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**12 April 2013**

# TUNE INS HOLDINGS BHD ("TUNE"): TUNE = Riding on AirAsia

**Recommendation: Buy**

**Share Price: RM1.43**

**FINANCIAL SUMMARY (PRO-FORMA)**

| FYE 31 Dec (RM mil) | 2011 | 2012 | 2013F | 2014F |
|---|---|---|---|---|
| Net Earned Premium | 210.9 | 217.0 | 238.8 | 262.6 |
| Pre-tax Profit | 69.2 | 58.6 | 79.4 | 107.8 |
| Net Profit | 49.1 | 41.5 | 61.6 | 82.3 |
| Core Net Profit | 49.1 | 56.0* | 61.6 | 82.3 |
| Underwriting margin (%) | 22.3 | 21.1 | 27.4 | 35.7 |
| Core EPS (sen) | 6.5 | 7.5 | 8.2 | 10.9 |
| DPS (sen) | - | - | 3.3 | 4.4 |
| PER (x) | 22.0 | 19.1 | 17.4 | 13.1 |
| Dividend Yield (%) | - | - | 2.3 | 3.1 |

**Adjusted for one-off non-recurring items i.e. listing expenses (~RM3.6mil), TIMB acquisition cost (~RM0.9mil), finance cost (~RM10mil) incurred for funding of TIMB acquisition.*

**OTHER KEY DATA**

| | |
|---|---|
| Listing | Main Board |
| Issued Cap. (mil, RM0.10 par) | 751.8 |
| Market Cap. (RM mil) | 1,075.1 |
| 52 Week Low/High (RM) | 1.48/ 1.27 |
| ROE (%) | 17.8 |
| P/BV (x) | 3.0 |
| BV/share (RM) | 0.48 |
| **Major Shareholders** | **(%)** |
| Tune Money Sdn Bhd | 55.9 |
| AirAsia | 16.2 |

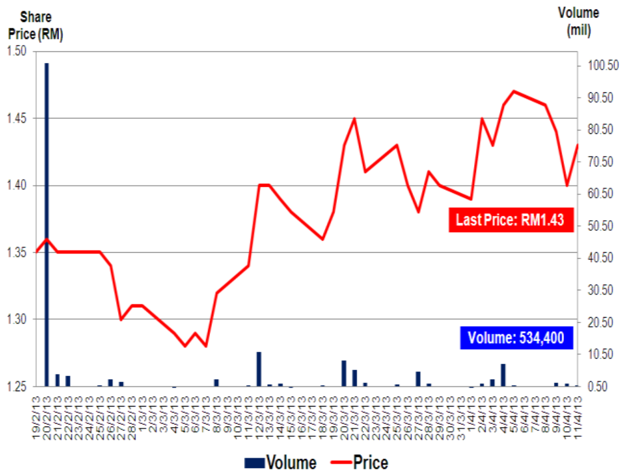
*Source: Company, Bloomberg & PCM estimates*

We favour TUNE for its resemblance of some the strong characteristics of AirAsia ranging from supreme market share, dynamic leadership, growth trajectory potential to geographical expansion. The stock also provides investors the opportunity to ride on AirAsia's growth and at the same time enjoy the following:

1) Good profit margins;
2) Negligible capex;
3) Zero risk to jet fuel cost;
4) Stable earnings; and
5) Strong free cashflow.

TUNE's FY2013F PER of 17.4x is justified due to its potential growth trajectory and interesting investment merits.

**Price Chart of TUNE (Feb'13 – Apr'13)**




*Source: Bloomberg*

## Highlights:

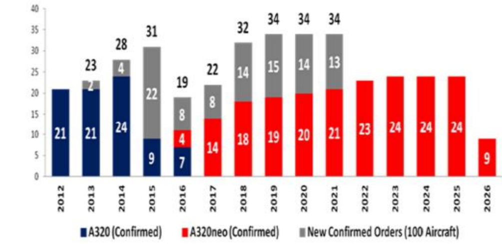
**Background** – TUNE is an insurance underwriter for both general and life insurance products, directly and via reinsurance, across the Asia Pacific region. It currently operates 2 core businesses encompassing 1) online insurance business in which it sells insurance products to customers of its online partners (at present AirAsia, Tune Hotels and AirAsia Expedia) and 2) general insurance business in Malaysia through its newly acquired Tune Insurance Malaysia Bhd (TIMB). Briefly, TUNE acquired 83.3% stake in TIMB in May 2012 to enable the Group to capture revenue from underwriting general insurance including travel insurance in Malaysia.

**Market dominance** – At present, TUNE is the sole air travel insurer for AirAsia and Tune Hotels customers who make their bookings via the internet. As such, it enjoys captive business which other insurance companies envy. eTiqa has similar arrangements with Malaysian Airlines though sales are limited to trips originating from Malaysia only.

