



COMPANY UPDATE

Fubon Financial Holdings (2881.TW)

Neutral

ING Life Taiwan deal: Strategic positive, mixed financial impacts

What's changed

Fubon FHC hosted a conference call to discuss its 100% acquisition of ING Life Taiwan ("ING"), the 5th largest life insurer in Taiwan, in detail.

Implications

It is a **strategically positive deal with mixed financial impacts**, in our view.

Strategically, we highlight: **(1) Complementary business profile**, including sales channel, policy focus and customer base; **(2) Scale expansion** on combined basis with 13-14% market share and a solid number 2 market position, which should help create more loading gain going forward.

Financially, the positives include: **(1) Self-financed deal** with 5% dilution to existing shareholders, and the remaining financed through sub-debt issuance to ING Group; **(2) Below-EV valuation** at 0.71X 2Q08 book value; According to Fubon, ING's latest adjusted EV (embedded value), based on Taiwan accounting standards, is higher than its book value. The negatives include **(1) Increasing equity value volatility**. Most of ING's investment is under the available-for-sales category, which does not require MTM on the P&L, but on the balance sheet; **(2) Negative interest spread**. ING's cost of liability is 5.5%-6%, but investment yield was merely 3.86% in the past 3.5 years, implying Fubon Life would have to pursue a more aggressive investment strategy to narrow the spread. However, recent financial market turmoil makes it challenging to get higher-yield investments that can match ING's liability duration (average 30-35 years).

Valuation

The market may view the deal positively for the complementary business profile and below-EV transaction value, in our view. We maintain our Neutral rating and 12-month SOTP-based target price at NT\$27.

Key risks

Substantial credit cost increase on its banking unit's property developer-related lending (6.5% of loan book); continued widening of negative interest spread if failure to obtain higher-yield, duration-matched investments.

INVESTMENT LIST MEMBERSHIP

Neutral

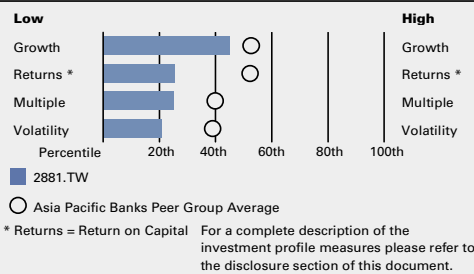
Coverage View: Neutral

Taiwan:
Banks

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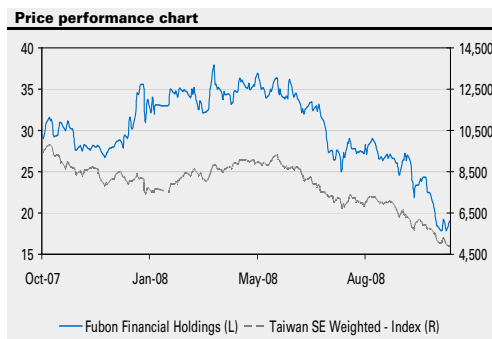
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Investment Profile: Fubon Financial Holdings



Key data	Current
Price (NT\$)	19.05
12 month price target (NT\$)	27.00
Market cap (NT\$ mn / US\$ mn)	147,048.7 / 4,515.7
Foreign ownership (%)	26.9

	12/07	12/08E	12/09E	12/10E
EPS (NT\$)	1.87	1.51	1.91	2.20
EPS growth (%)	75.7	(19.4)	26.5	15.2
P/B (X)	0.9	0.9	0.9	0.8
P/E (X)	10.2	12.6	10.0	8.7
Dividend yield (%)	7.9	6.7	8.5	7.5
P/PPOP (X)	4.5	6.9	6.5	5.8
PPOP growth (%)	34.2	(35.2)	5.8	11.3
Preprovision ROA (%)	1.9	1.2	1.2	1.3
Credit cost (%)	1.6	1.0	1.1	1.0
ROA (%)	0.82	0.64	0.78	0.85
ROE (%)	8.8	7.0	8.8	9.8



Share price performance (%)	3 month	6 month	12 month
Absolute	(28.7)	(47.2)	(36.7)
Rel. to Taiwan SE Weighted Index	(1.4)	(2.9)	23.3

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 10/20/2008 close.

