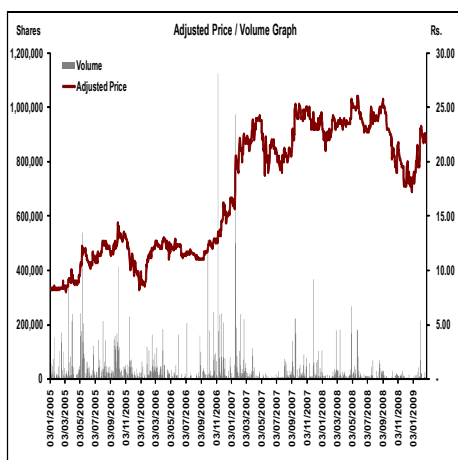


# HNB Assurance PLC (HASU)

**Rs. 22.00** **BUY**

<b>HASU</b>			
Reuters Code	HASU.CM		
Bloomberg Code	HASU.SL		
Share Price	22.00		
Issued Share Capital (Shares)			
Voting	37,500,000		
12 mth High / Low (Rs.)	26.00 / 17.25		
Average Daily Volume (Shares)	17,390		
Market Capitalisation - Rs. mn	825		
Price Performance (%)			
	1 mth	6 mth	12 mth
ASPI	(5.69)	(29.41)	(32.97)
HASU	12.82	(12.00)	(6.38)

Financial Year	Net Income (Rs. Million)	PAT (Rs. Million)	EPS (Rs.)	EPS Growth (%)	PER	NAVPS (Rs.)	P/B Value
2003	82.30	35.81	0.95	-	23.04	7.87	2.79
2004	106.42	16.38	0.44	-54%	50.35	8.31	2.65
2005	203.49	60.29	1.61	268%	13.68	9.92	2.22
2006	247.66	91.32	2.44	51%	9.03	12.02	1.83
2007	309.48	123.33	3.29	35%	6.69	14.64	1.50
2008	311.25	164.47	4.39	33%	5.02	18.03	1.22
2009E	436.47	193.05	5.15	17%	4.27	21.68	1.01
2010E	577.29	257.66	6.87	33%	3.20	27.05	0.81



## Company Profile

- ✓ HNB Assurance PLC (HASU), incorporated in 2001, commenced its operations as a General Insurance provider and in 2002, the company moved to the provision of Life Insurance products. HASU is a subsidiary of Hatton National Bank PLC (HNB), one of the largest commercial banks in Sri Lanka, owning approximately 60% of HASU. Since its incorporation, the company has grown steadily amidst turbulent economic conditions, achieving a market share of 3.7% and 2.26% in Life and General Insurance businesses respectively.
- ✓ The company, although still at the early stages of its growth phase, has enjoyed rapid growth in earnings averaging approximately 36% during the last 5 years. HASU has posted earnings of Rs. 164 million for FY2008, a 33% growth from 2007 earnings.

**Jeewanthi Malagala**

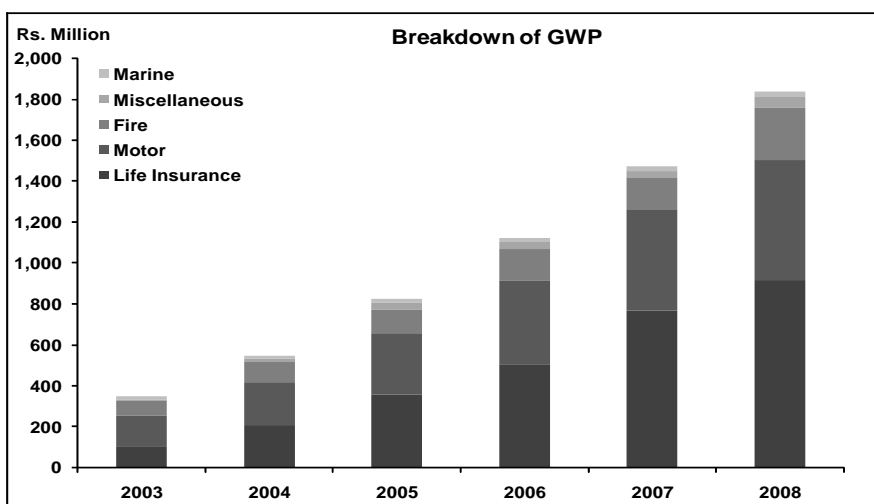
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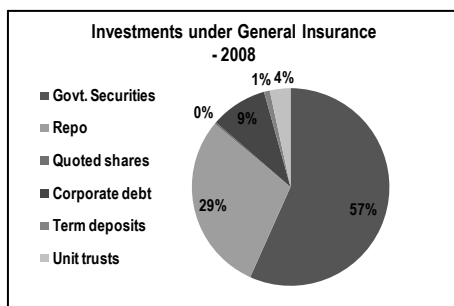
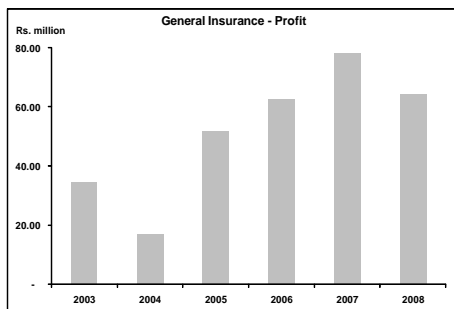
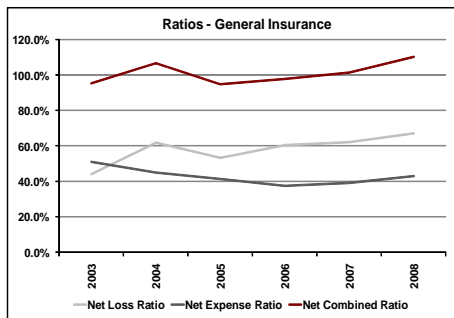


