

First Read

E.Sun Financial

Q223 review: worst is behind but ROE still underperforms most peers

Q: How did the results compare vs expectations?

E.Sun hosted a Q2 results briefing on August 21. As previously disclosed, E.Sun FHC reported H123 net income of NT\$10.6bn, a rebound from a low base of NT\$7.1bn in H122. With the Fed's rate hike cycle near its peak (so does the short-end treasury yield), we think MTM loss on bond holdings is largely behind and E.Sun Bank's monthly earnings has been largely stable YTD. Nevertheless, E.Sun Bank's profitability improvement still appears far lagging behind most peers in this rate hike cycle so far: 1) H123 net income were only 6% above H121's level despite a 19% asset expansion (versus major bank peers' +33% in net income/ +21% asset size over the same period); 2) revenue as a percentage of average assets (1.7% in H123) was only at par with its 2021-22 level (Figure 3), and remains notably below its 2015-20 average (2.2%); 3) even after excluding the dilution effect from its NT\$16bn equity raising in April, E.Sun Bank's H123 annualised ROE of 9.7% still notably underperformed bank peers' average at 11.2% (Figure 6).

Q: What were the most noteworthy areas in the results?

1) Reported NIM was flattish QoQ following a +4bps QoQ expansion in Q1. However, management backtracked previous guidance of a 8-9bps NIM expansion throughout Q2-Q4 and now expects reported NIM to stay largely flattish by year-end, in part due to rapid rise in deposit costs. If including swap revenue, we expect adjusted NIM to have peaked in Q1 and to trend down ahead. **2) Operating cost** at FHC level was up by 22% YoY in Q2, in part due to one-off factors such as costs related to employee subscription of new shares issued, which amounted to NT\$455m and equivalent to a 7% drag to Q2 pretax earnings. **3) Fee income growth** warmed up to +12% YoY from -3% YoY in Q1, driven by a rebound of wealth management income off a low base (+21% YoY) and good credit card fee growth (+14% YoY).

Q: Has the company's outlook/guidance changed?

We think some of the reasons behind E.Sun Bank's ROE underperformance since 2021 are cyclical (for example, a Fed rate cut could benefit E.Sun Bank more through MTM gain), while some appear to be structural: weaker deposit franchise than peers thus limited NIM improvements (Figure 5); credit card fee growth lost steam since 2020 due to intensified competition (Figure 4); wealth management income used to rely more on mutual fund sales which correlate heavily with stock markets. Looking ahead, while management appears confident to deliver a sustainable ROE of 10%+ at the FHC level (H123: 10.06%), we think a return to its 2019 ROE of 12.07% looks highly challenging.

Equities

Taiwan

Diversified Financial

12-month rating **Sell**

12m price target **NT\$20.40**

Price (21 Aug 2023) **NT\$24.85**

RIC: 2884.TW BBG: 2884 TT

Trading data and key metrics

52-wk range	NT\$27.17-21.68
Market cap.	NT\$389b/US\$12.2b
Shares o/s	15,646m (ORD)
Free float	95%
Avg. daily volume ('000)	18,813
Avg. daily value (m)	NT\$476.1
Common s/h equity (12/23E)	NT\$236b
P/BV (12/23E)	1.6x
Tier 1 ratio	12%

EPS (UBS, diluted) (NT\$)

	From	To	% ch	Cons.
12/23E	1.50	1.36	-9	1.39
12/24E	1.44	1.43	-1	1.46
12/25E	1.45	1.46	1	1.67

