Shin Kong Financial Holding Co. (2888 TT)

BUY

Financial

Initiation

ML Research Team

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Recommendation

BUY	
Date:	Jun. 07, 2005
Share Price (NT$):	30.85
Price Target (NT$):	39.10
Percent Change:	26.74%
52-wk range (NT$):	28.00~31.00
TWSE:	6137.57

Company Data

Capital Size (NT$):	32,0420mn
Market Cap (NT$):	9,885mn
Market Cap (US$):	317mn
Outstanding Shrs:	3,204mn
Free Floating Shrs:	3,075mn
PER ('05E):	17.22x
PBR ('05E):	2.25x
Foreign Ownership:	22.68%
Major Shareholder:	Shing Shang 8.25%

Performance	1-m	3-m	6-m
Absolute	2.83	(7.91)	4.40
Relative to TAIEX	(0.31)	(493.21)	69.30

Key Changes	Current	Prev.
Recommendation	BUY	NA
Price Target (NT$)	39.10	NA
Revenue (NT$mn)	8,668	NA
Gross Margin (%)	100.00	NA
Oper. Margin (%)	94.91	NA
EPS (NT$)	2.27	NA

Price Catalysts (+,-)

(+) Growing insurance sales

(+) Capital gains from CMBS issuance

Related Research

Far Eastern Bank (2845 TT) Sep. 10, 2004

A pure insurance play

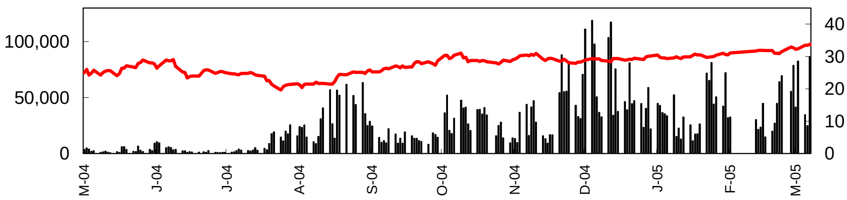
- We are initiating coverage on Shin Kong Financial Holding Company (SK FHC) with a buy rating of NT$ 39.10 target price. We view the company Taiwan's highest life insurance concentrated FHC who deserves a valuation of 2.25x BV multiple under a growing insurance-buying market, along with additional gains from CMBS issuances. Based on our estimation, the company's 2005 EPS will go up by 6.02% to NT$2.27 and BV for the same period will increase by 17.18% to NT$17.39 per share (Makoto addition factored in).

- **Life insurance business remains the core business driver.** We are positive on Taiwan's life insurance due to stimulation from new Labor Pension Act and people's awareness of aging population and dropping new birth rate. Shin Kong Life (SKL) is the 2nd largest insurance company, and we forecast 8% up net premium revenue for 2005, as a result of steady growth on traditional life products and cutback of investment–linked product sales.

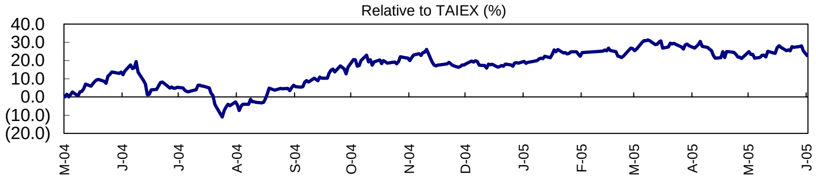
- **CMBS and REITs issuances will bring in good capital gains and enhance liquidation flexibility for the real estate investment assets.** SKL has issued two commercial mortgage backed security (CMBS) to dispose some of its real estate holdings, the transactions should post a net capital gains of NT$1,669 mn, or NT$0.44 EPS contribution in 2005.

- **Makoto addition strengthens the banking market share.** SK FHC just announced to buy Makoto for share exchange. The acquisition will help to increase the SK FHC's banking earnings; more importantly 80 bank branches will be added in to cross sell insurance products.

