



# CFA Institute

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## CFA Institute Research Challenge

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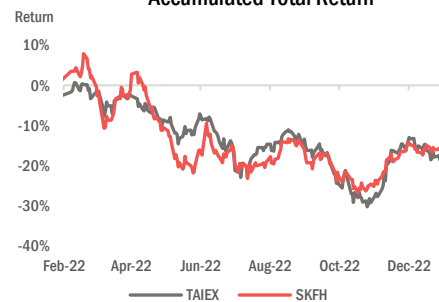
## Recommendation : SELL

Date	30-Dec-22
Current Price	\$8.77
Target Price	\$7.27
Downside	17.10%

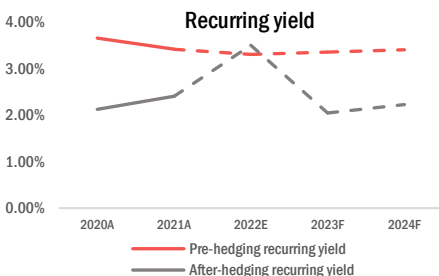
### Market Profile

Exchange	TWSE
Ticker	2888.TT
Industry	Financial Holding Company
Market Cap. (NTD)	\$135.83bn
Market Cap. (USD)	\$4.43bn
USD/TWD	30.66
Common Stocks	15bn
52-Week High	\$11.61
52-Week Low	\$7.71
EPS (TTM)	0.65
P/B	0.79

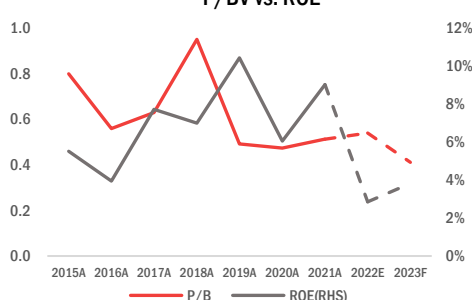
### Accumulated Total Return



### Recurring yield



### P/BV vs. ROE



## EXECUTIVE SUMMARY

We initiate coverage on Shin Kong Financial Holdings (SKFH) with a SELL recommendation based on a 12-month price target of NTD\$7.27/per shares triangulated between our Sum-of-the-Parts Valuation (SOTP). Our target price represents a 17.10% downside from the last close of \$8.77 on 30 December 2022.

Shin Kong Financial Holdings comprises subsidiaries including Shin Kong Life, Shin Kong Bank, and MasterLink Securities. Shin Kong Life is the fourth largest life insurance company in Taiwan. We see the market underappreciating: 1) new money yields rise but have little benefit, 2) ROE declines compress P/BV growth, and 3) board structure is rigid.

### The benefits of the new money yield are modest

Benefiting from Fed rate hikes and corporates' fantastic earnings in 2021, with 2022 dividend income higher than past averages. However, Shin Kong Life could not reduce the spread loss due to 1) the continuous decline in premium income; 2) the difficulty of disposing of assets; 3) the increase in hedging costs. We forecast:

- Continued decline in premium income: Although the increase in USD investment policies in 9M22 increased the first year premium (FYP) by 18.5%, the declining renewal premium (decreased by 40.5% YOY) led to a decline in the overall total premium income.
- Dilemma of disposition: Due to poor market conditions, evaluation losses up to NTD\$90B in 9M22, we believe that disposing of these assets to invest in new one will become a huge cost.
- Hedging costs increase: CS and NDF are main hedging tools for SKL. The larger the Taiwan-US interest spread, the more expensive USDNTD of the contrast is, and the current CS cost has reached 3.75%.

### Stress of Capital Raising and declining ROE compresses P/BV growth

Taiwan is about to gear to IFRS17 and ICS2.0 in 2026, and the insurance industry, especially older companies, must recognize the interest rate spread losses that have not been estimated in the past and the operating costs and system connection costs required to integrate with the new system, coupled with the poor capital adequacy performance of SKF, so it has the pressure to increase capital, and it will not be able to issue dividends this year, which will also dilute the equity and affect the valuation. SKFH's P/BV get stuck in the low level because ROE has not improved significantly. We decomposed the ROE with DuPont analysis, in which the continuous decline in profitability became the main reason.

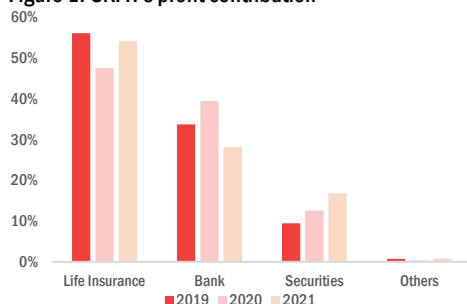
- In line with the spirit of asset-liability matching, IRD loss are forced to disclose. SKL will suffer from IFRS 17 and system replacement cost through facing the pressure of capital increase. If SKFH's capital adequacy need to reach the level of the peers, we estimate the funding requirement is 40B NTD.
- Profits and Unrealized Gains on Financial Assets are the two major factors affecting SKL's EV. Declining premium income and dilemma of disposition leads to SKL's difficulty in obtaining new money. In addition, accounting standards and market conditions make investment positions in trouble.

### The board structure is rigid

1) Wu-family involved deeply, all controlled by the relevant members of the Wu Ho Su family, 2) BoD's age are half above boomer's age, 3) gender ratio is unbalanced Seriously, if SKFH would like to attract international investors, deficiencies in corporate governance can be resistant and lack incentives. The biggest problem is that SKFH's corporate governance has not complied and has not fulfilled its responsibility to protect minority shareholders' interests.

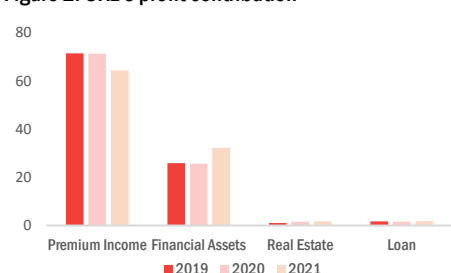
SKFH Key Financials	2020A	2021A	2022E	2023F	2024F
<b>SKFH</b>					
Net Revenue (Billion NTD)	268.14	216.51	168.34	160.88	198.52
Net Income (Billion NTD)	14.46	22.73	2.03	2.00	32.46
EPS	1.12	1.67	0.13	0.13	2.11
<b>SKL</b>					
Retained Premiums Earned	294.30	232.34	183.23	171.81	189.13
Pre-Hedging Recurring Yield (%)	3.65%	3.41%	3.30%	3.35%	3.40%
After-Hedging Investment Return (%)	3.77%	3.82%	3.69%	2.84%	3.52%
Net Income (Billion NTD)	7.24	12.66	-4.80	7.69	23.05
<b>SKB</b>					
NIM (%)	1.25%	1.26%	1.30%	1.33%	1.33%
Net Interest Income (Billion NTD)	11.25	12.60	14.45	15.76	16.48
Net Fee Income (Billion NTD)	3.36	3.47	3.33	3.36	3.47
Net Income (Billion NTD)	5.94	6.55	6.47	6.73	7.64