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Highlights (NT\$m)	12/20	12/21	12/22	12/23E	12/24E	12/25E	12/26E	12/27E
Revenues	56,249	57,897	54,806	64,054	66,133	68,401	71,697	75,148
Pre-tax profit	20,529	23,959	19,903	24,412	26,255	26,811	28,144	29,661
Net earnings (reported)	18,027	20,559	15,759	20,680	22,318	22,784	23,910	25,192
Net earnings (UBS)	18,027	20,559	15,759	20,680	22,318	22,784	23,910	25,192
Tier 1 ratio %	12.8	11.6	11.2	12.2	12.1	12.1	12.1	12.1
EPS (UBS, diluted) (NT\$)	1.22	1.39	1.07	1.36	1.43	1.46	1.53	1.61
Profitability/valuation	12/20	12/21	12/22	12/23E	12/24E	12/25E	12/26E	12/27E
ROE (UBS) %	10.2	10.9	8.1	9.6	9.2	8.9	8.9	9.0
P/PPOP (diluted) x	13.5	13.0	17.5	13.8	13.1	12.9	12.3	11.8
P/BV x	1.8	1.7	2.0	1.6	1.6	1.5	1.4	1.4
P/BV (UBS) x	1.8	1.8	2.0	1.7	1.6	1.5	1.5	1.4
P/E (UBS, diluted) x	17.8	16.4	24.4	18.3	17.4	17.1	16.3	15.4
Dividend yield (net) %	2.8	2.6	0.7	2.4	2.6	2.6	2.8	2.9

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of NT\$ 24.85 on 21-Aug-2023

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Valuation: Price Target of NT\$20.4; Sell rating

We lower 2023E earnings forecast by 9% on higher operating cost and slightly lowered NIM forecast. Our PT of NT\$20.4 implies 1.35x 2023E P/BV against an 2023E/ 24E outlook of 9.6/ 9.2% (2019: 12.1%). We think current valuation of 1.60x 12-month forward consensus P/BV (6% below +1SD of historical average) remains stretched and has not priced in a structurally weakened sustainable ROE outlook versus 2019. We maintain Sell rating.

