



Financial sector

September FHC earnings fell 27% MoM; life insurers posted better 3Q23 profits than their financial peers

Key message

The aggregate net profit of fourteen FHCs rose 100% YoY off a low 2022 base on substantial P&C insurance losses, but sank 27% MoM in September, mainly due to lower investment income. Whether or not the Fed will announce another rate hike in November depends on actual results of inflation, unemployment, and financial tightening, but we note that the ongoing rate hike cycle is nearing an end. We do not expect bank NIM to widen further in 2H23. Coupled with the fact that banks tend to increase their credit costs in 4Q, we expect FHCs that have benefitted from widening US-Taiwan interest spread YTD, namely Mega FHC (2886 TT, NT\$38.50, N), and First FHC (2892 TT, NT\$26.85, N), will see earnings lose steam in 4Q23. With long-term US Treasury yields bouncing above 4.5% of late, we expect financial firms to suffer valuation losses from overseas bond holdings in 4Q23, which in turn will drag down their net worth, tier-1 CAR, and distributable 2023 earnings. On a positive note, higher long-term Treasury yields will boost new money yields for life insurers, although life insurers still have to look out for liquidity pressure stemming from the surrendering of insurance policies. We prefer Fubon FHC (2881 TT, NT\$61.60, OP), Yuanta FHC (2885 TT, NT\$25.50, OP), and E. Sun FHC (2884 TT, NT\$24.60, OP) in the financial sector, and note that the suspension of rate hikes by the central bank of Taiwan will drive a rebound in interest spreads for leasing firm Yulon Finance (9941 TT, NT\$182.5, OP).

Event

The aggregate net profit of fourteen FHCs rose 100% YoY, but sank 27% MoM in September, mainly due to lower investment income amid increased capital market swings and reduced recognition of cash dividends. The aggregate 3Q23 net profit of the fourteen FHCs grew 54% YoY, with insurance- and bank-centric FHCs posting respective 92% and 34% YoY earnings growth, outpacing securities-centric FHCs' 6% YoY growth.

Analysis

Life insurance- & securities-centric FHCs. Fubon FHC (2881 TT, NT\$61.60, OP) reported September net profit of NT\$5.4bn, up from a net loss of NT\$4.0bn in September 2022 due to losses from the P&C insurance unit. However, September earnings fell 22% MoM, mainly as Taipei Fubon Bank's earnings declined 26% MoM on lower investment income, and Fubon Life's earnings declined 2.3% MoM, with forex and capital gains up by a respective 88% and 275% MoM to NT\$4.5bn and NT\$1.5bn, offsetting a recurring income decrease of NT\$1bn MoM, with total premiums being reduced by NT\$1.8bn. Fubon Insurance reported a net profit of NT\$180mn, on higher IBNR of commercial fire insurance, versus a previous loss of NT\$9.77bn in September 2022. January-September FHC earnings accounted for 80% of our full-year 2023 forecast.

Cathay FHC (2882 TT, NT\$45.95, R) saw its September net profit surge 326% YoY (as P&C insurance unit reported a loss of NT\$3.47bn in the same time last year), but retreat 16% MoM to NT\$4.77bn, with Cathay Life posting a 16% MoM earnings decline, while improved hedging cost was offset by lower cash dividend income, and bank earnings also booking a 15% MoM decline on lower investment and fee income. Yuanta FHC's (2885 TT, NT\$25.50, OP) September net profit arrived at NT\$1.72bn, down 18% YoY and 37% MoM, as securities earnings dropped 33.6% MoM (but rose 50% YoY due to a 28% YoY increase in brokerage fee income and narrowing other losses) to NT\$920mn, with brokerage fee income capped by a 19% MoM decline in TaieX daily turnover, while other income also fell on a MoM basis. In the meantime, bank and life insurance earnings retreated a respective 18% and 83% MoM in the face of a more volatile capital market. 3Q23 FHC earnings sank 7% QoQ, but grew 6% YoY to NT\$8.56bn, in line with our forecast, prompting 1Q-3Q23 FHC earnings to grow 20% YoY to NT\$23.5bn, accounting for 84% of our full-year 2023 estimate.