## HASU - General Insurance

- ✓ The segment, which accounted to nearly 50% of total GWP, witnessed an 18% decline in PAT in 2008 on account of a marginal increase in claims and higher administrative expenses due to adverse economic conditions. General Insurance has enjoyed a CAGR of 13% in PAT, since 2003,

**April 2009**



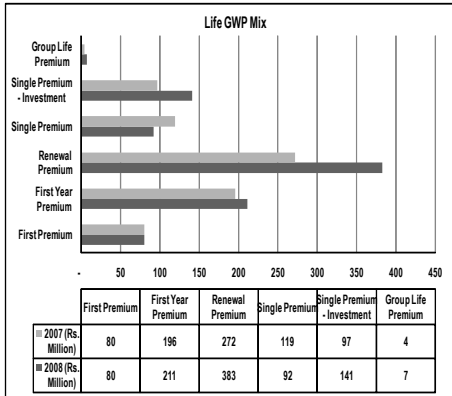


although in 2004 its earnings dipped 50% from 2003 levels consequent to high levels of claims caused by the Tsunami.

- ✓ HASU, over the last 5 years, has enjoyed a CAGR of 31% in GWP from General Insurance. The largest contributor continued to be Motor Insurance which accounted to 64% of the Premium in 2008 against 70% in 2007. This, albeit an improvement in 2008, is still higher than the average of approximately 55% for the industry. However, in order to maintain its competitiveness in the industry, the company has aligned its premiums in line with the rest of the insurance providers.
- ✓ The increase in the cost of leasing and other methods of financing the acquisitions of vehicles has had a dampening effect on the growth of General Insurance. However, over reliance on a single class of insurance may be deemed to be of high risk, thus the company is continuously taking measures to promote other classes of Non Motor insurance such as Fire, Marine etc. by underwriting large projects in the country.
- ✓ The company's insurance operations have been greatly supported from bancassurance, where by HASU sells its products through the branches of its parent company HNB. Over the years, bancassurance channel contributed over 50% of the General GWP. This channel generates a large proportion of Motor Insurance business as customers who lease motor vehicles through its parent company are being offered insurance through HASU.
- ✓ The existence of a widely distributed banking network has enabled HASU to penetrate into rural areas, thereby giving the company a competitive advantage over the other insurance providers.
- ✓ The segment's earnings are also influenced by the investment income which rose to Rs. 127 million in 2008 due to higher interest rates that prevailed in the economy. Although local interest rates have declined, the company is certain that its investment income is likely to grow in FY2009E as most of its funds have been invested at high interest rates.
- ✓ During 2008, majority of the investments held under General Insurance accounted to high yielding Government Securities. However, the proportion of investments in Quoted shares declined from 11% in 2007 to 9% in 2008 with a sharp fall in the Stock Market. Due to unpredictability in the level of claims, the segment is required to maintain at least 40% of its investments for an average tenure of less than 3 months.
- ✓ Despite growth, in 2008, the company failed to maintain its Combined ratio below 100% given intense price competition and escalating claims. Combined Ratio stood at 110.5% in 2008, up from 101.6% in 2007. The company is expected to undertake stringent cost reductions in the future with a view to reduce the Expense Ratio. However, the impact on Combined Ratio may not be known due to unpredictability in claims.
- ✓ The company has reinsured with Toa Reinsurance Company of America, Mitsui Sumitomo in Japan and General Insurance Corporation in India for its General Insurance products.