Figure 1: SKFH's profit contribution



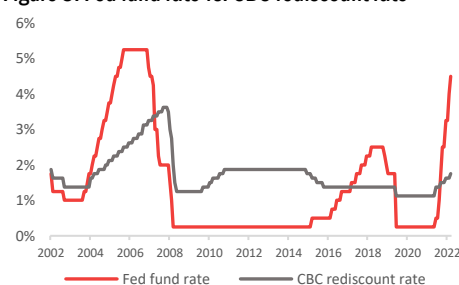
Source: Company Data

Figure 2: SKL's profit contribution



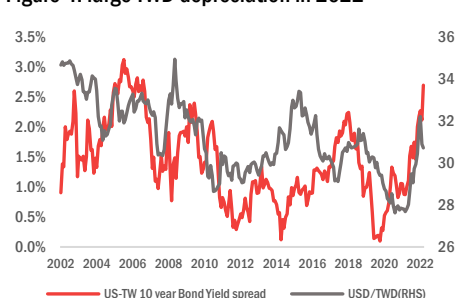
Source: Company data

Figure 3: Fed fund rate vs. CBC rediscount rate



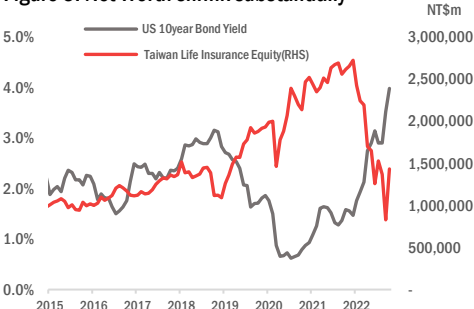
Source: TEJ

Figure 4: large TWD depreciation in 2022



Source: Bloomberg

Figure 5: Net Worth shrink substantially



Source: FSC, TEJ

## BUSINESS DESCRIPTION

### Overview

Ranking by total assets as of 2021, Shin Kong Financial Holdings, SKFH, is the fourth largest listing FHC in Taiwan, just behind Cathay, Fubon, and CTBC. With a long history of Life insurance, SKFH services 6 million customers in 2021. Currently the three pillars, Life, Banking, and Securities(Figure1), support SKFH.

### Business Model

**Shin Kong Life** (c.53% of 9M22 net income): SKL receives premium (as the main liability) from customers and generates income from three sources, 1) Financial assets: Total amount of investment is about NTD\$3,300B. The largest proportion is fixed income, divides into foreign and domestic, accounting for 67.3% and 10.4%. The portfolio includes equity, and the annualized ROI is 3.44%; 2) Real estate: The amount of investment property, located all over the cities in Taiwan, is about NTD\$194B (top 3 property owner in Taiwan's insurance company). The ROI in real estate is 0.2% in 1H22. (because of lifting rate and the loss in evaluation); 3) Loan: Total amount is NTD\$6.5B, contributed to 6.2% profit. Dive into SKL's cost structure, it's mainly from claim (58% of SKL's operating cost), net policy reserves, commission, (39% and 2% of SKL's operating cost), and administrative cost. The key drivers are 1) Interest rate - The change of rate will affect investing return and liability cost of policy. 2) Inflation - Long-term high inflation may trigger economic recession, cause consumers' income to shrink and reduce people's willingness to insure. 3) Product mix - An insurance policy with high deposit and payment through foreign currency can increase asset size and reduce exchange loss in investment.

**Shin Kong Bank** (c.49%): SKB raises income through three main channels, interest, fee, and investment. Interest income (c.70-75% of SKB's income): Mainly generated from the interest spread between depositors and lenders, the key drivers are 1) interest rate level: Higher interest rate level will generate wider spread and enhance the NIM; 2) Loan mix: SME and overseas loans have higher-than-average interest spread compared to normal corporate loan; 3) Fee income (c.19%): generated from wealth management (44%), credit card (25%), loan (16%), and others (15%). Investment (c. 5-10%) contribution mainly depends on the capital market and portfolio management.

**MasterLink Securities** (c. -0.7%): The securities business includes operating (50% of 3Q22 revenue), brokerage (53%), and prop trading (-3%), and it is significantly related to trading volume and market sentiment (Bull/Bear market will cause prop trading profit/loss).

## INDUSTRY OVERVIEW & COMPETITIVE POSITIONING

### Macro Overview

**More hawkish monetary policy to control inflation in the United States:** As the Ukrainian -Russian war boosted inflation, the United States officially entered a rate rising cycle in March 2022, with the current U.S. federal reserve rate at 4.5%, the unemployment rate at 3.7%, and the CPI at 7.1% (Core 6%) in November. According to the recent minutes of FOMC, We expect rising another 2 yards to 4.75~5% are possible and maintained to the end of 2023, and following up cutting in 2024. Regarding the economy outlook, the Fed has shown a willingness to trade a slowdown in exchange for a slippage in inflation, with the FOMC in December down-warding U.S. economic growth again to 0.5%(previous: 1.2%) and 1.6% (previous: 1.7%)this year and next.

**Taiwan's inflation is relatively moderate:** To follow the Fed's step, Taiwan's central bank, TCB, also start to hike interest rate in the March 2022. However, CPI pressure is under control, causing a slower and shorter rising cycle than the FED(Figure4). We expect TCB only raise 0.125% in 2023. As for the economy outlook, TCB followed FED's vision, down-warding Taiwan's economic growth again to 2.91%(previous: 3.51%) and 2.53% (previous: 2.9%)this year and next, and Bloomberg estimates Taiwan's economic growth from 2022 to 2024 to be 3.1%, 2.0% and 2.4% respectively .

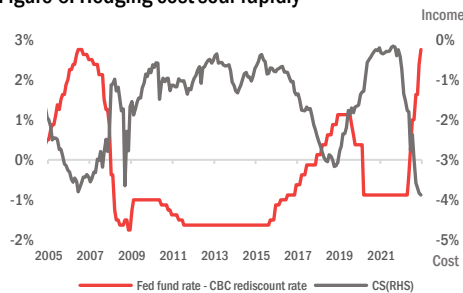
**Stronger TWD against USD in 2023/24:** Widen US-Taiwan interest spread and withdraw from FII pushed USD/NTD to a near high in 2022(Figure 4). However, we expect the depreciation of the NTD to slow down at the end of the 1Q23 rate hike cycle. According to Bloomberg's exchange rate forecast, the exchange rate of USD/NTD is 30.4, compared with 30.8, 30.4, 30.2 and 30.1 for the 2023 quarters, and 29.3 in 2024.