Average daily volume ('000, LHS) and share price (NT$, RHS)



Relative to TAIEX (%)



Investment Keynotes

SK FHC Company Overview

Distinguished from 13 other FHCs, Shin Kong FHC has the highest concentration in life insurance business. As the key business driver among the group companies, Shin Kong Life controls 89.6% group assets and has contributed 93.8% revenue and 100.9% earning as of 2005/03. The second largest subsidiary is Shin Kong Bank that holds 9.2% of group assets. The bank just turned profitable in 2004, although marginally, and is making efforts on transforming from a corporate banker to a consumer one. The transform progress is expected to expedite over next two years after join of Makoto scheduled in October this year.

Figure 1: SK FHC controlling assets & subsidiaries contribution (in NT$ mn)

	Assets under Control		Total Revenue Generated				Earnings Contribution			
	2005/03		2004		2005/03		2004		2005/03	
Shin Kong Life	864,312	89.6%	236,687	95.9%	58,834	93.8%	6,429	96.8%	2,994	100.9%
Shin Kong Bank	88,828	9.2%	2,809	1.1%	631	1.0%	28	0.4%	(17)	-0.6%
Shin Kong Securities	8,463	0.9%	407	0.2%	145	0.2%	90	1.4%	21	0.7%
New Light Assets Management	316	0.0%	33	0.0%	21	0.0%	3	0.0%	2	0.1%
Shin Kong Insurance Brokerage	50	0.0%	113	0.0%	37	0.1%	17	0.3%	5	0.2%
Shing Kong FHC	2,137	0.2%	6,776	2.7%	3,068	4.9%	76	1.1%	(37)	-1.2%
Total	964,106	100.0%	246,825	100.0%	62,736	100.0%	6,644	100.0%	2,968	100.0%

Source: Company data; MasterLink Securities

Shin Kong Life

Shin Kong Life is the 2~3 largest insurance company in Taiwan market whose gross premium revenue and first-year premium sales, respectively accounted for 10.69% and 9.25% market share, respectively in 1Q05, according to the industrial association statistics. Sales growth of investment-linked and interest-sensitive products (non-traditional products) skyrocketed since 2003 under a universe characterized by low bank saving rate and poor stock market performance. Nonetheless, these two types of products are exposed with greater rate spread risks and add limited value to insurer's L/T profitability. Hence, while continuing to offer various non-traditional products to cater market's fever, SK Life will reinforce sales activities in traditional life products.

Figure 2: First year premium sales (in NT$ bn)

	2004			First 4 months 2005		
	$$	%	yoy g.	$$	%	yoy g.
Traditional	7.8	16%	-37%	5.73	37%	41%
Investment-linked	8.3	17%	608%	3.42	22%	356%
Health, accident & others	3.5	7%	-21%	1.03	7%	-10%
Interest-sensitive annuities	30.6	61%	123%	5.4	35%	-36%
Total	50.2	100%	59%	15.59	100%	8%

Source: Company data; MasterLink Securities

Figure 3: Gross premium sales (in NT$ bn)

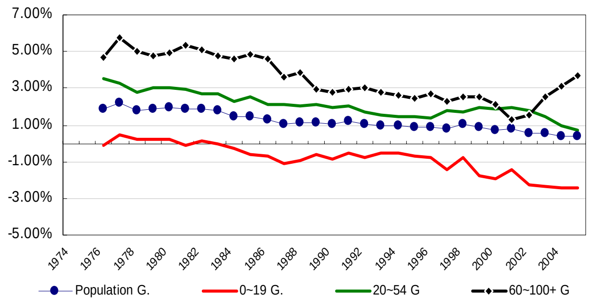
	2004			First 4 months 2005		
	$$	%	yoy g	$$	%	yoy g
Traditional	94.13	61%	-2%	32.8	68%	11%
Investment-linked	8.29	5%	609%	3.42	7%	356%
Health, accident & others	21.59	14%	1%	6.81	14%	2%
Interest-sensitive annuities	30.61	20%	123%	5.4	11%	-36%
Total	154.62	100%	17%	48.43	100%	7%