## HASU - Life Insurance

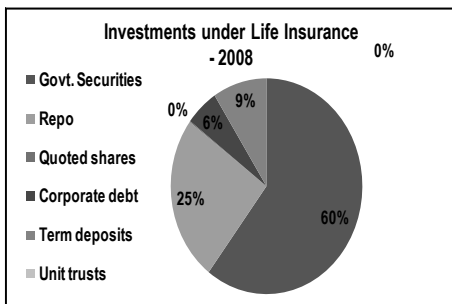
- ✓ Since 2005, the segment managed to make a positive contribution to group's bottom line. Within a short span of 4 years, Life Insurance enjoyed rapid growth in PAT of approximately 115% as CAGR. In 2008, Life Insurance segment accounted to 61% of Group earnings.



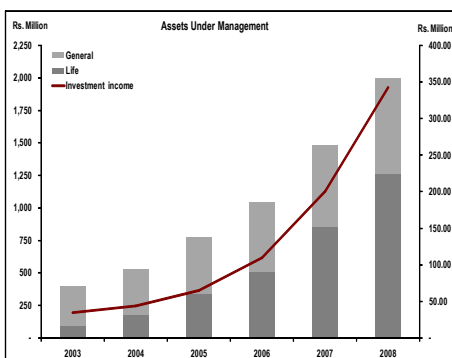
- ✓ Since 2003, the segment has witnessed sharp growth - GWP growing by approximately 54% on average during the last 5 years, which is believed to be the fastest among all Life Insurance providers. Low levels of Life Insurance penetration which currently stands at approximately 0.8% of GDP has fueled growth along with the new innovative products that have been offered to the public.

- ✓ The segment's relative share of endowment policies grew to 89% while Mortgage Reducing Policies (MRP) business declined to 11% in 2008 as a result of high interest rates which adversely impacted housing loans.

- ✓ HASU also launched Micro Insurance initiatives aimed at the low income earners, rural public and for the small entrepreneurs. Although number of policies generated has seen growth, the contribution from this segment tends to be rather low due to lower premiums collected. However, the company is of the view that with an expansion in economic activity and a growth in GDP per capita, this segment is likely to generate substantial premium income in the years to come.



- ✓ Life Insurance segment too has heavily benefited from the increase in investment income due to high interest rates. In 2008, approximately 75% of the segment's investments accounted for high yielding government securities. Despite an expected decline in interest rates during FY2009E, we believe that the segment will be able to record a growth in investment income as over 60% of the segment's investments have been placed in high rewarding government securities with a tenure of more than 1 year.



- ✓ Life fund witnessed a CAGR of 74% in 5 years to reach Rs. 1,361 million in 2008. Surpluses in the Life fund and profitability in individual product classes depend on the quality of the insurance written, and is best ascertained by an actuary. Therefore any forecast of possible surpluses in the Life Fund and consequent transfers to the P & L are arbitrary in nature.

- ✓ During 2008, HASU allocated Rs. 24.5 million as bonuses to its policy holders.

- ✓ The company has reinsured with Munich Re for its Life Insurance business.

## Outlook

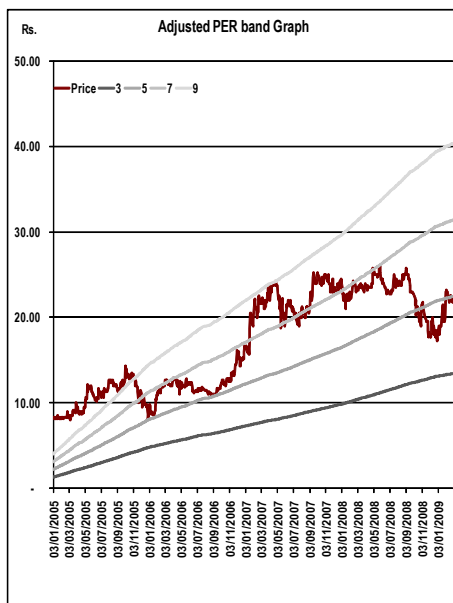
- ✓ Although the local industry is currently saturated with several operators, the low levels of penetration indicate that there is ample growth opportunities available. However, with improvements in interest and inflation rates being

evident, we expect HASU to benefit from growth in both General and Life Insurance.