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Fubon Financial Holdings: Summary financials

Profit model (NT\$ mn)	12/07	12/08E	12/09E	12/10E	Balance sheet (NT\$ mn)	12/07	12/08E	12/09E	12/10E
Net interest income	30,551.1	29,663.6	31,706.6	34,913.9	Gross loans	656,548.4	686,234.5	689,938.1	743,242.3
Non-interest income	29,431.1	16,580.7	17,002.1	17,493.7	NPLs	7,884.7	14,410.9	14,488.7	15,608.1
Operating revenue	59,982.2	46,244.3	48,708.7	52,407.6	Loan loss reserves	6,365.2	6,713.5	7,098.8	7,501.2
Non-interest expense	(27,051.3)	(24,902.1)	(26,126.4)	(27,264.2)	Total interest earning assets	1,239,610.9	1,342,159.1	1,395,776.9	1,519,359.2
Provision operating profit	32,930.9	21,342.2	22,582.3	25,143.3	Other non-interest earning assets	564,325.0	502,994.4	522,469.5	544,123.9
Total provision charge	(10,461.2)	(7,072.3)	(7,261.4)	(7,626.7)	Total assets	1,803,935.9	1,845,153.5	1,918,246.4	2,063,483.1
Associates	(95.7)	(394.2)	2,137.4	2,563.5	Customer deposits	982,651.9	997,429.1	1,048,286.6	1,146,134.9
Pretax profit	17,875.6	13,932.8	17,515.4	20,137.3	Total interest-bearing liabilities	1,240,317.6	1,269,850.1	1,328,092.1	1,446,751.1
Tax	(2,825.0)	(2,207.7)	(2,691.6)	(3,047.1)	Total equity	170,195.2	169,729.8	174,558.0	179,004.5
Minorities	(619.0)	(97.6)	(112.2)	(138.8)	CAMEL ratios (%)	12/07	12/08E	12/09E	12/10E
Net profit	14,431.6	11,627.5	14,711.6	16,951.3	C: Tier 1 capital ratio	9.6	12.9	13.1	12.5
Dividends	11,578.6	9,883.4	12,504.9	11,018.4	C: Equity/loans	20.5	20.1	20.3	19.3
Dividends payout (%)	80.2	85.0	85.0	65.0	C: Equity/assets	9.2	9.0	8.9	8.5
Earnings growth drivers (%)	12/07	12/08E	12/09E	12/10E	A: NPL ratio	1.2	2.1	2.1	2.1
Net interest margin	1.67	1.63	1.74	1.77	A: Loan loss reserves/NPLs	80.7	46.6	49.0	48.1
Provision charge/total loans	1.30	0.86	0.87	0.84	E: Net interest margin	1.67	1.63	1.74	1.77
YoY Growth (%)					E: Non int inc/oper revenues	49.07	35.85	34.91	33.38
Customer deposits	1.7	4.9	5.2	9.5	E: Cost-income ratio	43.5	51.9	51.7	50.2
Loans	10.3	2.2	1.7	8.3	E: ROAA	0.82	0.64	0.78	0.85
Net interest income	4.0	(2.9)	6.9	10.1	L: Loan/deposit ratio	82.1	82.7	80.0	79.2
Fee income	72.6	(17.5)	(7.9)	2.1	Key CAMELOT assumptions	12/07	12/08E	12/09E	12/10E
Non-interest income	47.3	(43.7)	2.5	2.9	GS CAMELOT implied P/B (X)	--	0.9	--	--
