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Interest, valuations pick up for general insurers

Joyce Goh

Hong Leong Financial Group Bhd (HLFG)'s deal with Japanese insurer Mitsui Sumitomo Insurance Co Ltd (MSI), which has turned the combined businesses of the two companies into the second largest general insurer in the country, has set a new benchmark for the industry.

The financial group will merge its non-life insurance business with that of MSIG Insurance (M) Bhd, the local unit of MSI, for RM619 million that will be satisfied by a 30% stake in MSI through the issuace of new shares. HLFG also proposed to sell a 30% stake in Hong Leong Assurance Bhd (HLA) to MSI for RM940 million cash. The completion of the exercise will result in HLFG, via its subsidiaries, owning a direct 30% stake in MSIG and retaining 70% equity interest in HLA.

Insurance analysts say it is tough to break down the exact value of the deal, but it looks like the general insurance business is worth a fair bit and that is a positive sign for the industry.

"The general insurance business was sold at zero net assets for a premium of RM619 million. It is tough to pin down the exact valuation to this given that the breakdown of information is not there. But it looks like the general insurance business was sold at a fairly high valuation. As at June 30, 2009, the book value of the general insurance business is estimated at RM493.7 million," says an analyst with RHB Research who covers the insurance sector.

"The price of RM619 million for the general insurance business also translates into a surplus transfer to income statement of 16 times. This is based on its FY2009 results. That is on the high end of that valuation. The surplus transfer to income statement is one of the methods that can be used to value general insurers," adds the analyst.

Some industry players believe a transaction today for a general insurance business could be 1.3 times to 1.8 times — stripping out related transactions and looking purely at the insurance business. "Pricing has improved, but of course it is still not like the heyday before the global financial crisis when it could be higher than 1.8 times book," says an industry observer.

Meanwhile, the insurance analyst adds that the portfolio of the insurer is also an important element in determining the price of a deal. "HLA has quite an attractive portfolio as a big portion of it is in the fire segment, and that could be a contributing factor for it to get an attractive price. For FY2009, its overall claims ratio is low," says the analyst.

"Looking at the breakdown of its claims ratio for its FY2009, 27.3% was for fire while 94% was for motor. Its overall claims ratio for that financial year was 57% which is quite good compared with the industry average of over 60%. Some local insurers have a claims ratio of 65%. That too could push the price higher for its insurance businesses as well as HLA's distribution channels," adds the analyst.

The sale of HLA values the insurance business at 6.5 times price-to-book. This is based on the company's shareholders funds of RM458 million. The price is high, but industry players point out that the 6.5 times-price-to book is the combined value of the deal.

"To determine the true value of how much HLA's general and life insurance businesses are worth, investors will have to break the value down for the both of them. This is because there are different methods to calculate them," says the CEO of a local insurance company.

"For the life side, investors should look at the multiple to the embedded value of the business rather than looking at book value. Whereas for the general insurance business, the book value is a better method of valuation. Unfortunately, in Malaysia local insurers do not make the embedded value public information," he adds.

The embedded value is a commonly used technique to estimate the economic value of the existing business of a life insurance company.

There are currently two other listed companies with general insurance businesses that have announced plans to dispose of their respective insurance units. Jerneh Asia Bhd made the announcement last December, while PacificMas Bhd announced its plans in April.

Jerneh Asia did not name the party it is in talks with. However, reports have noted that it is with a foreign party. In May, the company announced that it has submitted an application to Bank Negara Malaysia to enter into an agreement with its potential buyer for the disposal of its 80%-owned insurance company. The company did not spell out how much its insurance business is going for, but there is market speculation that the price could touch RM875 million, translating the potential sale to over 3.5 times price-to-book.

PacificMas, on the other hand, disclosed that it is entering into negotiations with Tokio Marine Asia Pte and Fairfax Asia Ltd. As at Dec 31, 2009, the insurance business' net book value stood at RM126.4 million.

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Great Eastern may continue looking

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The local insurer is also in talks with its related company Great Eastern Group. Singapore's Oversea-Chinese Banking Corp Ltd (OCBC) is the ultimate holding company of PacificMas and Great Eastern Group. The proposed acquisition of Pacific Insurance comes after Great Eastern's wholly owned unit, Overseas Assurance Corp (M) Bhd (OAC), engaged in talks to acquire the general insurance business of Tahan Insurance Malaysia Bhd.

Industry observers believe, should Great Eastern successfully acquire these two local insurance businesses, it may still continue to look for another one or two local general insurers.

There is also market talk that local general insurer Pacific & Orient Bhd has come onto the radar of potential buyers as well.

In April last year, Bank Negara liberalised the insurance sector. To further build the resilience and competitiveness of the insurance and takaful industry, operators were given greater flexibility to tie up with foreign partners. Accordingly, the foreign equity participation in insurance companies and takaful operators was increased to a limit of 70%. Interestingly, it added that a higher foreign equity limit beyond 70% for insurance companies would be considered on a case-by-case basis for players who can facilitate the consolidation and rationalisation of the insurance industry. Existing foreign insurers who participate in the process will be accorded flexibility in meeting the divestment requirement.

While it has taken some time for the shopping to start and the industry to consolidate, interest and valuations in the industry have begun to gather momentum.