public investor. The result, therefore, is from the perspective of a third party. It is not an evaluation of operation and is not based on inside information.

The survey result is as of the date appearing in the Corporate Governance Report of Thai Listed Companies. As a result, the survey result may be changed after that date. Krungsri Securities Public Company Limited does not confirm nor certify the accuracy of such survey result.

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Definition of Ratings

OUTPERFORM - Stocks with an expected capital gain above 10% in the next 12 months for small-caps, above 5% for big-caps
NEUTRAL - Stocks with an expected capital gain between -10% and +10% in the next 12 months for small-caps, -5% to +5% for big-caps
UNDERPERFORM - Stocks with an expected capital gain below 10% in the next 12 months for small-caps, below 5% for big-caps