Bank-centric FHCs. E. Sun FHC (2884 TT, NT\$24.60, OP) reported September net profit of NT\$1.95bn, up 274% YoY and 17% MoM, as the firm saw investment income of NT\$1.23bn (versus loss of NT\$960mn in September 2022). E. Sun Bank's net profit rose 160% YoY in September, on fee income growth and lower general provisions. 3Q23 FHC earnings arrived in line at NT\$5.34bn, up 18% QoQ and 17% YoY, pushing up YoY growth in 1Q-3Q23 FHC earnings to 36.4%. YTD earnings accounted for 77% of our full-year 2023 forecast.

CTBC FHC (2891 TT, NT\$24.90, N) posted a September net profit of NT\$4.46bn, up 26% YoY, but down 42% MoM, mainly as Taiwan Life's earnings plunged 61% MoM on reduced forex and cash dividend income, while CTBC Bank's September profit fell 23% MoM on higher ESOP, amid the stock rally. 3Q23 FHC net profit grew 25% QoQ and 151% YoY to NT\$19.8bn, beating our forecast by 10%. However, growth in 1Q-3Q23 earnings decelerated to 31% YoY, coming in at NT\$48.58bn, accounting for 87% of our full-year forecast.

Mega FHC's (2886 TT, NT\$38.50, N) September net profit arrived at NT\$1.93bn, down 36% MoM, but above a loss of NT\$1.21bn in September 2022, on provisions for COVID-19 insurance policies. The MoM decline in September net profit was mainly due to a 36.5% contraction in bank earnings, reflecting a NT\$400mn MoM shortfall in equity valuation gains under the FVTPL category and realized investment gains under FVOCI, in addition to a net increase of NT\$200mn in provisions, although FX swap gains, inclusive of exchange income, remained flattish MoM at NT\$1.2-1.3bn. 3Q23 FHC net profit grew 3% QoQ and 45% YoY to NT\$8.26bn, 2% above our forecast. 1Q-3Q23 earnings rose 98% YoY, accounting for 82% of our full-year 2023 estimate.

First FHC (2892 TT, NT\$26.85, N) September net profit fell 27.5% YoY and 34% MoM to NT\$1.25bn, as First Bank's moderate increase of NT\$100mn in FX swap gains and benefits from reduced net provisions were offset by a NT\$500mn MoM shortfall in investment income, given the absence of cash dividends. 3Q23 FHC earnings sank 10% QoQ and 5% YoY to NT\$5.87bn, missing our forecast by 5%, while 1Q-3Q23 net profit only grew 16% YoY to NT\$19.0bn, accounting for 77% of our full-year 2023 estimate.

Taishin FHC (2887 TT, NT\$17.80, N) reported a net loss of NT\$730mn in September, down 158% YoY and 141% MoM, mainly as 15% YoY growth in bank earnings was offset by Taishin Venture Capital's loss of NT\$2.1bn from an impaired valuation of Diamond Biofund (6901 TT, NT\$42.6, NR), which saw shares plunge about 40% after listing in September. 3Q23 FHC net profit fell 16% YoY, missing our forecast by 30% mainly due to a loss for the venture capital unit. 1Q-3Q23 earnings growth decelerated to 47% YoY, with earnings value accounting for 72% of our full-year 2023 forecast.

FHC exposure to Israel mainly in form of government bonds. The Israeli stock market has experienced drastic swings following the attack by Hamas in the south. According to statistics compiled by the Financial Supervisory Commission (FSC), as of 2Q23, the total financial exposure of Taiwanese FHCs to Israel was about NT\$136.8bn, of which NT\$133bn, or about 98%, was in the form of investments, while the remaining NT\$700mn, or 2%, was bank loans. Based on investment positions of over NT\$3.0bn disclosed by individual FHCs, Cathay FHC and Fubon FHC held a respective NT\$58.7b, and NT\$20.8bn worth of Israeli government bonds, as of 2Q23, with exposure equivalent to 8% and 3% of their respective net worth, with manageable risk of asset impairment.