Operating revenue	21.5	(22.9)	5.3	7.6	GS CAMELOT implied P/E (X)	--	10.3	--	--
Operating expenses	(9.0)	7.9	(4.9)	(4.4)	Risk-free rate (%)	2.5	2.5	2.5	2.5
Provision operating profit	34.2	(35.2)	5.8	11.3	Equity risk premium (%)	6.5	6.5	6.5	6.5
Provision charges	(31.7)	(32.4)	2.7	5.0	CAMELOT beta (X)	--	1.1	--	--
Pretax profit	86.1	(22.1)	25.7	15.0	Risk-adjusted cost of equity (%)	--	9.7	--	--
Net profit	71.8	(19.4)	26.5	15.2	3-yr adjusted DPS CAGR (%)	--	12.0	--	--
EPS	75.7	(19.4)	26.5	15.2	Sustainable ROE estimate (%)	--	9.5	--	--
DPS	49.8	(14.6)	26.5	(11.9)	LT dividend payout estimate (%)	--	40.0	--	--
Market dimensions	12/07	12/08E	12/09E	12/10E	Ex-growth bond-equivalent P/B (X)	--	1.0	--	--
No of branches	123.0	123.0	123.0	123.0	Loan portfolio (%)	12/07	12/08E	12/09E	12/10E
No of staff (000)	14.0	14.3	14.9	16.0	Commercial & corporate	52.3	50.7	49.0	50.0
Revenues/staff (US\$)	130,367.0	103,695.1	100,443.6	100,464.7	Mortgages/home loans	31.6	33.1	34.2	33.7
Net profit/staff (US\$)	31,366.0	26,072.7	30,337.3	32,495.5	Consumer	37.0	38.4	39.9	39.3
DuPont analysis (%)	12/07	12/08E	12/09E	12/10E	Valuation (current price)	12/07	12/08E	12/09E	12/10E
ROE	8.8	7.0	8.8	9.8	P/E basic (X)	10.2	12.6	10.0	8.7
x leverage	9.3	9.1	8.9	8.7	P/B (X)	0.89	0.89	0.86	0.84
= ROA	0.82	0.64	0.78	0.85	P/PPOP (X)	4.5	6.9	6.5	5.8
% of assets	12/07	12/08E	12/09E	12/10E	Dividend yield (%)	7.9	6.7	8.5	7.5
Net interest income	1.73	1.63	1.69	1.75	EPS, basic (NT\$)	1.87	1.51	1.91	2.20
Fee income	0.72	0.58	0.52	0.50	EPS, fully-diluted (NT\$)	1.87	1.51	1.91	2.20
Non-interest income	1.67	0.91	0.90	0.88	EPS, basic growth (%)	75.7	(19.4)	26.5	15.2
Operating revenue	3.40	2.53	2.59	2.63	EPS, fully diluted growth (%)	75.7	(19.4)	26.5	15.2
Operating expenses	1.53	1.36	1.39	1.37	BVPS (NT\$)	21.47	21.45	22.07	22.65
Provision operating profit	1.87	1.17	1.20	1.26	DPS (NT\$)	1.50	1.28	1.62	1.43
Loan loss provisions	0.59	0.39	0.39	0.38					
Pretax profits	1.01	0.76	0.93	1.01					
Taxes	0.16	0.12	0.14	0.15					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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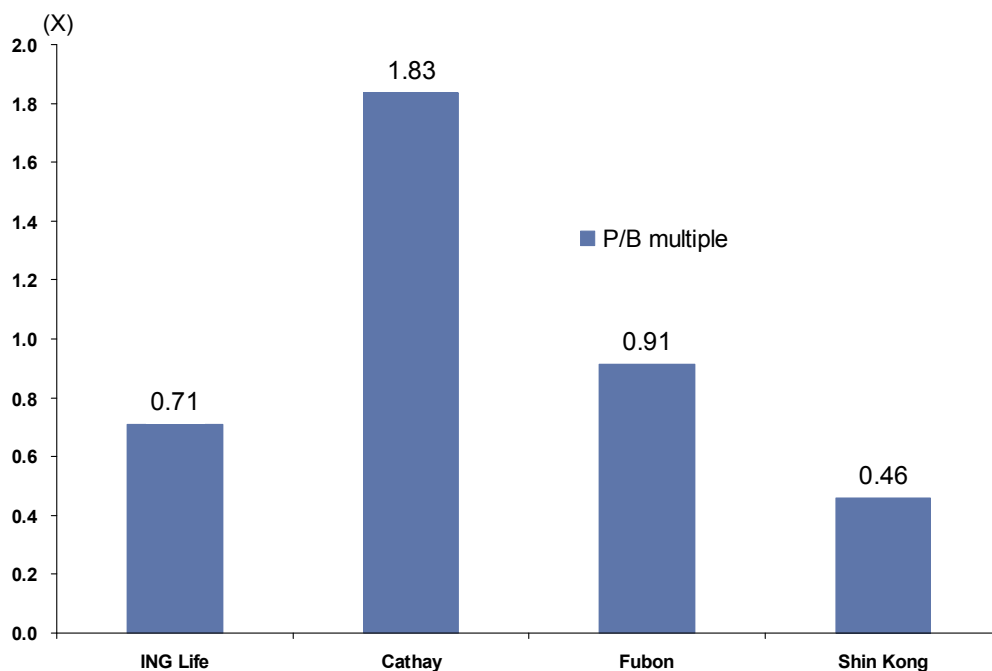
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Self-financed deal structure with 5% dilution to existing shareholders