### Industry Overview

#### Life

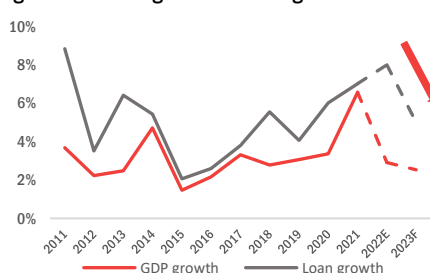
**Shift in demand for insurance policies:** According to the statistics of the Life Insurance Association, the traditional Interest-Sensitive life insurance has driven a certain demand due to interest rate increases. However, in the case of the lower- than- expected interest rate, the risen USD fixed deposit rate, and the mitigated depreciation of USDNTD, which increased by only 1% as of November compared with the same period, and the investment life insurance has led to a conservative investment mentality due to fluctuations in the capital market, which has declined by 38.5% compared with the same period. Although interest rates are expected to remain high in 2023, under the above scenario, we estimate that the initial year premium growth of interest variant life insurance will be flat in 2022, and in 2023 and 2024, it will grow by 6~10% under the condition that the increase in liability provision ratio leads to a decrease in premiums. The premium income of investment life insurance is expected to decline by 39 to 40% in 2022 due to the

Figure 6: Hedging cost soar rapidly



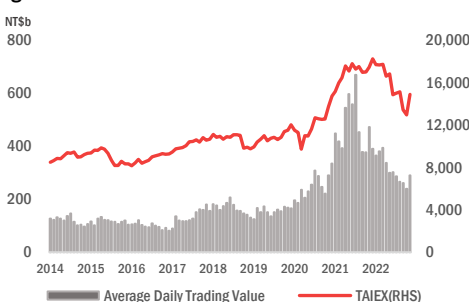
Source: Bloomberg

Figure 7: TW GDP growth vs. Loan growth



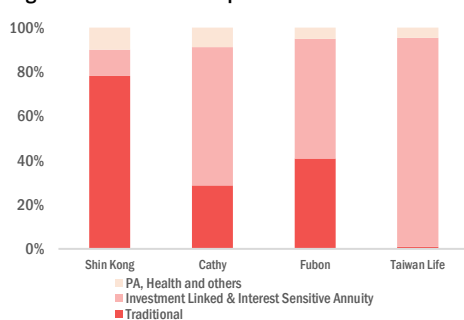
Source: TEJ, CBC, Team Analysis

Figure 8: TW stock market shrink down



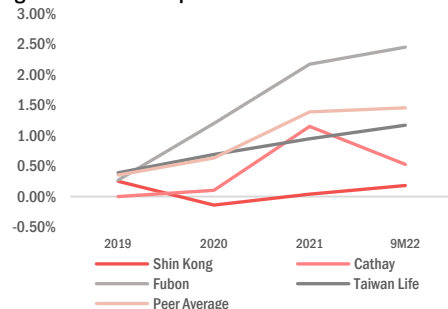
Source: FSC, TEJ

Figure 9: TW life insurers product mix 9M22



Source: Company Data

Figure 10: The worst performance on investment



Source: Company Data

continuous fluctuations in the capital market. In 2023, it will decline by 5~8% under the scenario of inflation stabilizing but the economy may decline and will grow by 10~12% after the economy stabilizes in 2024.

**Higher exposure of overseas investment than other countries:** Due to the size of Taiwan's fixed income market and the low interest rate of treasury, coupled with the large number of high-interest insurance policies sold in the past, Taiwanese life insurance companies invest about 70% of their funds in foreign market to improve yield (compared to Korea's 13.2% and Japan's 25.7% in 2021). However, recently the continuous hikes have had a significant impact on the life insurance industry: 1) US Treasury yields continue to soar, but the asset and liability of the life insurance industry adopts different accounting recognition principles, resulting in a serious accounting mismatch. According to the data of the Insurance Bureau, the net value of the life insurance industry declined by 67.6% compared with the same period in 9M22. Although the reclassification of assets initiated in Oct. 2022 had led to a risen by \$600 billion in net value in November compared to September (Figure 5), under the control of the FSC, the amount of net value recovery must be recognized in equal amounts to the special reserve to limit the distribution of dividends by the financial holdings; 2) The Taiwan-US interest rate spread continues to widen, leading the cost of hedging still rise. The currency swap (CS) cost at the end of 2022 has come to the level of 3.9%, and we expect, from empirical evidence, it will rise to more than 4% (Figure 6); 3) In the chaotic period of capital markets, the market value of stocks and bonds is shrinking, making it difficult for life insurance companies to generate profits to hand over to Financial Holdings, and at the same time, under the pressure of sufficient capital to be in line with IFRS 17, it may further limit the payout ratio of insurance-based FHC.

## Bank

**Lending demand will gradually ease:** Theoretically, the continuous interest rate hikes will widen the net interest margin of the banking industry. According to the central bank, the domestic 3Q22 interest rate differential of deposit has reached 1.36%. Interest income from Taiwan's banking sector is mainly derived from real estate and corporate lending. Since 2021, the government has implemented multiple credit controls on the real estate market, coupled with continued interest rate increases, and the annual growth rate of construction and residential loans has shown signs of slowing down. As for the corporate financing, we expect loan demand will slow down based on 1) Taiwan is an export-oriented country, and we see a dramatic plunge of export order in recent months; 2) US and Taiwan have revised down its own economic outlook for 2023 (Figure 7). Therefore, we expect lending will slow down to 3.5%~4.5% in 2023 (vs. 8~9% in 2022), and 5 to 7% in 2024 under the stabilization of the economy.

**Slow growth of net fee income:** The net handling-fee income of Taiwan's banking industry mainly comes from wealth management business, but the correction of the capital market emerged and led turnover rate to relatively low, which has caused a sharp decline in fee income from the mutual fund sector. On the other hand, the rise in interest rate has led to the demand for Interest-Sensitive life insurance, which has increased the insurance-related fees and offset the decline in fund fees. According to the statistics of the Banking Bureau, the net handling-fee income of domestic banks in 9M22 declined by 4.6% compared with the same period, and we expect that the volatility of interest rate and capital markets will stands rise, so that the net handling-fee income will decline 4 to 5% in 2022. In 2023, the growth will be flat when inflation stabilizes but the economy may decline, and it will grow by 3~4% after the capital market stabilizes in 2024.