Stocks for Action

Whether or not the US Fed will announce another rate hike in November hinges on the status of inflation, unemployment, and financial tightening, but we note that the ongoing rate hike cycle is nearing an end. We do not expect bank NIM to widen further in 2H23. Coupled with the fact that banks tend to increase their credit costs in 4Q, we expect FHCs that have benefitted from a widening US-Taiwan interest spread in most of 2023, namely Mega FHC and First FHC, will see earnings lose steam in 4Q23. With long-term US Treasury yields bouncing above 4.5% of late, we expect financial firms to suffer valuation losses from overseas bond holdings in 4Q23, which in turn will drag down their net worth, tier-1 CAR, and distributable 2023 earnings. On a positive note, higher long-term Treasury yields will boost new money yields for life insurers, although life insurers still have to look out for liquidity pressure, likely from the surrendering of insurance policies. At the moment, we prefer Fubon FHC, Yuanta FHC and E. Sun FHC in the financial sector, and note that the suspension of rate hikes by the central bank of Taiwan will drive a rebound in interest spreads for leasing firm Yulon Finance (9941 TT, NT\$182.5, OP).

Risks

Weakening global financial markets; high credit costs for banks.

Figure 5: Shanghai Commercial & Savings Bank (5876 TT, NT\$44.35, N) consolidated net revenue fell 7.8% MoM in September, on lower investment income; 3Q23 net revenue growth slowed to 2% YoY, & fell 1% QoQ as growth in net interest income slowed

NT\$m	2022		1Q23		2Q23		3Q23			Aug-23	Sep-23		MoM(%)	Jan-Sep 23	YoY(%)
		YoY(%)		YoY(%)		YoY(%)		YoY(%)	QoQ(%)			YoY(%)			
Net interest income	32,812	25.9	8,857	31.2	9,814	26.0	10,592	16.0	7.9	3,553	3,534	15.5	(0.5)	29,007	43.6
Net fee income	6,027	(9.7)	1,482	(14.6)	1,450	(1.1)	1,645	23.7	13.4	538	510	10.4	(5.1)	4,729	9.3
Investment income	4,844	37.3	862	(24.6)	2,108	143.1	1,111	(55.9)	(47.3)	419	111	(38.6)	(73.5)	4,027	(8.1)
Others	888	(52.6)	190	(52.5)	177	5.8	62	(59.7)	(65.0)	17	16	(73.5)	(1.8)	463	(29.3)
Net revenue	44,570	16.9	11,391	13.6	13,550	31.7	13,410	2.1	(1.0)	4,527	4,172	10.8	(7.8)	38,226	29.3

Source: Company data, KGI Research

Figure 6: Taix daily turnover fell 19% MoM to NT\$337.8bn in September amid global capital market weakness, dragging down brokerage fees & investment income for securities firms, which saw earnings decline 32% MoM