Source: Company data; MasterLink Securities

Starting from June 2005, 65% workers in Taiwan will allocate 6% wages earned into pension annuity fund, either to individual designated or to corporate designated accounts, following by the implementation of the new Labor Pension Act. We believe the new system has raised people's attention on retirement preparation to increase insurance buying, especially on low risk and long-paying term annuities products and high-coverage traditional life policies. We; therefore, estimate robust insurance sales growth for the next two years. We also extend our positive view to the insurance industry over a long term. As witnessed in the figure below, Taiwan is experiencing the declining birth rate and aging population, which will eventually change people's retirement plan from living off their offspring to buying more insurance to take care of their own.

We project the SK Life's net premium revenue to rise 8% in 2005 for steady growth on traditional premium revenue and cutback sales on investment-link products. After required reservation and benefits paid, insurance operation margin will post at negative end.

Figure 4: Taiwan Population Age Profile



Source: Ministry of Interior; MasterLink Securities

Our estimation shows by the end of 2005, Shin Kong Life will be managing an investment fund of NT$853,994 mn that generates an investment yield equal to 4.7%. The investment portfolio will weight heavily on fixed income investments due to concerns on the turbulent stock market performance.

In addition, we should see good capital gains from the real-estate investment as the company began to transfer its invested properties under the trust to issue commercial mortgage backed security (CMBS) or real estate investment trust (REITs) beginning from 2005. We view the securitization a better alternative to dispose real estate investment, as the property valuation is less bargained, compared with traditional disposition method. Two CMBSs were sold to the public so far this year. After SK Life's 56.6% retention, the transactions are expected to post a gains of NT$1,669 mn, or NT$0.44 EPS contribution in total.

Our discussion with company management reveled the issuance proceed will be used in new land development projects. The insurer just announced to spend NT$ 9,000mn to co-build two other service apartment complexes with Formosa International Hotels Corporation (2707 TT) to house 350 apartment units in the busiest business district in Taipei, Hsin Yi district. According to the company projection, its newly open service apartment project, Jasberg, also in Hsin Yi district, could generated a rental yield of 4.5%~5.0% with 75% occupancy rate.

Figure 5: CMBS & REITs issuance planning (in NT$ mn)

Issuing type	CMBS		REITs	
Issuing date	01/2005	09/2005	2006E	2007E
Underlying building	Chunshen Bldg.	Tunhwa S. Bldg.	SK Commercial Int'l Bldg.	Tienmu Jasberg
Issuing amount	2,800	3,080	1,260	5,498
Book value	1,250	1,668	537	2,689
Retention	56.4%	56.4%	None	None
Capital gain	874.2	796.368	723	2,809
FHC EPS contribution	0.23	0.21	0.19	0.73

Source: Company data; MasterLink Securities

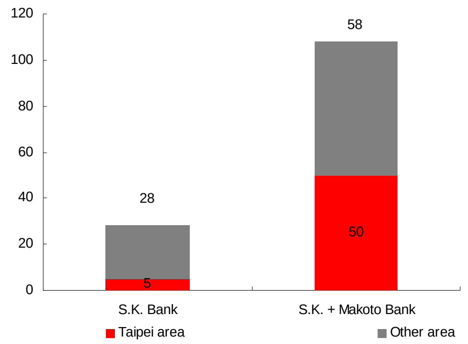
Banking

SK FHC just announced to buy Makoto Bank in April with an exchange of 622mn FHC shares. The acquisition value is equal to NT$20bn based on FHC's 10-day average closing price. The effective merging date is set at October this year and the operation integration is scheduled to complete within two years. We are glad to see the FHC finally made its bank acquisition to expand its banking operation. More importantly we view the consolidation more a strategic move to expand SK Life's bancassuance channels to sell annuities and investment-linked products, which are sold through 20 different banks at current. We believe the FHC aims for becoming an omnipotent player provider that offers full range of retirement and financial planning tools on its insurance and bank platforms.