Figure 1: Quarterly results summary

	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23
P&L (NT\$ bn)														
E.Sun Bank														
Nil	5.0	5.1	5.3	5.7	6.0	6.3	6.5	6.9	7.3	7.7	7.7	6.5	6.5	7.3
Fee income	4.7	4.4	4.3	4.7	4.6	4.3	4.7	4.7	4.6	4.1	4.2	4.3	4.4	4.6
Net trading gain/ loss	4.1	4.1	3.2	2.3	1.7	2.7	2.6	1.7	0.5	(0.5)	2.0	3.7	3.8	2.6
Total net revenue	14.0	13.6	12.8	12.7	12.4	13.3	13.8	13.3	12.4	11.4	13.9	14.4	14.8	14.5
Operating expenses	(7.7)	(7.6)	(7.5)	(8.0)	(7.4)	(7.3)	(7.4)	(7.8)	(7.4)	(7.3)	(7.7)	(8.7)	(7.9)	(8.9)
PPOP	6.3	6.0	5.2	4.7	4.9	6.0	6.4	5.5	5.0	4.1	6.2	5.7	6.9	5.6
Impairment charges	(0.4)	(1.2)	(0.7)	(1.0)	0.4	(0.7)	(0.8)	(1.1)	(0.3)	(0.5)	(0.6)	(0.6)	0.0	(0.4)
Net income	5.0	4.0	3.9	3.5	4.4	4.6	4.9	3.7	3.7	2.6	4.4	4.1	5.5	4.0
E.Sun FHC														
Net revenue	14.0	15.0	13.6	13.7	13.7	14.3	15.2	14.7	13.6	12.1	14.4	14.8	15.8	15.5
FHC net income	4.5	5.2	4.3	4.1	5.2	5.0	5.6	4.7	4.3	2.8	4.6	4.1	6.0	4.5
FHC net income (YTD)	4.5	9.7	14.0	18.0	5.2	10.3	15.9	20.6	4.3	7.1	11.7	15.8	6.0	10.6
YoY (%)														
E.Sun Bank														
Nil	4%	4%	6%	15%	20%	23%	22%	20%	21%	24%	19%	-5%	-10%	-6%
Fee income	21%	1%	-12%	1%	-2%	-3%	10%	1%	-1%	-4%	-10%	-9%	-3%	12%
Total net revenue	8%	5%	-7%	-5%	-12%	-2%	8%	5%	0%	-14%	1%	8%	20%	27%
Operating expenses	17%	14%	2%	1%	-3%	-5%	-1%	-3%	0%	1%	3%	12%	6%	22%
PPOP	-2%	-4%	-17%	-12%	-22%	1%	21%	17%	0%	-32%	-2%	3%	40%	35%
Impairment charges	-31%	138%	145%	226%	-200%	-43%	4%	7%	-197%	-27%	-18%	-44%	-100%	-12%
Net income	0%	-22%	-28%	-14%	-12%	13%	27%	4%	-17%	-42%	-10%	11%	50%	52%
E.Sun FHC														
Net revenue	4%	13%	-3%	-1%	-2%	-4%	11%	7%	-1%	-15%	-5%	1%	17%	28%
FHC net income	-13%	2%	-23%	-5%	15%	-2%	32%	15%	-17%	-45%	-19%	-12%	40%	63%
FHC net income (YTD)	-13%	-6%	-12%	-10%	15%	6%	14%	14%	-17%	-31%	-27%	-23%	40%	49%
FHC book value	177	173	177	181	187	193	190	194	196	184	185	197	205	223
QoQ	2%	-2%	2%	3%	3%	3%	-2%	2%	1%	-6%	1%	6%	4%	9%
Double leverage ratio	104%	103%	103%	103%	103%	99%	103%	103%	103%	103%	103%	103%	103%	103%
BS (NT\$ bn)														
Total loans	1,500	1,558	1,594	1,640	1,679	1,686	1,744	1,791	1,849	1,896	1,941	1,959	1,953	1,986
NT\$ loans	1,202	1,265	1,316	1,358	1,394	1,387	1,437	1,478	1,504	1,536	1,562	1,583	1,598	1,626
FCY loans (incl. subsidiaries)	298	293	278	283	286	299	306	313	345	360	380	376	356	360
Deposits	2,089	2,172	2,254	2,442	2,398	2,459	2,511	2,699	2,720	2,784	2,855	2,903	2,865	2,948