**Dynamic management** – TUNE's management team comprises members with extensive experience ranging from revenue generation, innovation to profitability and have strong track record with leading insurance companies. Most importantly, its major shareholders especially Tan Sri Dato' Sri Dr. Tony Fernandes and Dato' Kamarudin Bin Meranun, both of whom have reputations and proven track records as leading entrepreneurs could apply their expertise and supports in driving TUNE into another success story. TUNE could also leverage its access to AirAsia and the Tune Companies (which involve in the hotel, financial services, education, entertainment and mobile services industries) for marketing and branding opportunities to attract customers to purchase a greater range of products underwritten by TIMB.

**Strong growth prospects –** TUNE unique business model of collaborating with AirAsia to distribute travel insurance products enables it to ride on the growth of AirAsia which is the leading low-cost carrier in Asia. AirAsia is embarking on an aggressive fleet expansion in the regional air travel, particularly Thailand and Indonesia as well as the recent joint ventures in Philippines (March 2012) and Japan (August 2012). We expect AirAsia's annual passengers carried would continue to increase to be underpinned by its capacity expansion plans as it has secured delivery of new aircrafts up to year 2026 (see **Chart 1**).

Chart 1: Current Schedule of Firmed Delivery of

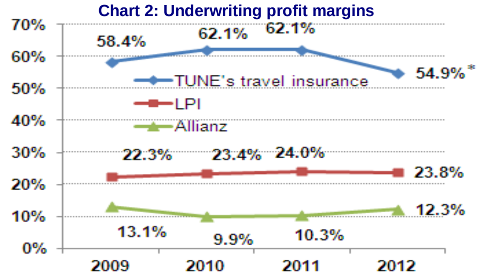


Source: AirAsia

Besides that, in recent years internet has become the main distribution channel for air tickets and the growing trend for online purchases of tickets could benefit TUNE since customers are given the option to buy travel protection plan online and the option is part of the online ticket purchase process. Worth highlighting is that since April 2011, TUNE managed to build a substantial database of approximately 7.6mil policyholders derived from policies it had underwritten through its tie-up with AirAsia. This provided a huge customer base which is still growing swiftly for TIMB to cross-sell other insurance products to, including personal and fire insurance.

**Regional exposure to further drive revenue growth** - More interestingly, Malaysia's business insurers are predominantly generated from the domestic market which is relatively more matured. However with AirAsia's extensive network, TUNE is currently offering insurance products to AirAsia customers in 14 out of 21 countries and territories to which AirAsia currently flies. Exposure to less penetrated markets in Thailand, Indonesia and Philippines will provide TUNE with better growth prospects in the longer term. Moving forward, TUNE intends to expand into new markets alongside AirAsia and may buy into local general insurer in Indonesia and Thailand.

Chart 2: Underwriting profit margins



Source: Companies & * PCM estimates

**High profit margins bolsters by low claims ratio** – TUNE's travel insurance, the Group's key growth driver moving forward, enjoys low claims ratio at 2 – 3%, due to the nature of travel-related insurance which is more lucrative compared with motor and fire insurance that have high claims ratio of between 38% to 79%. The low claims ratio enables TUNE's travel insurance to command the highest profit margins (see **Chart 2**). TUNE's profit from underwriting is more stable than other general insurers where a significant portion of profit comes from investment incomes which could be volatile. Worth highlighting is that the full ownership of TIMB allows TUNE to fully underwrite its Malaysia's air travel insurance without any partnership and hence TUNE is able to retain its profit that it used to share with its local partner.

**Strong balance sheet and negligible capex**– Upon listing, TUNE will be in better position to acquire local general insurer in Indonesia and Thailand to capture the insurance premium. Overall, there is negligible amount to be spent on capital expenditure as TUNE uses the distribution channels of both AirAsia and Tune Hotels, primarily their respective online booking websites to offer these products to their customers as part of their booking process.

**Over reliance of AirAsia poses no risk** – AirAsia would receive a portion of the gross premium paid by customers for each purchase of TUNE's travel insurance plan and the attractive commissions would vary in each market ranging from 16% - 31%. As such, we opine that it is highly unlikely for AirAsia to turn down the renewal of TUNE's distribution agreement which is due in 2022.

**Additional investment merits** – TUNE has minimal underwriting risk since air travel plan is of short tenors of about 1 – 3 weeks as such its short tail nature (where generally claims are usually known and settled within a short period of time) is not hard to manage as it is easy to work out the exact amount to be paid out. Its customer base comprises of small of groups of individual customers which is naturally not lumpy unlike those from the corporate and hence provides recurring revenue to the company. Aside this, TUNE's Labuan-based subsidiaries, TIL, TMLR and TMGR are paying taxes based on Labuan's tax act which is at substantially lower rate and hence, overall TUNE is able to enjoy a lower effective tax rate.