We believe Makoto should serve a good complement to SK FHC:

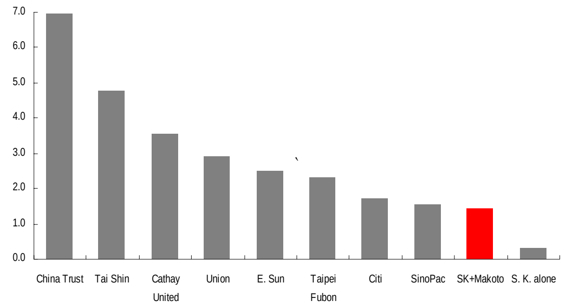
- Total bank branch count will add from 28 to 108, which will significant enhance the FHC's banking presence, especially in the Taipei Metropolitan area where 25% of Taiwan population or 6.3 mn people resides
- Fast penetration to the consumer and credit card banking business, which are the dearth under SK Bank's current product lines
- Create cross-selling synergy between consumer banking and insurance selling

Figure 6: Bank channel addition



Source: BoMA; MasterLink Securities

Figure 7: Credit Card Issuance as of 2005/04 (in thousand cards)



Source: BoMA; MasterLink Securities

We believe SK FHC will slowdown looking for next M&A target bank, as the integration of SK FHC and Makoto should take about two years to complete before we see some resplendent sparkle between the two. However, our comparison table below leads us to believe that Makoto should immediately boost up SK FHC's banking operation both in operating and earning efficiency.

Figure 8: Operation & Earning Efficiency Comparison

	SK Bank	Makoto
# of branches	28	80
2004 revenue	2,355	11,761
2004 net earnings bfr. tax	8	233
2004 net earnings	28	206
2004 average asset	77,770	221,695
2004 average equity	6,979	10,820
Per branch revenue	84.1	147.0
Asset Turnover	3.03%	5.30%
ROA	0.01%	0.11%
ROE	0.11%	2.16%

Source: Company data; MasterLink Securities

Nonetheless, we anticipate no significant banking earning contribution until 2006, as the acquired bank is likely to write off massive amount of bad loan to lower the NPL ratio in 2005. As of April 2005 total Makoto's broad-base NPL ratio post was 3.94% (an NPL amount of NT$4,306 mn), still inferior to the industry average of 3.67% for the same period.

Valuation and Recommendation

The stock is currently trading at NT$30.85 (1.77x 2005 BV ratio) within its trading valuation band of 1.75x ~2.00 BV multiple for the past 10 months. Nevertheless, we would like to raise the share's valuation to 2.25x BV multiple, given it's unique position of the highest insurance concentration, which will be benefited the most under a growing insurance buying market as we stated. Our one-year target for the stock is NT$ 39.10, or 2.25x BV multiple, implying 26.74% upside from current share price.

Figure94: Historical PB Band

		Assets Controlled (%)	Earnings Contribution (%)
2888	Shin Kong FHC	89.57%	96.77%
2882	Cathay FHC	60.96%	51.90%
2881	Fubon FHC	13.37%	11.36%

Source: BoMA; MasterLink Securities

Figure10: Historical PB Band

Source: BoMA; MasterLink Securities

SK Life P&L					NT$mn
Year to December	**2002**	**2003**	**2004**	**2005E**	**2006E**
Net Premium Revenue	107,264	123,550	139,673	150,847	165,931
Benefit to Policyholders	51,804	50,139	51,564	55,813	64,713
Net Provision & Reserve	126,277	127,279	149,924	161,029	174,228
Recoveries	46,721	39,765	38,939	42,237	53,098
Total Insurance Underwriting	(24,095)	(14,102)	(22,877)	(23,758)	(19,912)
Interest Income (Net)	17,625	19,131	23,868	28,895	30,856
Real Estate Investment (Net)	3,436	3,519	2,885	4,889	4,749
Other Investments (Net)	4,773	9,400	9,169	6,971	10,309
Other Operting Revenue (Net)	(307)	(289)	4,257	6,000	600
Total Operating Revenue	1,432	17,659	17,303	22,996	26,602
SG&A	16,577	14,166	12,689	15,019	16,542
Operating Earning (Net)	(15,145)	3,493	4,614	7,977	10,060
Non Operating (Net)	2,025	1,970	2,146	0	1,097
Pretax Earnings	(13,120)	5,463	6,759	7,977	11,157
Tax Expense	39	410	221	319	247
Net Earnings	(13,159)	5,053	6,539	7,658	10,910