Total assets (Bank)	2,584	2,678	2,758	2,947	2,903	2,971	3,024	3,196	3,264	3,319	3,468	3,458	3,404	3,533
YoY (%)														
Gross loans	10%	11%	12%	12%	12%	8%	9%	9%	10%	12%	11%	9%	6%	5%
NT\$ loans	10%	13%	15%	15%	16%	10%	9%	9%	8%	11%	9%	7%	6%	6%
FCY loans	10%	6%	-3%	0%	-4%	2%	10%	11%	21%	21%	24%	20%	3%	0%
Deposits	10%	12%	13%	19%	15%	13%	11%	10%	13%	13%	14%	8%	5%	6%
NT\$ deposits	2%	6%	11%	22%	19%	16%	12%	6%	8%	6%	4%	4%	7%	13%
FCY deposits	26%	26%	17%	14%	7%	9%	11%	19%	24%	27%	31%	13%	2%	-6%
Total assets (Bank)	10%	13%	14%	19%	12%	11%	10%	8%	12%	12%	15%	8%	4%	6%
QoQ (%)														
Gross loans	3%	4%	2%	3%	2%	0%	3%	3%	3%	3%	2%	1%	0%	2%
NT\$ loans	2%	5%	4%	3%	3%	0%	4%	3%	2%	2%	2%	1%	1%	2%
FCY loans	5%	-2%	-5%	2%	1%	5%	3%	2%	10%	4%	5%	-1%	-6%	1%
Deposits	2%	4%	4%	8%	-2%	3%	2%	7%	1%	2%	3%	2%	-1%	3%
NT\$ deposits	1%	5%	5%	10%	-2%	2%	1%	5%	1%	0%	0%	4%	3%	5%
FCY deposits	4%	2%	2%	5%	-2%	4%	4%	13%	1%	7%	7%	-2%	-8%	-1%
Total assets (Bank)	4%	4%	3%	7%	-2%	2%	2%	6%	2%	2%	4%	0%	-2%	4%
Key ratio														
NIM (reported basis)	1.34%	1.29%	1.25%	1.22%	1.20%	1.18%	1.18%	1.18%	1.20%	1.23%	1.23%	1.26%	1.30%	1.30%
NIS	1.36%	1.30%	1.25%	1.30%	1.32%	1.33%	1.31%	1.30%	1.34%	1.40%	1.41%	1.30%	1.29%	1.32%
Lending rate	2.19%	1.94%	1.72%	1.68%	1.66%	1.65%	1.61%	1.60%	1.63%	1.86%	2.27%	2.53%	2.72%	2.95%
Deposit rate	0.83%	0.64%	0.47%	0.38%	0.34%	0.32%	0.30%	0.30%	0.29%	0.46%	0.86%	1.23%	1.43%	1.63%
Credit cost	0.10%	0.31%	0.19%	0.24%	-0.09%	0.16%	0.18%	0.24%	0.08%	0.10%	0.13%	0.12%	0.00%	0.09%
NPL ratio	0.19%	0.19%	0.20%	0.19%	0.19%	0.17%	0.17%	0.16%	0.15%	0.16%	0.16%	0.16%	0.17%	0.17%
Cost-to-income ratio	54.8%	56.2%	58.9%	63.2%	60.1%	54.7%	53.9%	58.7%	59.9%	64.0%	55.3%	60.7%	53.1%	61.6%
NT\$ CASA ratio	63.1%	63.6%	63.5%	63.4%	64.7%	63.3%	64.5%	64.6%	64.9%	63.8%	63.7%	62.4%	59.8%	57.8%
Overall LDR	71.8%	71.7%	70.7%	67.2%	70.0%	68.6%	69.4%	66.4%	68.0%	68.1%	68.0%	67.5%	68.2%	67.4%
NT\$ LDR	91.3%	91.5%	90.7%	84.9%	88.6%	86.7%	88.8%	87.3%	88.4%	90.7%	92.3%	89.7%	87.7%	84.7%
FCY LDR	38.6%	37.1%	34.6%	33.5%	34.6%	34.7%	34.4%	31.1%	33.9%	33.0%	32.6%	33.1%	34.1%	35.0%
Net fee income growth														
WM fee income (quarterly)	2.4	2.3	2.2	2.3	2.5	2.4	2.6	2.4	2.2	1.8	1.9	1.9	2.2	2.2
YoY	36%	9%	-8%	7%	4%	1%	19%	6%	-10%	-22%	-25%	-22%	-1%	21%
Credit card fee income (quarterly)	1.6	1.7	1.5	1.8	1.4	1.3	1.4	1.6	1.5	1.5	1.6	1.8	1.6	1.7
YoY	4%	8%	-19%	-10%	-8%	-20%	-9%	-10%	1%	16%	20%	10%	12%	14%