## Security

**The outlook for stock markets is still uncertain:** Due to systematic factor (e.g. QT, Russo-Ukrainian War, acceleration of FED hawkish monetary policies, etc.), TWSE had -22.6% YTD as of 2022, and the average daily trading value (ADTV) had -32.4%YoY compared to 2021 (Figure 8). We expect the ADTV will decline by 25% to 30% in 2023, as we believe the headwind of enterprises' earnings is just beginning. In 2024, the growth rate will bethe ADTV will rebound by 10~15%YoY after the economy stabilizes.

## Competitive Position

### Life

**Distinctive policies strategies:** Shin Kong, Cathay, Fubon, and China Trust (Taiwan Life) Financial Holdings are the four representative financial holdings of Taiwan's life insurance industry, with the total premium market share of the four financial holdings is 52%. In terms of policies portfolio, SKFH is dominated by traditional life insurance, while Cathay, Fubon and China Trust are mainly from investment life insurance and interest-sensitive annuities (Figure 9). In addition, SKFH and Cathay belong to the long-history life insurance companies, accumulated more high-interest rate policies than peers. Both companies are expected to recognize larger interest rate loss to their insurance liabilities under the 2026 transition of IFRS 17, meaning SKFH and Cathay will face greater pressure to increase capital than other FHCs.

**Lagging behind the peers on investment performance:** Due to the past investment failure, SKFH is more conservative on asset allocation, proved by the proportion of fixed income is 77% in 3Q22, higher than the peers average (71%). The asset reclassification in October shifted the fixed income of most life insurers to AC (Shin Kong 99%, Cathay 86%), while the proportion of stocks is 7.5%, lower than the peers average (11.4%), resulting in the overall return rate much lower than the peers. In terms of the cost of liabilities, although the past high-interest rate insurance policies have expired successively, and the cost of liabilities has continued to decrease, it is still higher than the average of the peers. In sum, the lower rate of return with higher cost of liabilities lead to investment spreads of SKFH far behind to the peers. (Figure 10)

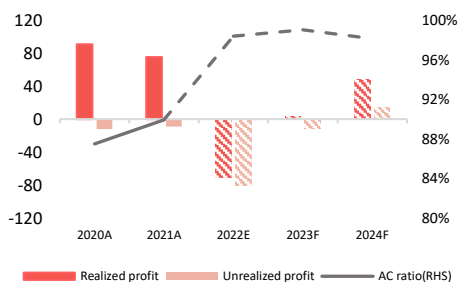


Figure 11: TW banks operating performance 9M22

	LDR	CASA	CIR	NIM	Loan Growth	Fee Growth
Shin Kong	71.6%	45.5%	52.2%	1.30%	7.2%	-2.5%
Cathay	63.2%	70.3%	49.3%	1.33%	11.2%	-1.6%
Fubon	63.1%	53.3%	44.4%	1.04%	6.9%	-15.6%
CTBC	67.9%	58.2%	52.2%	1.60%	17.3%	-6.5%
E.Sun	67.1%	52.1%	59.5%	1.22%	11.1%	-5.3%
State-owned Average	72.6%	58.5%	48.8%	0.97%	7.1%	1.5%
Peer Average	69.4%	57.6%	49.9%	1.13%	8.9%	-2.4%

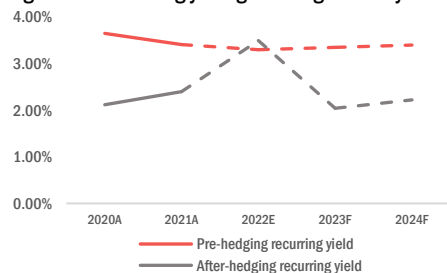
Source: TEI

Figure 12: Huge evaluation loss in SKL's investment



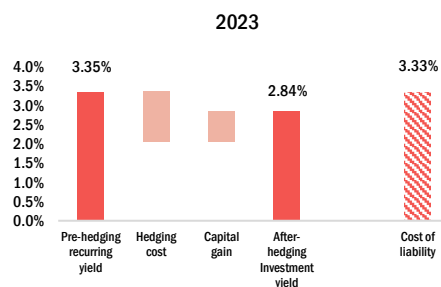
Source: Company Data, Team Analysis

Figure 13: Recurring yield grow insignificantly



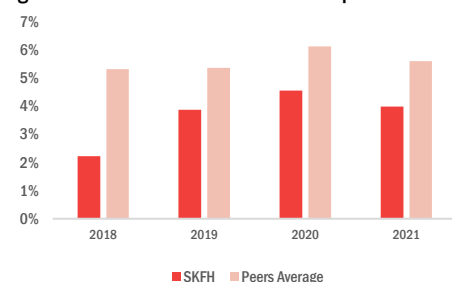
Source: Company Data, Team Analysis

Figure 14: Decomposed investment yield by ...



Source: Team Analysis

Figure 15: SKFH's dividend worse than peer



Source: Company Data

## Bank

**Good performance with constrained development:** SKFH's share on lending market is 2.1%, lower than the major competitors including China Trust (6.4%), Cathay (5.3%), E-SUN (5.2%) and Fubon Financial Holdings (4.9%). In terms of lending portfolio, SKFH mainly based on housing (45.2%) and jumbo enterprise (37.6%) lending, of which foreign currency lending accounted for 15%, SMEs accounted for 24%. SKFH's deposits is mainly dominated by NTD, although its cost of capital is higher than the peers, the positive customer structure makes its NIM better than the peers. (Table 1) In the handling-fee income sector, competitors develop diversified sources except from financial management. (Figure 11) The obvious weakness of SKFH is the lack of overseas development, so it cannot expand its business through overseas markets like its peers and add more colors to the source of profit.

## INVESTMENT SUMMARY

### The benefits of the new money yield are modest

Benefiting from Fed rate hikes, U.S. 30-year investment grade (BBB) corporate bonds reached a 5.5% level in Sep 2022, and corporate earnings reached new record in 2021, with 2022 dividend income higher than past averages. However, this only provides a slight help to SKL's investment yield, because 1) the premium income continues to decline, 2) assets are difficult to dispose, 3) the cost of hedging is soaring. As a result, it's still difficult to solve the spread loss problem.