SK Life Investment Fund Mix					NT$mn
Year to December	**2002**	**2003**	**2004**	**2005E**	**2006E**
Investment Return:					
Interest Assets Yield	5.6%	4.4%	4.4%	4.7%	4.7%
Real Estate Investment Yield	10.1%	5.0%	3.7%	5.7%	5.4%
Trading, Dividend, Unrealized Yield	2.9%	9.3%	9.1%	4.5%	6.0%
Total Investment Yield	5.0%	5.3%	5.0%	4.8%	4.9%
Interest Income (Net)	17,625	19,131	23,868	28,895	30,856
Real Estate Investment (Net)	3,436	3,519	2,885	4,889	4,749
Trading, Dividend,Unrealized, (Net)	4,773	9,400	9,169	4,924	8,167
Total Investment Income	25,834	32,050	35,922	38,708	43,772
Investment Assets:					
Total Cash & Equivalent	43,347	75,916	39,452	34,160	73,545
Marketable Securities	91,397	69,743	93,021	85,399	137,898
Secured Loans	90,126	80,335	169,494	123,829	73,545
Policy Loans	95,903	96,113	-	102,479	110,318
L/T Domestic Bonds	92,462	91,934	368,840	17,080	91,932
L/T Oversease Bonds	49,260	159,909	-	384,297	312,568
Real Estates	67,828	72,086	85,896	85,399	91,932
Equity Investment	21,084	19,527	19,081	21,350	27,580
Others	-	34	30	-	-
Total Invesment Assets	551,407	665,598	775,813	853,994	919,317
Average Investment Assets	513,978	608,503	720,706	814,904	886,656
Investment Assets/Total Assets (Avg.)	91.3%	93.1%	93.4%	93.0%	92.3%

SK Life Balance Sheet					NT$mn
Year to December	**2002**	**2003**	**2004**	**2005E**	**2006E**
Cash & Equivalent	43,347	75,916	39,452	34,160	73,545
Marketable Security	91,397	69,743	93,021	85,399	137,898
Total Other Current Assets	17,412	18,099	29,887	32,918	36,256
All Loans	186,030	176,448	169,494	226,308	183,863
L/T Equity Investment	24,096	19,528	19,081	21,350	27,580
L/T Bond Investment	141,722	251,843	368,840	401,377	404,500
Real Estate Investment	67,828	72,086	85,896	85,399	91,932
Other L/T Investment	-	34	30	33	36
Fixed Assets (Net)	14,799	14,336	13,731	15,123	16,657
Total Other Assets	11,391	10,687	14,955	16,942	29,134
Total Assets	598,022	708,721	834,386	919,010	1,001,401
S/T Borrowings	-	4,450	-	-	-
Payables & Other Current Liab.	8,003	9,739	9,301	10,244	11,162
Other L/T Liab.	6,166	6,878	10,716	12,861	13,471
Insurance Reserve	568,060	655,573	766,559	840,895	916,282
Total Liabilities	582,229	676,641	786,575	863,999	940,915
Common Shares	21,811	21,312	21,209	21,209	21,209
Preferred Shares	-	8,000	15,000	15,000	15,000
Reserve	13,422	852	5,025	5,678	6,444
Retained Earnings	(12,570)	4,359	6,577	13,124	17,833
Adjustments	(3,825)	(629)	-	-	-
Treasury Stocks	(3,044)	(1,815)	-	-	-
Total Equity	15,794	32,080	47,811	55,011	60,486
Total Liabilities & Equity	598,022	708,721	834,386	919,010	1,001,401