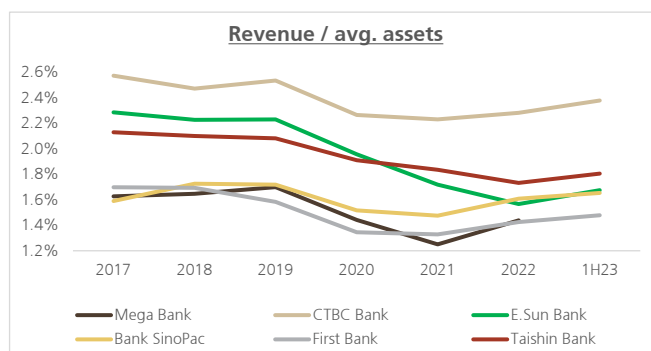
Source: Company data

Figure 2: Summary of key forecasts

NTS million	Actual/ Forecast					YoY growth					Forecast revision	
	2020	2021	2022	2023E	2024E	2020	2021	2022	2023E	2024E	2023E	2024E
Net income by subsidiary												
E.Sun Bank	16,487	17,587	14,833	20,132	21,262	-16%	7%	-16%	36%	6%	-9%	-1%
E.Sun Securities	790	1,686	1,004	1,150	1,163	83%	113%	-40%	14%	1%	0%	0%
Net income to common shareholders (UBSe)	18,027	20,559	15,759	20,680	22,318	-10%	14%	-23%	31%	8%	-9%	-1%
Net income to common shareholders (Consensus)				21,176	21,991					4%	-1%	-2%
% diff. vs consensus				-2%	1%							
ROA	0.66%	0.66%	0.47%	0.58%	0.59%	-18bps	0bps	-19bps	11bps	1bps	-6bps	-1bps
ROE	10.2%	10.9%	8.1%	9.6%	9.2%	-1.9ppts	0.8ppts	-2.9ppts	1.5ppts	-0.3ppts	-0.9ppts	0.0ppts
Cash div. payout ratio	42.5%	43.5%	18.1%	45.0%	45.0%	-3ppts	1ppts	-25ppts	27ppts	0ppts	5ppts	5ppts
DPS (NTS, UBSe)	0.61	0.67	0.20	0.59	0.64	-23%	10%	-70%	197%	8%	2%	12%
DPS (NTS, Consensus)				0.58	0.60					3%	2%	0%
% diff. vs consensus				3%	7%							
E.Sun Bank												
Net interest income	21,095	25,591	29,239	29,249	30,813	7%	21%	14%	0%	5%	-2%	0%
Net fee income	18,044	18,289	17,135	18,775	20,312	2%	1%	-6%	10%	8%	0%	0%
Trading gains	13,976	8,877	5,737	12,951	11,878	-10%	-36%	-35%	126%	-8%	0%	6%
Total operating income	53,115	52,757	52,110	60,975	63,002	0%	-1%	-1%	17%	3%	-1%	1%
Operating costs	(30,885)	(29,935)	(31,165)	(34,281)	(34,624)	8%	-3%	4%	10%	1%	6%	3%
PPOP	22,230	22,823	20,945	26,694	28,379	-9%	3%	-8%	27%	6%	-8%	-1%
Impairment	(3,241)	(2,134)	(2,081)	(3,009)	(3,365)	102%	-34%	-3%	45%	12%	0%	0%
Net income	16,487	17,587	14,833	20,132	21,262	-16%	7%	-16%	36%	6%	-9%	-1%
Net loans	1,620,374	1,768,641	1,934,792	2,068,545	2,204,353	12%	9%	9%	7%	7%	0%	0%
Deposits	2,491,467	2,695,063	2,902,599	3,044,040	3,222,256	20%	8%	8%	5%	6%	0%	0%
ROE	9.5%	9.6%	7.8%	9.5%	9.0%	-2.5ppts	0.2ppts	-1.8ppts	1.7ppts	-0.6ppts	-0.9ppts	0.0ppts
NII/ avg. assets	0.78%	0.83%	0.88%	0.83%	0.83%	-5bps	6bps	5bps	-5bps	0bps	-2bps	0bps
Credit cost	0.20%	0.12%	0.10%	0.14%	0.15%	9bps	-8bps	-1bps	4bps	1bps	0bps	0bps
NPL ratio	0.19%	0.15%	0.16%	0.23%	0.22%	0bps	-3bps	1bps	7bps	-1bps	0bps	0bps
Coverage ratio	677%	814%	782%	550%	586%	10ppts	137ppts	-31ppts	-233ppts	36ppts	0ppts	0ppts