NT\$m	2022		1Q23		2Q23		3Q23			Aug-23	Sep-23		Jan-Sep 23	YoY(%)	EPS (NT\$)			
FHC ticker	Subsidiary name	Earnings	YoY(%)	EPS (NT\$)	Earnings	YoY(%)	Earnings	YoY(%)	Earnings	YoY(%)	QoQ(%)	Earnings	Earnings	YoY(%)	MoM(%)	Earnings	YoY(%)	EPS (NT\$)
2880 TT	Hua Nan Securities	1,107	(56.2)	1.69	220	(35.9)	468	88.2	486	51.8	3.8	97	107	N.A.	10.3	1,174	28.7	1.79
2881 TT	Fubon Securities	2,760	(61.0)	2.59	1,530	100.0	1,800	231.7	2,040	69.2	13.3	510	340	3,300.0	(33.3)	5,490	118.7	3.38
2882 TT	Cathay Securities	1,410	(35.9)	1.83	460	16.4	580	66.7	540	39.8	(6.9)	220	100	(9.1)	(54.5)	1,580	39.8	2.05
2883 TT	KGI Securities	3,665	(71.6)	1.62	1,891	31.0	1,802	159.5	1,695	211.5	(5.9)	300	261	222.2	(13.0)	5,390	101.0	2.90
2884 TT	E.Sun Securities	1,003	(40.6)	2.51	286	(0.7)	323	17.8	355	N.A.	9.9	102	92	84.0	(9.8)	962	18.3	2.41
2885 TT	Yuanta Securities	12,052	(48.3)	1.83	3,039	(13.2)	4,100	33.7	3,907	23.9	(4.7)	1,385	920	50.1	(33.6)	11,046	13.7	1.68
2886 TT	Mega Securities	603	(78.1)	0.52	466	169.2	622	3,143.6	541	53.6	(13.0)	90	1	(94.1)	(98.9)	1,629	114.9	1.40
2887 TT	Taishin Securities	520	(70.5)	0.75	440	109.7	444	2,366.3	240	(17.5)	(45.9)	30	20	N.A.	(33.3)	1,110	113.5	1.60
2888 TT	MasterLink Securities	362	(90.8)	0.23	771	N.A.	774	N.A.	446	65.0	(42.4)	25	24	N.A.	(4.0)	1,989	N.A.	1.24
2890 TT	SinoPac Securities	1,580	(67.1)	0.97	803	1.7	926	806.8	1,328	517.9	43.4	304	319	N.A.	4.9	3,057	176.9	1.89
2892 TT	First Securities	403	(73.1)	0.66	331	168.8	333	485.5	167	(26.6)	(49.8)	15	31	(60.8)	106.7	831	103.7	1.35
2855 TT	President Securities	729	(81.8)	0.50	458	N.A.	1,170	194.1	823	21.3	(29.7)	116	-105	N.A.	N.A.	2,451	378.6	1.68
5880 TT	Taiwan Cooperative Securities	286	(61.4)	0.55	41	(58.6)	93	88.9	101	N.A.	8.6	11	-8	N.A.	N.A.	234	(14.3)	0.45
6005 TT	Capital Securities	1,173	(78.5)	0.38	1,211	327.6	1,198	N.A.	1,191	390.2	(0.5)	351	314	8.6	(10.5)	3,600	621.4	1.50
Total of 15 brokerages		27,653	(64.6)		11,947	45.9	14,633	150.3	13,860	76.1	(5.3)	3,556	2,415	70.1	(32.1)	40,542	73.0	

Source: Company data, KGI Research

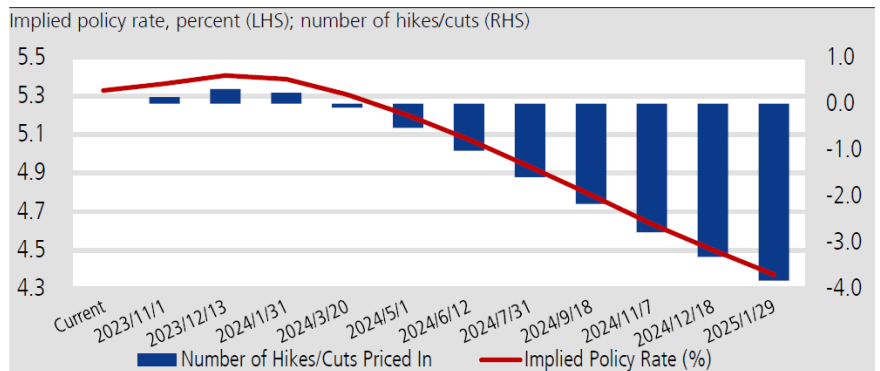
Figure 7: Sales of Yulon Finance & Hotal Finance were flattish MoM, but grew over 14% YoY in September; Chailease saw 3.7% MoM sales decline on lower solar income in Taiwan and reduced new business in ASEAN countries; Yulon September net profit grew 7.7% MoM & 23% YoY, despite reduced non-op income & income tax expenses