SK FHC total assets controlled					NT$mn
Year to December	**2002**	**2003**	**2004**	**2005E**	**2006E**
Shin Kong Life Insurance	598,022	708,721	834,386	919,010	1,001,401
Makoto Bank	-	-	-	229,157	230,423
Shing Kong Bank	-	69,260	86,280	86,335	86,460
Shin Kong Securities	7,962	9,351	8,858	8,948	9,068
New Light Asset Management	-	-	312	347	382
Shin Kong Insurnace Brokerage	-	15	44	62	82
Shin Kong F.H.C.	1,913	2,512	1,628	2,980	7,450
Total	607,897	789,860	931,507	1,246,839	1,335,265

SK FHC P&L					NT$mn
Year to December	2002	2003	2004	2005E	2006E
Shin Kong Life Insurance	(13,159)	5,053	6,429	7,658	10,910
Makoto Bank	-	-	-	844	1,266
Shin Kong Bank	-	(2,004)	28	55	125
Shin Kong Securities	-	373	90	90	120
New Light Asset Management	-	-	3	3	35
Shin Kong Insurnace Brokerage	-	4	17	17	20
Other Investment Income	(804)	2,008	77	-	-
Total Investment Income	(13,963)	5,434	6,644	8,668	12,476
Shin Kong Life Insurance%	94.2%	93.0%	96.8%	88.4%	87.4%
Makoto Bank%	-	-	-	9.7%	10.1%
Shin Kong Bank%	-	-36.9%	0.4%	0.6%	1.0%
Shin Kong Securities%	-	6.9%	1.4%	1.0%	1.0%
New Light Asset Management%	-	-	0.00	0.0%	0.3%
Shin Kong Insurnace Brokerage%	-	0.1%	0.3%	0.2%	0.2%
Other Investment Income%	5.8%	36.9%	1.2%	-	-
Total Investment Income%	100.0%	100.0%	100.0%	100.0%	100.0%
Operating Expenses	73	92	237	474	710
Operating Income	(14,037)	5,342	6,407	8,227	11,765
Non Operating (Net)	(44)	(93)	(50)	458	458
Pretax Earnings	(14,081)	5,249	6,357	8,684	12,223
Tax Expense	4	2	(15)	(10)	(10)
Net Earnings	(14,085)	5,247	6,372	8,694	12,233
EPS	(5.80)	2.21	2.14	2.27	3.20

SK FHC Balance Sheet					NT$mn
Year to December	2002	2003	2004	2005E	2006E
Cash & Equivalent	1,856	2,434	1,420	2,515	6,287
MarketableSecurity	55	-	-	-	-
Total Other Current Assets	1	77	204	459	1,148
Long-term Investment	22,900	38,333	60,760	80,333	87,373
Total Fixed Assets	1	1	4	6	16
Total Assets	24,812	40,845	62,387	83,313	94,823
S/T Borrowings	3,500	2,220	4,020	0	3,600
Payables & Other Current Liab.	5	67	488	750	854
Total L/T Liab.	-	10,000	13,759	15,291	14,646
Total Liab.	3,505	12,287	18,267	16,781	19,100
Common Shares	24,270	23,772	29,729	38,262	38,262
Reserve	15,699	2,888	8,020	13,850	12,260
Retained Earnings	(14,085)	5,245	6,463	14,511	25,293
Others	-	-	(63)	(63)	(63)
Treasury Stocks	(4,577)	(3,348)	(29)	(29)	(29)
Total Equity	21,307	28,557	44,121	66,531	75,723
Total Liabilities & Equity	24,812	40,845	62,388	83,313	94,823
Book Value	8.78	12.01	14.84	17.39	19.79

MasterLink Securities – Stock Rating System
BUY: Total return expected to appreciate 10% or more over a 3-month period.
HOLD: Total return expected to be between 10% to –10% over a 3-month period.
SELL: Total return expected to depreciate 10% or more over a 3-month period.

Additional Information Available on Request