Fubon FHC announced on October 20 that it will acquire 100% of ING Life Taiwan for US\$600mn by issuing new shares and subordinated debt securities to ING Group. This implies a transaction multiple of 0.71X 2Q08 P/B. Management did not disclose the exact number for ING Life Taiwan’s EV, but indicated that its EV (based on Taiwan accounting standards) is higher than its book value.

Exhibit 1: Fubon is acquiring ING Life Taiwan at 0.71X P/B



Note: BVPS are based on 2Q08 numbers.

Source: Company data.

Stock portion

- Fubon FHC will issue 406 mn new common shares (5% dilutive to existing shareholders), with a 1-year lock-up period, to ING Group;
- The price of the new shares will be based on 20-day moving average of Fubon FHC’s market price prior to the pricing day, which will be in 1Q2009;
- Based on the Oct 20th closing price of NT\$19.05, this implies 47% of the deal will be paid through common shares;
- The floor price for such common share issuance is NT\$15 per share.

Sub debt

- The size of the debenture is based on the total transaction value minus the stock portion, and has a duration of 8 years;
- The interest rate is mid-swap rate (c.4% currently) plus 338 bp;

- The sub-debt will be qualified as tier-2 capital when calculating the capital adequacy ratio.

Additional optional financing

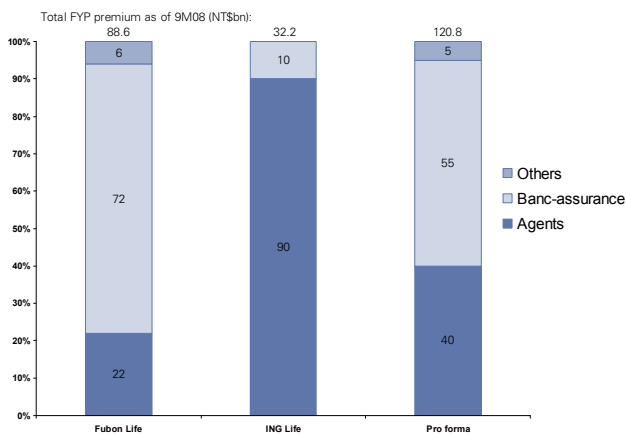
- Fubon has the option to issue another US\$350mn sub-debt to ING Group before the end of 2009, should it have further capital needs.
- The additional financing will be on the same terms as the subordinated debt issued for the transaction.

The deal is pending Fubon’s shareholder approval (meeting scheduled in December 2008) and Fubon will then submit the acquisition application to the FSC. Fubon expects to close the deal by the end of 1Q2009, with ING Life becoming one of its subsidiaries. After a 3-9 month alignment period, it will then merge Fubon Life and ING Life.

Complementary business profile

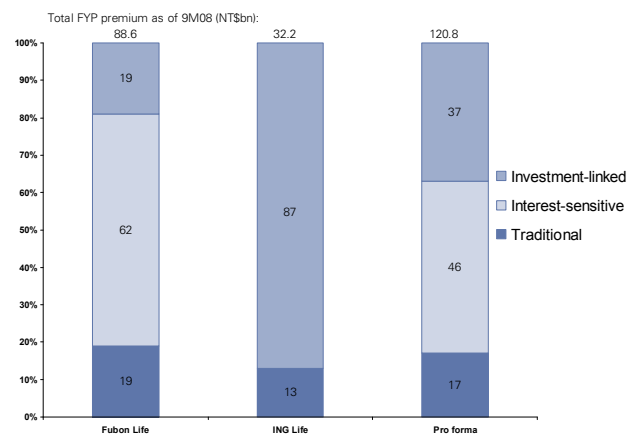
- **Distribution channel:** 90% of ING Life’s FYP is distributed through tied sales agents and 10% is through bancassurance, versus 22% and 72% for Fubon Life. With an additional 8,100 agents, the agency force of the combined entities will be ranked third in the market and the distribution model will be more diversified (40%/ 55% respectively).
- **Policy focus:** ING Life focuses on regular premium policies, which accounts for average of 46% of its FYP during 2005–9M08, while 96% of Fubon Life’s policy are single-premium (e.g., interest sensitive policies, investment-link policies).
- **Customer base:** Fubon FHC has 6.5 mn customers, while ING Life has 2.2 mn. Fubon’s management estimates there are only 560,000 overlapped customers.