NT\$m	2022		1Q23		2Q23		3Q23			Aug-23	Sep-23		Jan-Sep 23	2023F			
FHC ticker	Subsidiary name	Sales	YoY(%)	Sales	YoY(%)	Sales	YoY(%)	Sales	YoY(%)	QoQ(%)	Sales	Sales	YoY(%)	MoM(%)	Sales	YoY(%)	Achieved(%)
5871 TT	Chailease	78,835	20.4	23,140	16.1	24,137	14.0	25,185	12.9	4.3	8,496	8,179	11.1	(3.7)	72,462	14.3	74.2
9941 TT	Yulon Finance	33,256	14.2	9,783	16.3	10,380	16.3	10,711	14.1	3.2	3,577	3,550	13.9	(0.8)	30,875	15.4	74.0
6592 TT	Hotal Finance	20,640	27.3	6,565	26.6	6,920	26.7	7,503	26.9	8.4	2,545	2,555	29.7	0.4	20,988	26.7	73.1

NT\$m	2022		1Q23		2Q23		3Q23			Aug-23	Sep-23		Jan-Sep 23	2023F					
FHC ticker	Subsidiary name	Earnings	YoY(%)	EPS (NT\$)	Earnings	YoY(%)	Earnings	YoY(%)	Earnings	YoY(%)	QoQ(%)	Earnings	Earnings	YoY(%)	MoM(%)	Earnings	YoY(%)	EPS (NT\$)	Achieved(%)
5871 TT	Chailease	26,946	24.5	18.01	6,890	(3.9)	13,064	89.0				2,086							
9941 TT	Yulon Finance	5,801	12.6	12.30	1,793	10.6	3,535	173.4	1,716	10.0	(1.5)	552	594	23.1	7.7	5,251	17.3	9.30	74.0
6592 TT	Hotal Finance	4,070	29.5	7.04	899	3.6	1,786	94.4											

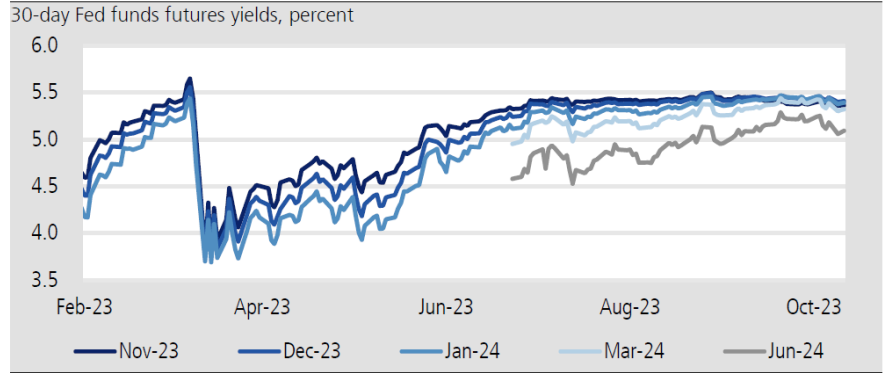
Source: Company data, KGI Research

Figure 8: Market has lowered expectations for a 25bps rate hike by the Fed in November, & expects rate cuts to begin in 2Q24F



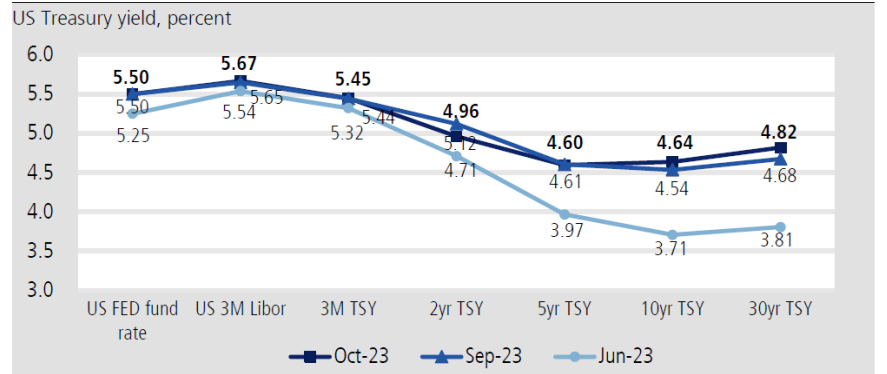
Source: Bloomberg, KGI Research

Figure 9: Expectations have fallen for a 25bps rate hike by Fed in November due to geopolitical events & upticks in long-term Treasury yields