**Recommendation:-**

We find TUNE is in a unique position where it has most of the strengths of AirAsia ranging from market share supremacy, dynamic leadership, ample room for growth to regional exposure with exception of the former having good profit margins, insignificant capex and zero risk to fuel cost which leads to solid balance sheet and cash position. As such, we have a ***BUY*** call on TUNE for investors who seek to ride on AirAsia growth with less volatility (caused by fluctuation in fuel jet prices). TUNE's FY2013F PER of 17.4x is justified as it is supported by potential growth trajectory and the attractive investing merits.



For Phillip Capital Management Sdn Bhd

**Nona Salleh**
*Executive Chairperson*

**APPENDIX**
**LIST OF STOCKS RECOMMENDED SINCE 2011**

| Our Picks – 2011/12/13 | | | | | | |
|---|---|---|---|---|---|---|
| **No** | **Stock** | **Date** | **Price*** | **Price @ 11/04/13** | **% Change** | **Comments** |
| 1 | CIMB | 9 Mar 11 | RM 7.71 | RM7.78 | 0.9 | Hold. Foreigners don't think GE13 will affect CIMB. |
| 2 | TRC | 20 Apr 11 | RM0.586 | RM0.545 | -7.0 | Buy. Accident at Kelana Jaya LRT job will dent short-term earnings. |
| 3 | Bstead | 4 Aug 11 | RM4.245 | RM5.12 | 20.6 | Buy/Hold. Expect BHIC to turn around this year. |
| 4 | Dialog | 19 Aug 11 | RM2.354 | RM2.37 | 0.7 | Long Term Buy. Trading near it support of RM2.30. |
| 5 | Yinson | 13 Sep 11 | RM1.129 | RM2.80 | 148.0 | Hold. Final quarter operating results above expectation |
| 6 | Eng Kah | 18 Nov 11 | RM 3.09 | RM3.28 | 6.1 | Medium Term Buy. RM3.40 support broken, next support of RM3.20 is strong. |
| 7 | Prestariang | 14 Dec 11 | RM0.565 | RM1.23 | 117.7 | Hold. Trading at resistance now. |
| 8 | Padini | 21 Mar 12 | RM1.39 | RM1.95 | 40.3 | Hold. News of privatisation caused the price to move higher. |
| 9 | MPHB | 27 April 12 | RM2.58 | RM3.63 | 40.7 | Buy. Listing will be on again after SC agree to property valuation at a later date |
| 10 | Top Glove | 17 May 12 | RM4.20 | RM5.90 | 40.5 | Hold. H9N7 outbreak in China lifted its share price. |
| 11 | Genting | 30 May 12 | RM9.965 | RM10.20 | 2.4 | Hold. Foreign support lifted price to upper range. |
| 12 | Airport | 8 June 12 | RM5.56 | RM5.90 | 6.1 | Hold. Break RM5.90 resistance, next resistance is RM6.60. |
| 13 | RHB Cap | 31 July 12 | RM7.31 | RM8.55 | 17.0 | Buy. We don't think there is a need to privatise RHB Cap but merger with MBSB is possible. |
| 14 | OCK | 6 Aug 12 | RM0.435 | RM0.50 | 14.9 | Still a Buy. Likely to issue 10% placement of new share to a GLC. |
| 15 | Pantech | 18 Aug 12 | RM0.628 | RM0.765 | 21.8 | Buy/Hold. Raised its stock level expecting higher sales. |
| 16 | POS | 19 Oct 12 | RM3.10 | RM4.35 | 40.3 | Buy. Has tied up with more retailers to handle its courier business. |
| 17 | DRB | 30 Nov 12 | RM2.40 | RM2.60 | 8.3 | Medium-Term Buy. Proposed to sell land in Johore and KL for RM605m. |
| 18 | Telekom | 7 Dec 12 | RM5.46 | RM5.48 | 0.4 | Hold. Valuation is getting expensive from recent results. |
| 19 | MBSB | 24 Jan 13 | RM2.25 | RM2.70 | 20.0 | Still a Buy. Surprise market with 18 sen special div from Section 108 |
| 20 | REDtone | 20 Mar 13 | RM0.395 | RM0.425 | 7.6 | Buy. RM25m from Maxis to book in coming quarter(s). |
| 21 | Daya | 22 Mar 13 | RM0.21 | RM.215 | 2.4 | Buy. Main attraction is its large order book/mkt cap ratio. |

**Price adjusted for dividend, bonus and rights*