- ✓ HASU hopes to slightly deviate from its usual business model of underwriting policies for individuals with relatively low risk, to underwriting large development projects concerned with economic development bearing higher level of risk.
- ✓ Double digit inflation and high interest rates which reduced growth in mainly the General Insurance segments is expected to recover as leasing and other options become more viable. Further, import restrictions on cars have been relaxed, favouring a growth in Motor Insurance in the medium term. However, we expect to see the benefit of this recovery towards the latter half of 2009.
- ✓ On the Life Insurance segment, we expect a growth of approximately 31% in GWP for FY2009E. With inflation reaching single digit levels, it is expected to boost purchasing power of mainly the middle and low income groups, thereby having a positive impact on growth of Life Insurance.
- ✓ The clearance of rebel held areas in the North and East is also likely to generate more income with the opening of more HNB branches, a major channel of distribution for the General Insurance segment.

### Earnings & Valuations

- ✓ Taking into account the possible growth opportunities available, we expect the company to enjoy a CAGR of 21% in GWP over the next 2 years. The profitability of the company is much dependent upon the claims incurred during the year which to a great extent is difficult to forecast.
- ✓ Although during the next 2 years Net Expense Ratio is likely to decline given falling inflation, we expect the Combined Ratio to exceed 100% given higher claims.
- ✓ Life Insurance segment is expected to witness a growth of 42% on average during the next 2 years in earnings available to shareholders against a 16% growth in the General Insurance segment. We expect HASU to post earnings of Rs. 266 million and Rs. 280 million for FY2009E and FY2010E respectively.
- ✓ At a price of Rs. 22.00 the counter trades at a P/E multiple of 4.27x FY2009E earnings and 3.2x FY2010E earnings. This represents a discount of 39% to the market. Given the potential growth opportunities available for HASU, we recommend **BUY**.