Overall, since total premium income in 2023 is expected to decline by 6.24%, and evaluation losses will remain at TWD\$11.53B (Figure 12), we believe that SKL cannot dispose of assets to obtain new funds and can only rely on weak premium income to invest higher yields in foreign assets, keeping the recurring yield to remain at around 3.35%. At the same time, due to expanded US-Taiwan interest spread and normalized foreign exchange loss (compared to huge gains on foreign exchange profit in 2022), rising hedging costs will also erode SKL's recurring yield further to around 2.04% (Figure 13). Under the lack of capital gains, SKL's spread loss will expand to -0.49% in 2023 (Figure 14).

### Stress of Capital Raising and declining ROE continues to compress its valuation

It plans to abide IFRS 17 after 2026 in Taiwan, and it will bring two major impacts on the insurance industry. 1) To immediately reflect the potential IRD loss and face the pressure of capital increase. 2) Increasing system replacement and upgrade cost. In addition, ICS2.0 has stricter capital requirements and will impact the investment strategy, resulting in life insurance corp. facing capital increase pressure, which will dilute the equity and affect the valuation. Also, it might distribute dividends using its capital reserve or statutory reserve this year if its dividend remains at the level of the past three years. In terms of the BIS and RBC ratio, SKFH has been at a low level for many years, meaning a sustainable demand for capital increase. If SKFH's capital adequacy need to reach the level of the peers, we estimate the funding requirement is 40B NTD at least.

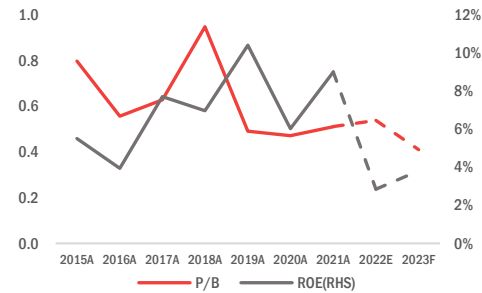
We give SKFH a SELL rating through the SOTP method, 12-month TP is NTD\$7.27 with 17.10% downside, implying SKFH's 2023 0.26x P/BV or 0.28x P/EV. The valuation is highly convinced, as the P/BV multiple is in line with the historical P/BV vs. ROE (Figure 16). Meanwhile, we decomposed ROE by DuPont analysis (Figure 17), and found the soft profit is the key to SKFH's decline ROE. SKFH's downtrend ROE is hard to reverse, as: 1) We estimate profits and Unrealized Gains on Financial Assets to be the most important factors influencing SKL's EV trend in the coming year. Considering SKL's difficulty in obtaining new money and market conditions, net income will be NTD\$-6.25B in 2023F (vs NTD\$12.60B in 2021, NTD\$-4.80B in 2022E). The expansion of unrealized loss in SKL's investment portfolio will drag SKFH's profitability (NTD\$-2.58B in 2021, NTD\$-80.02B in 2022E, NTD\$-11.53B in 2023F). 2) SKB's widen NIM provides limited help to SKFH's ROE: The favorable interest rate hikes, including Taiwan-US spreads, will bring less benefits to SKB than expected. In addition, SKB's rising operating expenses will push its CIR to 52%. We estimate SKB's net income will be NTD\$6.73B in 2023F (vs NTD\$6.47B in 2022E), with ROE to be 10.0% in 2023F (vs 9.0% in 2022E). 3) Shrinking trading volume will depress MasterLink Securities profits deeper: We believe TWSE's ADTV had entered the peak in 2021 and will dropdown further in 2023F, resulting in MLS's decline profits in 2022E&23F vs.2021. We expect MLS's NI will be NTD\$1.52B (vs NTD\$3.92B in 2021, NTD\$0.36B in 2022E).

### The rigidity of the board structure makes it difficult for companies to innovate and reform

Poor governance is waiting for the Messiah: 1) SKFH needs to improve its BOD composition: Family-owned, elder directors, and lack of gender diversity are characteristics of SKFH's BOD. 2) Severe agency problems still exist: Despite the former chairperson Mr. Wu was dismissed by FSC since 2020, he still attended several executives meeting in 2021, showing SKFH's risk management in name only.

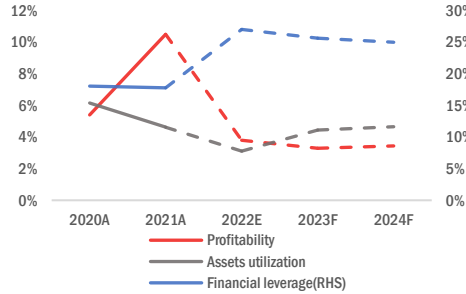
The BoD of SKFH, First, remaining strong family background, all controlled by the relevant members of the original Wu Huoshi family. Second, the age of BoD is in high level. Third, the gender ratio is seriously imbalanced, if SKFH wants to attract international investors, it may exist resistance and lack of incentives. The risk management mechanism existed in name only: the settlement of multiple levels seem to be able to fully protect SKFH's risk management, or there are scandals such as insider trading, violations of insurance laws, and violations of financial holdings laws. In terms of the amount of penalty, TWD27.6M on the violation of the Insurance Law in July 2021 last year was the largest case, and the biggest problem was that Wu Dongjin, a major shareholder of the former management class, still had the intention of controlling SKFH, thus we concluded that SKFH's corporate governance was not compliant and did not fulfill the

Figure 16: Positive relationship between P/BV & ROE



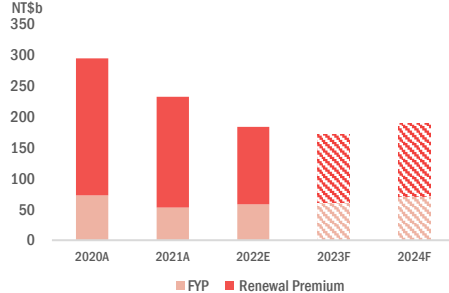
Source: TEI, Team Analysis

Figure 17: Decomposed ROE by DuPont analysis



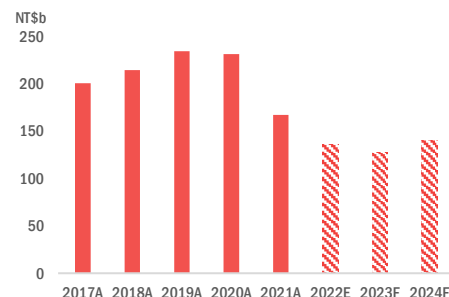
Source: TEI, Team Analysis

Figure 18: Total premium decline in recent years



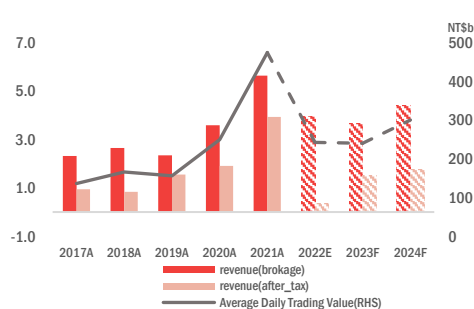
Source: Company Data, Team Analysis

Figure 19: Net change in insurance liabilities



Source: TEI, Team Analysis

Figure 20: MLS's revenue trend with ADTV



Source: TEI, FSC, Team Analysis

responsibility of protecting the rights and interests of minority shareholders.