Exhibit 2: Fubon FHC is stronger in bancassurance, while ING Life mainly focuses on the tied sales agent channel
FYP distribution channel (as of first 9 months in 2008)



Source: Company data

Exhibit 3: The combined entity will have a more diversified policy mix
FYP premium breakdown (as of first 9 months in 2008)

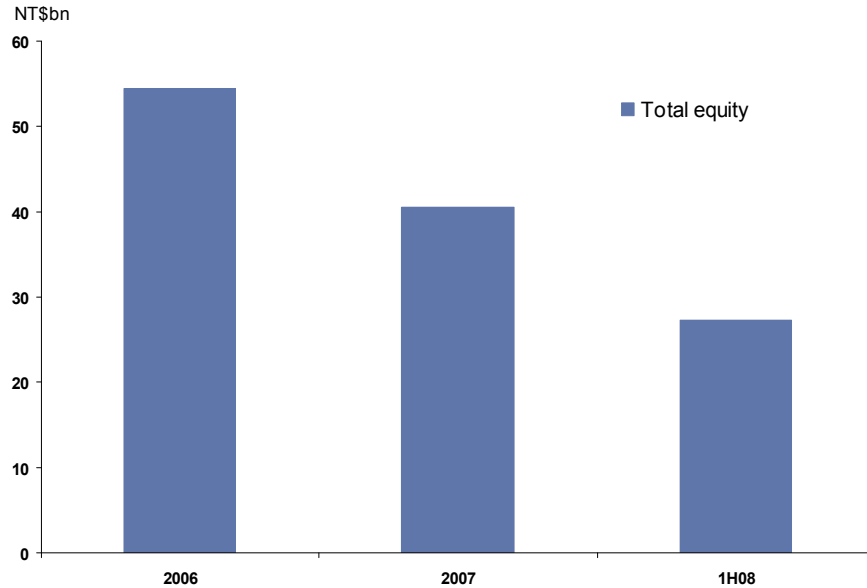


Note: Regular premium accounts for only 14% of ING Life’s FYP in 9M08 due to the special environment; however, it is still higher than the 4% of Fubon Life.

Source: Company data

Increasing volatility in its equity

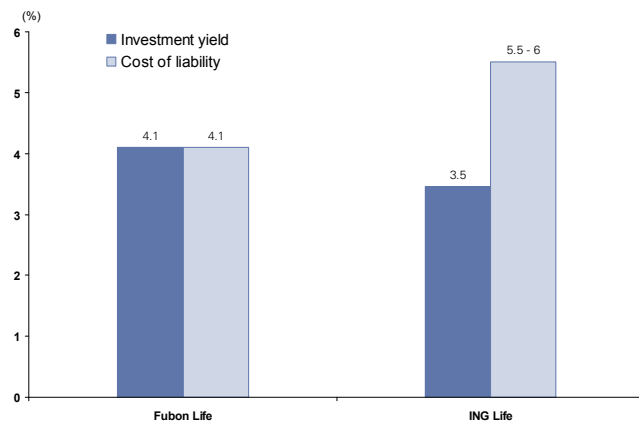
Exhibit 4: The deal might increase Fubon Life's equity value volatility as most of ING Life's investments are booked under the available-for-sale category



Source: Company data.