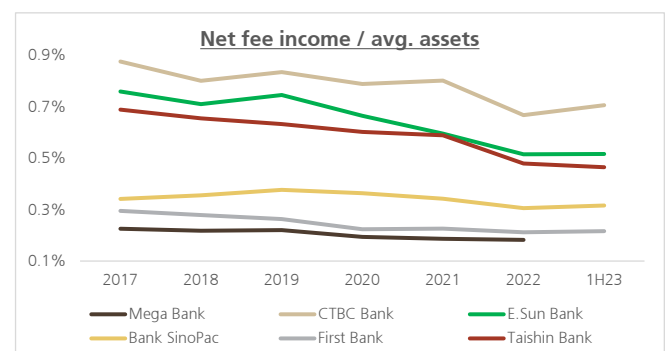
Source: Company data, UBS estimates

Figure 3: Revenue as % of average assets



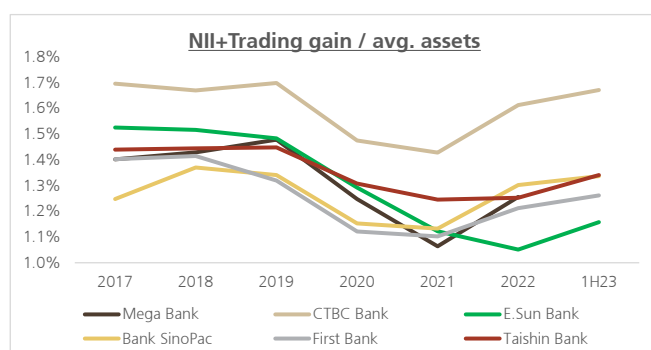
Source: Company data, UBS

Figure 4: Net fee income as % of average assets



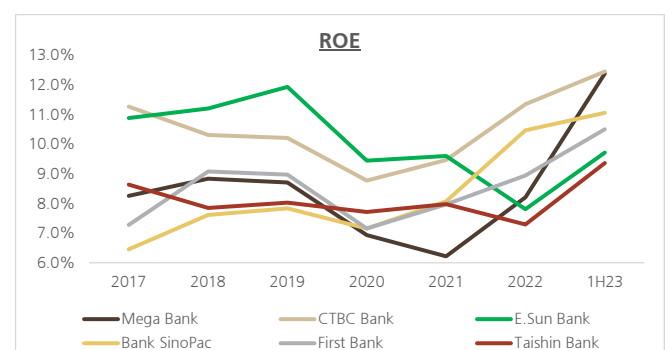
Source: Company data, UBS

Figure 5: NII + trading gain as % of average assets



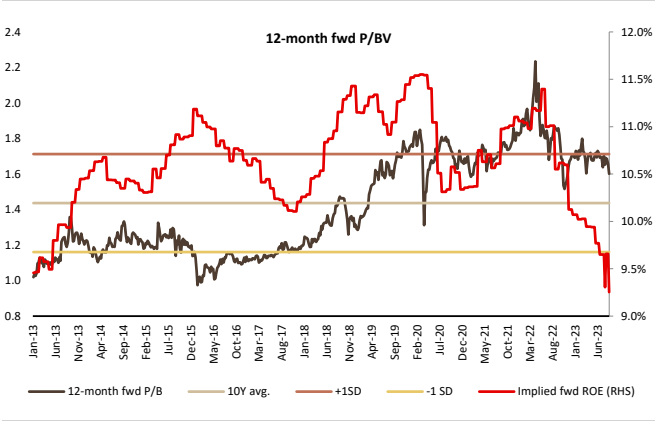
Source: Company data, UBS

Figure 6: ROE trends by major Taiwan banks



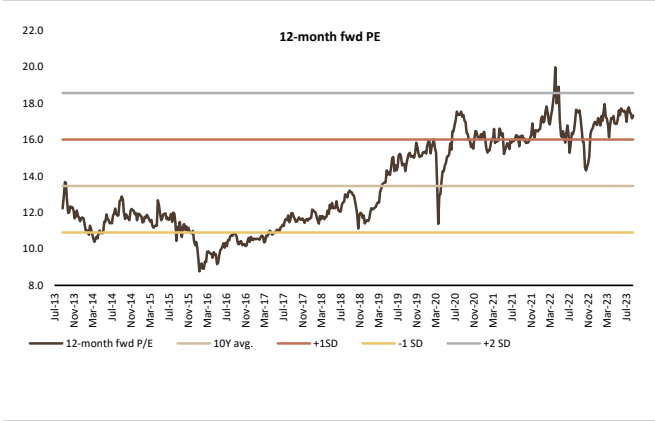
Source: Company data, UBS. Note: We have excluded the dilution effect from E.Sun's equity raising in April.