Income Statement (Rs. '000) For the year ended 31st December	2005			2006			2007			2008			2009E			2010E		
	General	Life	Group	General	Life	Group	General	Life	Group	General	Life	Group	General	Life	Group	General	Life	Group
<b>Revenues</b>			653.73			924.12			1,367.44			1,719.69			2,063.27			2,402.02
Gross Written Premium	469.93	354.18	824.11	618.50	503.32	1,121.82	704.58	767.58	1,472.15	924.71	914.17	1,838.88	1,093.97	1,193.41	2,287.38	1,279.95	1,432.09	2,712.03
Premium ceded to reinsurers	(140.66)	(35.50)	(176.15)	(206.69)	(51.40)	(258.09)	(202.33)	(69.53)	(271.86)	(308.96)	(79.95)	(388.91)	(382.89)	(107.41)	(490.30)	(447.98)	(128.89)	(576.87)
Net Written Premium	329.27	318.68	647.96	411.82	451.92	863.74	502.25	698.05	1,200.29	615.75	834.22	1,449.97	711.08	1,086.00	1,797.08	831.97	1,303.20	2,135.17
Net change in reserve for unearned premium	(59.21)	-	(59.21)	(49.28)	-	(49.28)	(33.65)	-	(33.65)	(74.29)	-	(74.29)	(80.00)	-	(80.00)	(85.00)	-	(85.00)
<b>Net Earned Premium</b>	<b>270.06</b>	<b>318.68</b>	<b>588.74</b>	<b>362.54</b>	<b>451.92</b>	<b>814.46</b>	<b>468.60</b>	<b>698.05</b>	<b>1,166.64</b>	<b>541.46</b>	<b>834.22</b>	<b>1,375.68</b>	<b>631.08</b>	<b>1,086.00</b>	<b>1,717.08</b>	<b>746.97</b>	<b>1,303.20</b>	<b>2,050.17</b>
<b>Benefit, Losses and Expenses</b>																		
Insurance claims and benefits (Net)	(144.55)	(12.18)	(156.73)	(219.34)	(14.92)	(234.26)	(291.28)	(25.60)	(316.88)	(363.81)	(44.67)	(408.48)	(426.65)	(42.84)	(469.50)	(443.68)	(50.12)	(493.80)
Underwriting and net acquisition cost	(4.95)	(88.68)	(93.62)	(6.06)	(115.13)	(121.19)	1.55	(154.21)	(152.67)	(6.27)	(161.89)	(168.17)	(0.50)	(186.18)	(186.68)	(6.00)	(204.80)	(210.80)
Increase in provision of Life Insurance fund	-	(131.05)	(131.05)	-	(206.90)	(206.90)	-	(372.95)	(372.95)	-	(479.83)	(479.83)	-	(612.23)	(612.23)	-	(749.64)	(749.64)
Other insurance related costs	0.03	(3.89)	(3.85)	(0.57)	(3.88)	(4.45)	(7.50)	(7.16)	(14.66)	(0.21)	(7.74)	(7.95)	(6.41)	(5.80)	(12.21)	(10.50)	(8.15)	(18.65)
<b>Total Benefits, Losses and Expenses</b>	<b>(149.46)</b>	<b>(235.80)</b>	<b>(385.26)</b>	<b>(225.97)</b>	<b>(340.84)</b>	<b>(566.80)</b>	<b>(297.24)</b>	<b>(559.92)</b>	<b>(857.16)</b>	<b>(370.29)</b>	<b>(694.14)</b>	<b>(1,064.43)</b>	<b>(433.56)</b>	<b>(847.05)</b>	<b>(1,280.61)</b>	<b>(460.18)</b>	<b>(1,012.70)</b>	<b>(1,472.88)</b>
<b>Net premium less benefits, losses and expenses</b>	<b>120.60</b>	<b>82.89</b>	<b>203.49</b>	<b>136.58</b>	<b>111.08</b>	<b>247.66</b>	<b>171.36</b>	<b>138.13</b>	<b>309.48</b>	<b>171.17</b>	<b>140.08</b>	<b>311.25</b>	<b>197.52</b>	<b>238.95</b>	<b>436.47</b>	<b>286.79</b>	<b>290.49</b>	<b>577.29</b>
<b>Other Revenue</b>																		
Income from Investments	38.51	26.48	64.99	56.05	53.17	109.22	86.16	113.84	200.00	126.80	215.47	342.27	120.87	224.47	345.34	122.80	228.07	350.87
Other income	-	-	-	0.11	0.33	0.44	(0.28)	1.08	0.80	(0.01)	1.76	1.74	0.43	0.43	0.85	0.49	0.49	0.98
<b>Expenses</b>																		
Other operating, investment related & administrative expenses	(95.10)	(98.75)	(193.85)	(113.87)	(133.75)	(247.62)	(158.60)	(186.71)	(345.31)	(202.57)	(255.68)	(458.25)	(232.08)	(320.50)	(552.58)	(263.27)	(363.56)	(626.83)
Depreciation & Ammortisation	(11.79)	(0.62)	(12.41)	(15.87)	(0.83)	(16.70)	(20.08)	(1.34)	(21.42)	(25.36)	(1.62)	(26.98)	(25.08)	(1.60)	(26.69)	(27.87)	(1.78)	(29.65)
<b>Operating Profit</b>	<b>52.21</b>	<b>10.00</b>	<b>62.21</b>	<b>63.00</b>	<b>30.00</b>	<b>93.00</b>	<b>78.56</b>	<b>65.00</b>	<b>143.56</b>	<b>70.03</b>	<b>100.00</b>	<b>170.03</b>	<b>61.64</b>	<b>141.75</b>	<b>203.39</b>	<b>118.95</b>	<b>153.71</b>	<b>272.66</b>
Interest Expense	(0.21)	-	(0.21)	(0.29)	-	(0.29)	(0.22)	-	(0.22)	(0.15)	-	(0.15)	(0.18)	-	(0.18)	-	-	-
<b>Profit Before Tax</b>	<b>52.01</b>	<b>10.00</b>	<b>62.01</b>	<b>62.70</b>	<b>30.00</b>	<b>92.70</b>	<b>78.33</b>	<b>65.00</b>	<b>143.33</b>	<b>69.87</b>	<b>100.00</b>	<b>169.87</b>	<b>61.46</b>	<b>141.75</b>	<b>203.21</b>	<b>118.95</b>	<b>153.71</b>	<b>272.66</b>
Taxation	-	-	(1.72)	-	-	(1.38)	-	-	(20.00)	(5.40)	-	(5.40)	(10.16)	-	(10.16)	(15.00)	-	(15.00)
<b>Profit after Tax</b>	<b>52.01</b>	<b>10.00</b>	<b>60.29</b>	<b>62.70</b>	<b>30.00</b>	<b>91.32</b>	<b>78.33</b>	<b>65.00</b>	<b>123.33</b>	<b>64.47</b>	<b>100.00</b>	<b>164.47</b>	<b>51.30</b>	<b>141.75</b>	<b>193.05</b>	<b>103.95</b>	<b>153.71</b>	<b>257.66</b>