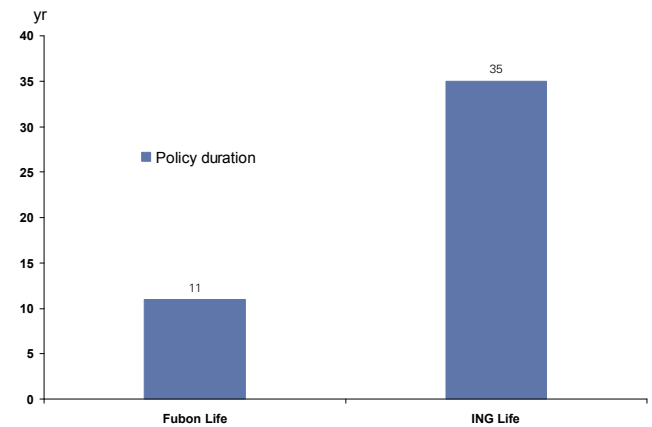
Widened negative interest spread

Exhibit 5: Fubon Life does not have significant negative interest spread issues, but ING Life does
As of first 9 months in 2008



Source: Company data

Exhibit 6: Owing to the policy/customer base difference, ING Life's policy duration is much longer than Fubon Life's
As of first 9 months in 2008



Source: Company data

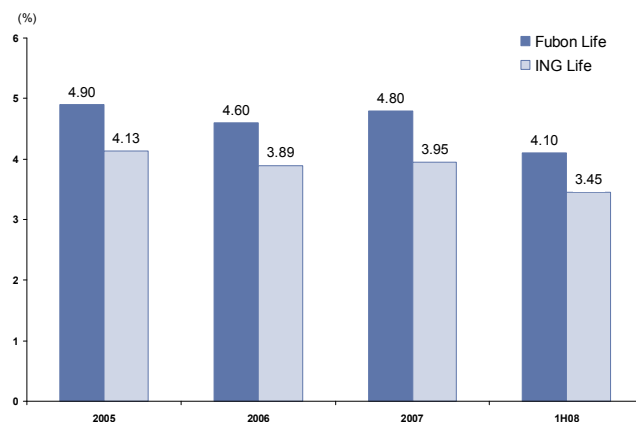
Exhibit 7: As a result, ING Life has to invest more longer duration fixed income securities (which has low yield in Taiwan) to match its expected cash outflow

NT\$bn	Fubon Life	%	ING Life	%
Deposits and cash equivalent	19	6.9	5	1.0
Fixed income-domestic	92	33.3	270	51.6
Equity market-domestic	44	16.0	30	5.8
Overseas investments	88	31.8	147	28.1
Real estate	11	4.1	13	2.5
Policy loans	8	2.8	30	5.7
Mortgage loans	14	5.1	28	5.3
Total	276	100.0	524	100.0

Note: Fubon Life's data is as of 2Q08; ING Life's data is as of 9M08

Source: Company data

Exhibit 8: Consequently, ING Life has structurally lower investment yield. It would be a challenging task for Fubon FHC to enhance its investment yield in the near term



Source: Company data

Key risk

Exhibit 9: Taipei Fubon Bank has 6.7% of its loans in the more risky construction/developer-related financing
(As of the latest company disclosures)

Bank name	Construction /developer financing	Total loan balance	% of loan in construction/devel oper financing	Construction/devel oper financing as % of equity
Cathay United Bank	57.4	830	6.9%	32.5%
Taipei Fubon Bank	48.7	730	6.7%	30.2%
Taishin Bank	21.8	569	3.8%	24.3%
Chinatrust	28.7	924	3.1%	19.4%
First Bank	32.2	1,073	3.0%	31.7%
Sinopac	13.0	633	2.1%	15.5%
E.Sun	8.0	552	1.4%	17.1%

Source: Company data.

Reg AC

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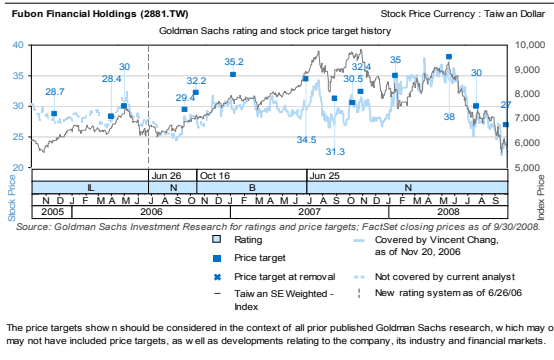
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Price target and rating history chart(s)



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