## FINANCIAL ANALYSIS

### Profitability

#### Shin Kong Life (SKL): The most important pillar

In our prediction of 2023 and 2024 financial results, the improvement in macroeconomic conditions in 2022 will not bring an increase in the return rate of SKL. The hedged investment return rate show signs of weakness mainly from two aspects:

**The insurance industry struggled to acquire new money on investments:** From the operational perspective, first year premium (FYP) grew by 18.5%YoY in 3Q22 mainly due to the strong sales momentum of foreign currency insurance policies, accounting for about 80% of the overall FYP. Unfortunately, declining renewal premiums (-31.2% YoY) will continue to hurt SKL's profitability. SKL's 3Q22 total premium income is NTD\$143B, decreased by 21.5% YoY (Figure 18). Looking forward to 2023, as the US dollar weakens, it is expected that the attractiveness of foreign currency policies will be reduced in the future. To comply with IFRS17 and meet the requirements of authorities, the predetermined interest rate and declared interest rate of TWD insurance policies remain unchanged, and the company's mismatch on the balance sheet will reduce sales of TWD policies significantly. In addition, insurance investment is mostly invested with spare money, affected by the recession, people will have less room to make additional insurance investment, and the high interest rate of the market will also reduce people's willingness to invest in insurance, and turn to other more conservative investment tools. We expect life insurance policies to be less attractive in the future compared to 1H22 so that SKL is facing a lot of ordeals in absorbing new policies and will have a collateral impact on annual premiums in the coming years. From the perspective of investment, SKL's bond position is mainly comprised of AC, meaning a limited room for SKL to earn new money from disposing existing assets. In 2H22, affected by the high interest rate in the market, there was a wave of termination of policies with a maturity of 6 years, and SKL's deposit reserve was higher than the self-retained maturity premium. Based on the above, we believe that SKL has limited new money to invest in the market (Figure 19), so the improvement in the recurring yield is limited. Therefore, we estimate the pre-hedging recurring yield to 3.35% in 2023.

**Flatish market with higher hedging cost, looming outlook for insurance investment:** SKL's main hedging tools are CS and NDF, with a proportion of 51% and 49% respectively. The larger the Taiwan-US interest rate spread, the more expensive USDNTD of the CS contract is. The hedging cost is estimated to be 2.0%. Challenging conditions have caused evaluation losses of up to NTD\$192.4B in 3Q22, and we believe that disposing of these existing assets to invest in new ones will realize unacceptable losses, which will also become burdens when investing new money. Through the market downturn, 3Q22 disposition of investment losses approximately 78.8billion. Under the expectation of slowdown economy for following years, we expect the market to remain lukewarm next year and estimate capital gain will be 0.8%, the after-hedged investment return rate in 2023F is estimated to be 2.84%.

#### Shin Kong Bank (SKB)

The drivers for SKB's 2022E and 23F financial result come from interest rate hikes and widen Taiwan-US interest rate spread. However, we expect the improvement is mediocre, given the following reasons:

**Limited benefit from TCB's rate adjustment:** SKB's purely domestic operation leads itself hard to adjust its deposit structure, while peers with higher portion of foreign deposit are benefiting from widen US-Taiwan interest rate spread. Meanwhile, TCB's rate hiking were accompany with raising deposit rates and required reserve ratio, leading limited NIM and NIS expansion, therefore we expect net interest income to be NTD\$15.8B in 2023F (vs NTD\$12.6B in 2021, NTD\$14.5B in 2022E).

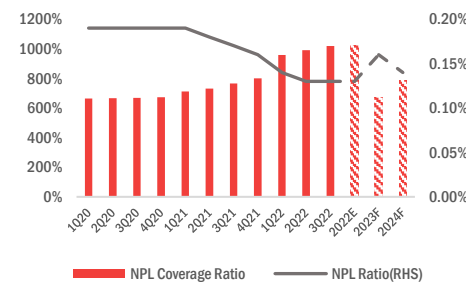
**The cost structure leads to a high cost of funds:** Demand deposit is the cheapest source of funds, but SKB's demand deposit ratio is only about 45.5% (lower than the peers' average 58.5%), and the impact of the interest rate increase will lead to an increase in interest expense. Affected by the market downturn, the momentum of lending declined, affecting the total amount of lending.

**Lukewarm growth for the fee income:** SKB's net fee income source is mainly from wealth management (about 44.3% in 9M22), and the significant increase from insurance fee income in 1H22 offset the negative impact from the capital market. However, we expect that the incentives for foreign currency policies will decrease since 2H22, leading a flatish growth of net service fee revenue and commissions (-4% YOY in 2022E and 1% YOY in 2023F)

#### MasterLink Security (MLS)

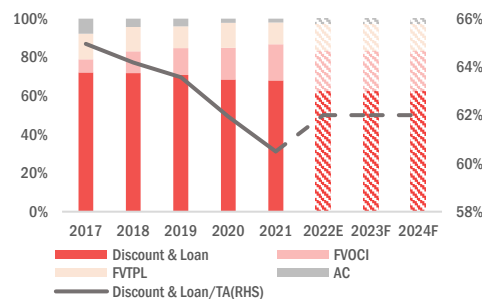
We expect ADTV of TWSE will fall off a cliff (NTD\$474B/242B/240B in 2021/22E/23F), leading MLS's 2022E/23F financials suffered, especially from its brokerage and self-operated business. We expect to continue to suffer from losses in the self-operated sector in the coming year, resulting in a contraction in net profit after tax, with an estimated net profit of approximately NTD\$1.5B in 2023F (vs NTD\$3.9B in 2021, NTD\$0.4B in 2022E) (Figure 20).