Figure 7: E.Sun - Consensus 12m forward P/BV vs forward ROE



Source: Datastream, pricing date as of August 21, 2023.

Figure 8: E.Sun - Consensus 12m forward PE



Source: Datastream, pricing date as of August 21, 2023.

Forecast returns

Forecast price appreciation	-17.9%
Forecast dividend yield	2.4%
Forecast stock return	-15.5%
Market return assumption	5.8%
Forecast excess return	-21.3%

Company Description

E.Sun Financial was established in 2002. Its business portfolio is mainly focused on banks and includes E.Sun Bank, E.Sun Venture Capital and E.Sun Securities. The company is one of few private financial holding companies in Taiwan not majority-owned by a family. Its three largest shareholders as of 2021 are: 1) Ron-Yuan Investment (4.41%); 2) E.Sun Commercial Bank Trust Fiduciary Trust Account (3.86%); and 3) Morgan Stanley (2.48%). The bank had 139 domestic and 28 overseas branches as in 2021.

Valuation Method and Risk Statement

We use sum-of-the-parts methodology to value Taiwanese FHCs, which typically operate multiple financial-service businesses, each with its own profit drivers and risk profiles. Banks' earnings are affected by credit risks, and regulatory requirements regarding minimum capital may limit growth. Investment returns for insurers and brokers are subject to interest rate, currency and equity-market risks. The financial industry is highly regulated and therefore exposed to regulatory risks. Any future M&A could result in shareholder-value dilutions

We think upside risks to E.Sun include: 1) stronger-than-expected loan growth; 2) fee income growth outperforming peers; 3) larger-than-expected improvements in cost-to-income ratio.

Quantitative Research Review

UBS Global Research publishes a quantitative assessment of its analysts' responses to certain questions about the likelihood of an occurrence of a number of short term factors in a product known as the 'Quantitative Research Review'. The views for this month can be found below. Views contained in this assessment on a particular stock reflect only the views on those short term factors which are a different timeframe to the 12-month timeframe reflected in any equity rating set out in this note. For previous responses please make reference to (i) previous UBS Global Research reports; and (ii) where no applicable research report was published that month, the Quantitative Research Review which can be found at <https://neo.ubs.com/quantitative>, or contact your UBS sales representative for access to the report or the Quantitative Research Team on qa@ubs.com. A consolidated report which contains all responses is also available and again you should contact your UBS sales representative for details and pricing or the Quantitative Research Team on the email above.

E.Sun Financial

Question	Response
1. Is the industry structure facing the firm likely to improve or deteriorate over the next six months? Rate on a scale of 1-5 (1 = getting worse, 3 = no change, 5 = getting better, N/A = no view)	3
2. Is the regulatory/government environment facing the firm likely to improve or deteriorate over the next six months? Rate on a scale of 1-5 (1 = getting tougher, 3 = no change, 5 = getting better, N/A = no view)	3
3. Over the last 3-6 months in broad terms have things been improving/no change/getting worse for this stock? Rate on a scale of 1-5 (1 = getting a lot worse, 3 = not much change, 5 = getting a lot better, N/A = no view)	3
4. Relative to the current CONSENSUS EPS forecast, is the next company EPS update likely to lead to: (1 = negative surprise vs consensus, 3 = in-line with consensus, 5 = positive surprise vs consensus expectations, N/A = no view)	3
5. What's driving the difference?	
6. Relative to YOUR current earnings forecast, is there relatively greater risk at the next earnings result of: (1 = downside skew risk to earnings, 3 = equal upside or downside risk to earnings, 5 = upside skew risk to earnings, N/A = no view)	3
7. What's driving the difference?	
8. Is there an upcoming catalyst for the company over the next three months?	No Catalyst
9. Is there an actual or approximate date for the catalyst?	
10. Is the catalyst date an actual or approximate date?	N/A
11. What is the catalyst?	