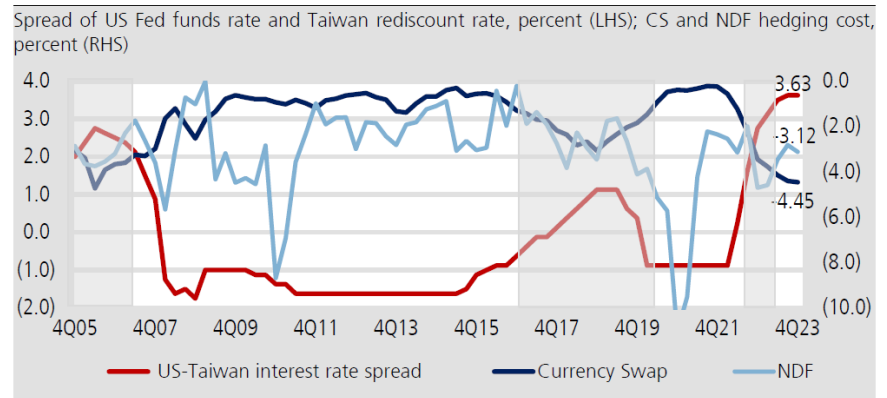
Source: Bloomberg, KGI Research

Figure 10: US 10-year & 30-year Treasury yields hit respective highs of 4.8% and 4.9% in September, but 10-year rate retreated to 4.6% as geopolitical events have steered funds into Treasuries for hedging; whether long-term yields will stay above 4.5% depends on Fed's 2024 rate cut guidance



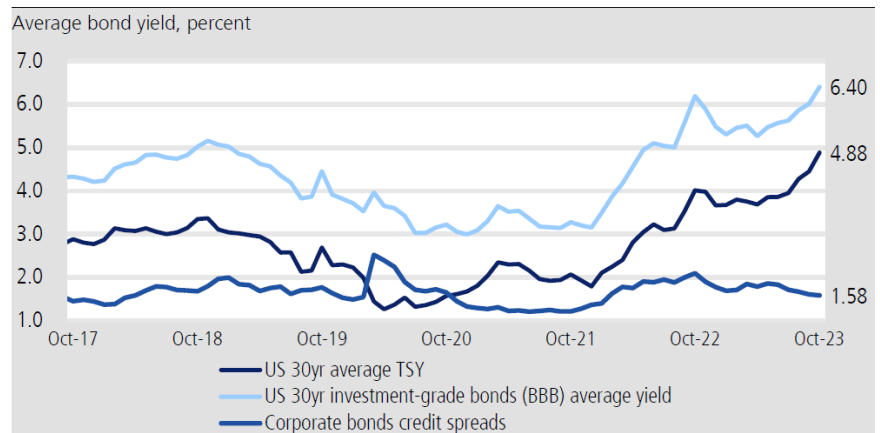
Source: Bloomberg, KGI Research

Figure 11: 4Q23 CS cost rose to 4.45% on US-Taiwan interest spread widening to 3.63%, but as Fed rate cuts are near end, we do not expect CS cost to rise further



Source: Bloomberg, KGI Research

Figure 12: Long-term US Treasury yields have risen, prompting BBB-rated US corporate bond yields to rise to over 6%, which has boosted new money yields for life insurers



Source: Bloomberg, KGI Research

Figure 13: Based on investment positions of over NT\$3.0bn disclosed by individual FHCs, Cathay FHC and Fubon FHC held a respective NT\$58.7bn and NT\$20.8bn worth of Israeli government bonds, as of 2Q23, with exposure equivalent to 8% and 3% of their respective net worth, with manageable risk of asset impairment