Balance Sheet (Rs. '000) As at 31st December	2005			2006			2007			2008			2009E			2010E		
	General	Life	Group	General	Life	Group	General	Life	Group	General	Life	Group	General	Life	Group	General	Life	Group
<b>Assets</b>																		
Investments at cost	442.08	335.22	777.30	530.91	513.48	1,044.39	627.66	852.94	1,480.60	735.86	1,263.17	1,999.03	850.97	1,571.71	2,422.68	1,100.40	1,884.50	2,984.90
Intangible assets	-	-	-	18.53	1.87	20.40	17.60	2.94	20.54	17.32	5.74	23.06	13.78	7.42	21.20	11.92	6.42	18.35
Loans to life policy holders	-	0.98	0.98	-	1.28	1.28	-	1.59	1.59	-	4.67	4.67	-	9.60	9.60	-	10.05	10.05
Property, Plant and Equipment	64.32	2.99	67.31	54.05	1.21	75.66	70.19	1.40	92.13	66.25	8.15	91.72	75.56	2.51	99.27	75.93	3.34	97.62
Reinsurance receivable	63.37	5.33	68.70	32.03	10.28	42.30	24.68	6.23	30.92	59.29	10.03	69.31	64.73	16.18	80.91	75.66	18.91	94.57
Premium Receivable	67.54	-	67.54	95.57	-	95.57	86.72	-	86.72	120.92	-	120.92	165.53	-	165.53	198.19	-	198.19
Other Assets	49.69	17.00	66.70	80.37	30.23	110.60	120.96	78.78	199.74	152.40	150.52	302.92	218.05	145.37	363.42	257.39	171.59	428.98
Cash and Cash Equivalents	44.58	13.31	57.88	46.43	38.85	85.28	48.82	47.83	96.65	147.91	39.94	187.85	11.29	333.90	345.19	15.20	630.03	645.24
<b>Total Assets</b>	<b>731.57</b>	<b>374.83</b>	<b>1,106.41</b>	<b>857.89</b>	<b>597.20</b>	<b>1,475.48</b>	<b>996.63</b>	<b>991.71</b>	<b>2,008.88</b>	<b>1,299.95</b>	<b>1,482.21</b>	<b>2,799.48</b>	<b>1,399.91</b>	<b>2,086.69</b>	<b>3,507.80</b>	<b>1,734.69</b>	<b>2,724.85</b>	<b>4,477.89</b>
<b>Liabilities</b>																		
Insurance provision	267.02	300.82	567.84	319.54	507.72	827.26	340.56	880.67	1,221.24	470.21	1,360.51	1,830.71	472.10	1,972.73	2,444.83	499.39	2,722.37	3,221.76
Interest Bearing Borrowings	2.13	-	2.13	1.81	-	1.81	1.42	-	1.42	0.99	-	0.99	0.67	-	0.67	0.35	-	0.35
Retirement benefit obligations	2.64	0.46	3.10	3.53	0.46	3.98	6.56	0.92	7.48	9.64	1.68	11.32	14.05	1.92	15.97	18.20	2.48	20.68
Other Liabilities	87.81	73.55	161.36	102.61	89.02	191.63	119.49	110.11	229.60	160.32	120.02	280.34	121.38	112.04	233.42	114.80	-	220.77
Bank overdraft	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
<b>Total Liabilities</b>	<b>359.59</b>	<b>374.83</b>	<b>734.42</b>	<b>427.48</b>	<b>597.20</b>	<b>1,024.67</b>	<b>468.03</b>	<b>991.71</b>	<b>1,459.74</b>	<b>641.16</b>	<b>1,482.21</b>	<b>2,123.37</b>	<b>608.20</b>	<b>2,086.69</b>	<b>2,694.89</b>	<b>632.74</b>	<b>2,724.85</b>	<b>3,463.57</b>
<b>Shareholders' Equity</b>																		
Stated Capital			250.00			250.00			375.00			375.00			375.00			375.00
Revenue Reserves			121.99			200.81			174.14			301.11			437.92			639.33
<b>Total Shareholder's Equity</b>			<b>371.99</b>			<b>450.81</b>			<b>549.14</b>			<b>676.11</b>			<b>812.92</b>			<b>1,014.33</b>
<b>TOTAL LIABILITIES &amp; SH EQUITY</b>			<b>1,106.41</b>			<b>1,475.48</b>			<b>2,008.88</b>			<b>2,799.48</b>			<b>3,507.80</b>			<b>4,477.89</b>