Figure 21: SKB's asset quality will get worse in 2023



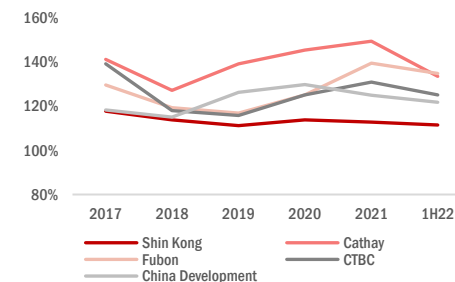
Source: TEJ, Team Analysis

Figure 22: SKB's asset allocation



Source: TEJ, Team Analysis

Figure 23: SKFH perform terribly on CAR



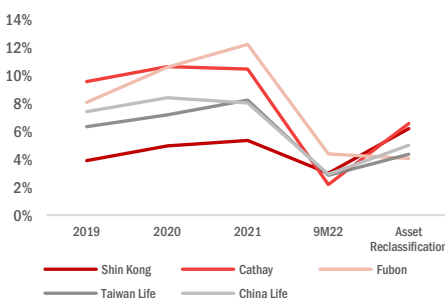
Source: Company Data

Figure 24: Capital raising by SKFH in recent years

Total Amount	EPS	Diluted EPS
92.43 bn NTD	-0.07	-0.07
GDR: 400mn USD;		
Employee stock Ownership:	-0.07	-0.07
460mn NTD		
99.9bn NTD	0.76	0.72
33.75bn NTD	0.68	0.65

Source: Company Data

Figure 25: SKL's equity ratio is worse than peers



Source: Company Data, MOPS

## SKB's Asset Quality

The asset quality of SKB has been gradually improved, indicated by the declining Non-Performing Loans Ratio and the rising non-performing debt coverage ratio. Since both the US and Taiwan start the interest rate hike cycles in 2022 and already revised down 2023 outlook, we expect the macro slowdown will drag SKB's asset quality, especially from the jump of SME's default rate. In sum, we estimate the coverage ratio in 2023 will be 671%, and the Non-Performing Loans Ratio will be 0.16% (Figure 21).

## Asset Allocation : Hard to actively dispose and adjust

SKL's financial assets classified by accounting accounts, 1) Amortized Cost: Over 90% of AC are invested in foreign bonds; 2) FVPL: Domestic investment accounts for 85%; 3) FVTOCI: Fixed income and equity are 60%/40%, respectively. Since the asset reclassification effective from 4Q22, SKL's bond position under AC will reach 98% of total, indicating it can only dispose small shares from any potential rebound of bond price, and hard to make more active adjustments.

## SKL

SKL's total assets grow in 2017-22 by 8.2% CAGR, reach to NTD4,860B as of 3Q22, and 70% are used to invest. Dive into its portfolio, 77.7% are fixed income (10.4% domestic + 67.3% foreign), 7.5% are equities (6% domestic + 1.5% foreign, mainly dominated by USD). However, we expect the gloomy global outlook will hurt SKL's investment assets from the valuation loss of 1) equities: enterprises' earnings warning is just to begin; and 2) fixed income: USDTWD hedge cost are expected to rise in 2023, indicating the after-hedge profits will be offset. (Appendix 3)

## SKB

SKB's total assets grow in 2017-22 by 9.6% CAGR, reach to NTD1,187B as of 3Q22. It remains stable weightings on AC/OCI/TPL for years, and shows a decline on discount loan. In our economy slowdown expectation for next year, we estimate the lending business will be flat, and weightings of each item will remain stable in 2023 (Figure 22).

## Capital Management

**Transitioning to IFRS 17 and ICS2.0 will counter the capital pressure:** It plans to abide IFRS 17 after 2026 in Taiwan, and it will bring two major impacts on the insurance industry. 1) To immediately reflect the potential IRD loss: in line with the spirit of asset-liability matching, IRD loss (declared rate vs. current rate) are forced to disclose. With long history burden, SKL will suffer from IFRS 17 through facing the pressure of capital increase. 2) System replacement and upgrade: after formalization, corporations will use new ledger, whether it is classification of transaction, revenue recognition, liability composition, etc., which is very different from the past, increasing the operation cost and the formalization cost.

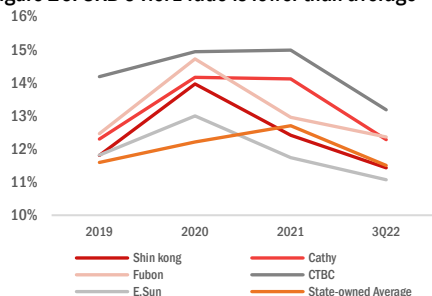
In addition, ICS2.0 differs from the current RBC regulation, the main principle is asset-liability matching and categorization of capital, as well as covering physical risk and considering interest rate risk over the full term. The new regulation has stricter capital requirements and will also impact the investment strategy, resulting in life insurance corp. facing capital increase pressure. After calculations, the new regulation will reduce the BIS ratio of the life insurance corp. by 8.25%, and the average BIS ratio will be reduced from 325.88% to 317.63%. (Appendix 10)

**SKFH's BIS performance is worse than the peers:** According to Taiwan's regulations on capital adequacy in the life insurance industry, there is currently no immediate capital increase demand for SKFH. However, in terms of the BIS ratio (Figure 23), SKFH has been at a low level for many years, meaning a sustainable demand for capital increase (Figure 24); In addition, SKL's 2019-22 RBC is at least lower 70-100 percentages than the peers (Figure 25, Appendix 11), and the performance of SKB in the CET1 ratio and Tier1 ratio is also lower than the peers for many years (Figure 26, Appendix 12), indicating SKFH's capital risk management are worse than the peers. If SKFH's capital adequacy need to reach the level of the peers, we estimate the funding requirement is 40B NTD at least. From its past capital increase history and the forthcoming IFRS17 and ICS2.0, SKFH will face the capital increase demand on the edge. (Appendix 13)

**Capital Raising:** Based on the capital raising tools and practical considerations used by SKFH in the past, the issuance of common stock will be the most possible and effective way. The reasons are as follows: 1) In the past, the financial holding companies rarely issued convertible bonds because CB can not be included in the qualified capital, to improve adequacy ratio of the Financial Holdings. 2) Although the financing cost of preferred stock is lower than that of common stock, it has limit issuance. Under the regulation, the sum of preferred stock and sub-liquent bonds can not exceed one-third of qualified capital, and we calculate the room for SKFH's available capital raise from preferred stock is only TWD\$2,970M left. 3) The two preferred stock issued by SKL in the past, Shin Kong preferred stock A and Shin Kong preferred stock B, are less popular with market investors, and the price has fallen below the issue price, which may be difficult to achieve the company's target. Therefore, the issuance of common stock would be the best way for SKFH to increase its capital, and. Although it by common stock will dilute EPS, it is the most helpful source for qualified capital (the goal that SKFH most wants to achieve). (Appendix: Comparison table of current additions)