Amount of US Financial exposure in 2Q23(NTSmn)		Israel Government International Bond	2Q23 Total exposure of Israel Government International Bond	2Q23 Total Equity Attributable to Equity Holders of the Parent	% of net worth
Ticker	Company	Israel Government International Bond			
2882 TT	Cahtay FHC	58,714	58,714	707,204	8%
2881 TT	Fubon FHC	20,785	20,785	743,309	3%
2888 TT	Shin Kong FHC	17,460	17,460	403,247	7%
2885 TT	Yuanta FHC	5,478	5,478	222,553	2%
2892 TT	First FHC	358	358	235,458	0%
2891 TT	CTBC FHC				
2884 TT	ESUN FHC				
2887 TT	Taishin FHC				
2880 TT	Hua Nan FHC				
2890 TT	Sinopac FHC				
5880 TT	Cooperative FHC				
2886 TT	Mega FHC				
Total		102,795	102,795		

Source: KGI Research

Figure 14: Overall bank NPL ratio was flat MoM at 0.15% in August; Mega Bank's NPL ratio fell 0.05ppt MoM to 0.2% on bad loan write-offs, while Shanghai Commercial & Savings Bank saw NPL ratio rise 0.01ppt to 0.18%; we believe high interest rates in US & EU will continue to weigh on overseas asset quality of banks

FHC/Bank ticker	Bank	Aug-23				Aug-23				Aug-23			
		NPL ratio (%)	YoY (ppts)	YTD (ppts)	MoM (ppts)	NPL (NT\$mn)	YoY	YTD	MoM	Coverage ratio (%)	YoY (ppts)	YTD (ppts)	MoM (ppts)
2834 TT	Taiwan Business Bank	0.18	(0.02)	(0.02)	0.00	2,535	(189)	(189)	(29)	726.2	125.4	84.5	20.2
2801 TT	Chang Hwa Bank	0.17	(0.05)	(0.03)	0.00	2,910	(625)	(625)	7	726.7	137.2	88.7	(15.9)
2886 TT	Mega Bank	0.20	0.08	0.09	(0.05)	4,273	760	760	(925)	762.2	(79.6)	(168.4)	129.0
5880 TT	Taiwan Cooperative Bank	0.20	0.01	0.04	(0.02)	5,612	259	259	(307)	547.0	(19.8)	(90.4)	32.8
2892 TT	First Bank	0.17	(0.01)	(0.01)	0.00	4,042	46	46	107	782.3	105.3	73.1	(12.8)
2881 TT	Taipei Fubon Bank	0.12	(0.05)	(0.07)	0.00	2,302	(489)	(489)	12	1,118.3	354.6	416.5	16.8
2888 TT	Shin Kong Bank	0.12	(0.01)	0.00	0.00	910	(69)	(69)	1	1,124.9	118.3	34.8	2.6
2884 TT	E.Sun Bank	0.17	0.01	0.01	0.00	3,421	342	342	63	700.7	(49.6)	(51.8)	(4.6)
2880 TT	Hua Nan Bank	0.15	0.02	0.01	0.01	3,129	713	713	36	898.2	(209.6)	(95.3)	5.2
5876 TT	SCSB	0.18	(0.07)	0.01	0.01	1,564	(439)	(439)	85	814.8	273.7	(90.8)	(35.9)
2891 TT	CTBC Bank	0.13	(0.03)	0.00	0.00	3,748	675	675	(42)	897.4	(60.7)	(84.6)	16.3
2885 TT	Yuanta Bank	0.02	(0.01)	0.02	(0.01)	231	(174)	(174)	(17)	6,115.6	2,904.4	(493.7)	462.7
2890 TT	Bank Sinpac	0.08	(0.03)	(0.03)	0.00	1,179	(760)	(760)	37	1,519.2	638.3	351.0	(24.5)
2887 TT	Taishin Bank	0.12	(0.01)	(0.02)	0.00	1,786	(125)	(125)	(35)	1,147.1	143.1	173.8	34.5
2882 TT	Cathay United Bank	0.10	0.01	0.02	0.00	2,048	324	324	(5)	1,718.6	(47.0)	(431.0)	16.2
2809 TT	King's Town Bank	0.02	0.00	0.00	0.00	42	2	2	(1)	8,542.2	58.9	(328.1)	19.3
	Bank industry	0.15	(0.01)	0.00	0.00	56,630	69	69	(1,587)	907.2	60.1	(3.3)	29.9

Source: TEJ, KGI Research

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