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12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	54%	41%
Neutral	FSR is between -6% and 6% of the MRA.	37%	43%
Sell	FSR is > 6% below the MRA.	9%	36%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2023.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

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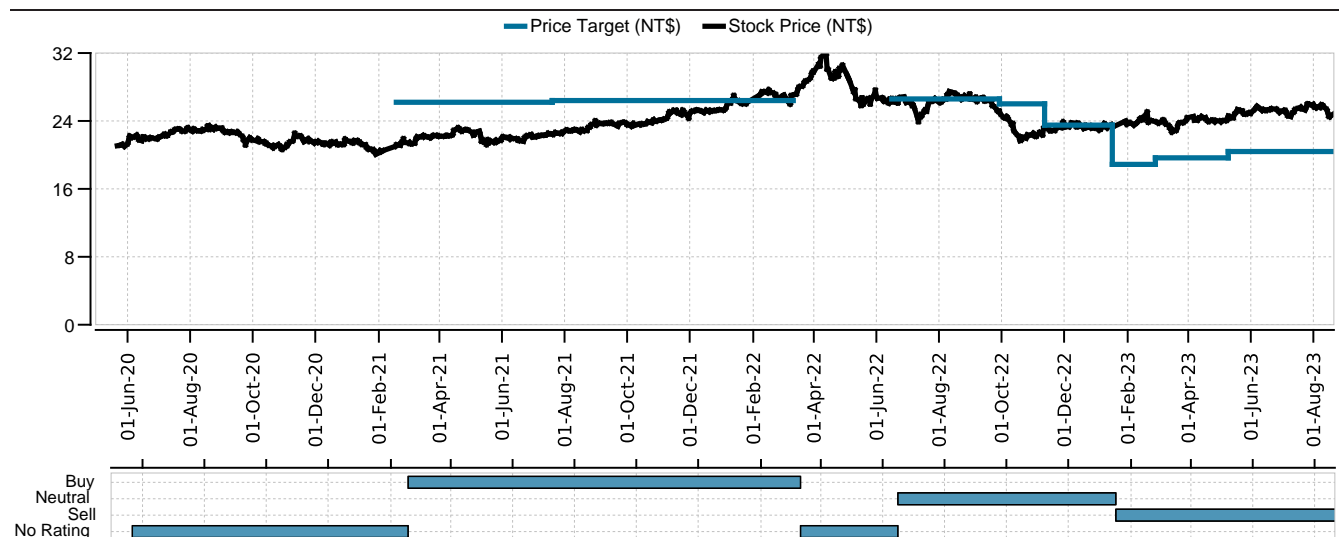
Company Name	Reuters	12-month rating	Price	Price date
E.Sun Financial⁷	2884.TW	Sell	NT\$24.85	21 Aug 2023

Source: UBS Global Research; Refinitiv. All prices as of local market close. Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date.

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E.Sun Financial (NT\$)



Date	Stock Price (NT\$)	Price Target (NT\$)	Rating
2020-05-21	21.27	-	No Rating
2021-02-17	21.01	26.201	Buy
2021-07-19	22.46	26.403	Buy
2022-03-11	27.04	-	No Rating
2022-06-15	26.31	26.593	Neutral

Date	Stock Price (NT\$)	Price Target (NT\$)	Rating
2022-09-28	25.15	26.015	Neutral
2022-11-11	23.12	23.51	Neutral
2023-01-16	23.56	18.885	Sell
2023-02-27	24.04	19.656	Sell
2023-05-09	24.14	20.40	Sell

Source: UBS Global Research; Refinitiv as of 21-Aug-2023. All prices as of local market close. Ratings as of date shown.

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