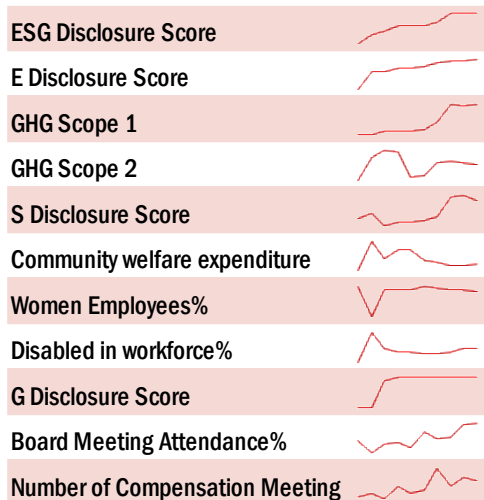
**Impact on dividend:** In summary, SKFH's capital adequacy is worse than that of its peers, and it is also facing severe capital raising demand, with an unrealized loss of about TWD\$91.4B on the financial products account at the end of the 3Q22. In the 3Q22, it expanded by about TWD\$31.1B due to interest rate impact. We expect that if SKFH's 2024

Figure 26: SKB's Tier1 ratio is lower than average



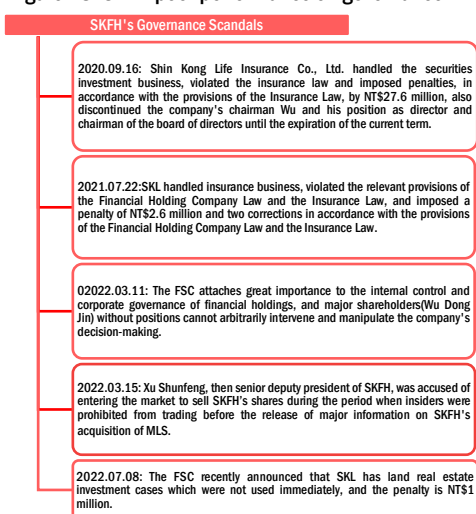
Source: MOPS

Figure 27: SKFH ESG Performance



Source: Bloomberg

Figure 28: SKFH poor performance on governance



Source: FSC

dividend next year is to remains at the level of the past three years, it have to use its capital reserve or statutory reserve to pay dividend. However, the premise of the distribution of dividends in the statutory reserve must be when the company has no losses, and only to the extent that the statutory reserve exceeds 25% of the paid-in capital, and must also be approved by the competent management, and the capital reserve on the current SKFH's account still exceeds TWD\$18B.

## ENVIRONMENTAL, SOCIAL AND GOVERNANCE

The Financial Supervisory Commission had selected Cathay, CTBC, First, Yuanta, and E-Sun as the Sustainable Finance Pioneer Alliance in the Sep, and we do see SKFH's ESG performance is behind these pioneers.

### Environmental

**The mechanism of Responsible Investment and lower carbon footprint:** SKFH abides the Principles of Responsible Investment and integrates ESG issues into decision-making of investment process. Despite with the unfavorable +58%YoY in 2021, the carbon footprint of SKFH's overall portfolio is lower than pioneers.

**Sustainability Linked Loan: Long way to chase the steps of pioneers:** SKFH's sustainable loans in 2021 is TWD 5.1B (+24.4%YoY), which is far behind the pioneers. On this issue, E-Sun is the leader with more than TWD 250B in 2021.

**Beyond the carbon emission reduction target:** In order to reduce the company's environmental impact, SKFH and its subsidiary companies have set a target of reducing 12% carbon emission within 6 years since 2019. Through comprehensive environmental management measures and mechanisms, in 2021, the total GHG emissions (Scope 1 and Scope 2) decreased by 10% compared to 2019.

**Conclusion of SKFH's Environmental performance:** From major ratings organization, SKFH's E scores is fall behind, affirming our comparison.

### Social

We chose three key elements, covering internal and external relation, to assess SKFH's social performance:

**Key talent retention:** SKFH's retention rate is 95.9% in 2021, ranking #3 if compared to pioneers. This result indicates SKFH's working environment, salaries and benefits policy abreast with leaders.

**Gender compensation ratio:** To pave the way for equality, the pioneers are shortening the compensation gap between gender. However, SKFH's ratio is only 88% in 2021, showing 12% behind male's salary.

**Total public welfare expenditure:** By definition, cash donations, time contributions, in-kind donations and management expenses, implying the company's degree of social participation. SKFH's public welfare expenditure in 2021 is TWD 108M, only higher than the First FHC.

**Conclusion of SKFH's Social performance:** From major ratings organization, SKFH's S scores is slightly below average, supporting our comparison.

### Governance

**Need to improve its BOD composition:** SKFH's board of directors has a strong family color (See Overview of broad members), and is prone to huge changes in management due to changes in family relations. In terms of age, more than half of the board members are over 70 years old, implying the potential problems from rigidity thinking and succession plan may affect SKFH's business. Gender diversity is also a concern, as SKFH only has one female independent director in BOD. (Appendix 15)

**The remuneration of the BOD to NI is on average:** The ratio of directors' compensation to net profit is a signal to observe whether a severe agency problem between management and shareholders. SKFH's ratio is less than 1% and on the industry average, showing no evidence for the fat cat.

**Risk management mechanism is in name only:** SKFH's risk management structure follows three lines of defense. By the level from low to high: 1) Business operation and management units: Each subsidiary bears the risks arising from daily affairs. 2) Legal compliance and risk management unit: the authorized units are in charge of consolidated analysis, reporting, and supervision. 3) Audit units: SKFH sets the audit unit to report directly to the president, and also sets risk management committee to make important decision. On the top, BOD and audit committee will evaluate the effectiveness of overall risk control. However, SKFH is the frequent name on FSC's penalty list, from administrative fines to executives' dismissal, showing the lesion from family-owned structure with one-man decision.

**Conclusion of SKFH's governance performance:** We believe the valuation discount is mainly from SKFH's poor governance, not only lower the investment returns of life insurance, but the reputation to investors.



Figure 29: CAPM assumption

Assumptions	Base Case	ESG-adjusted
Risk-free Rate	1.30%	1.30%
Beta	0.87	0.87
Beta(after ESG-adjusted)		1.02
Market Return	9.9%	9.9%
Cost of Equity	8.8%	1.01%
Terminal Growth Rate	2%	2%

Input	Rate	Source
Risk-free Rate	1.30%	Taiwan Bond 10-Year Treasury Bond Yield
Beta	0.87	Regressed by share price in the past five years
Market Return	9.9%	Taiwan's annualized return rate in the past five years
Cost of Equity	8.8%	CAPM
Terminal Growth Rate	2%	Taiwan's long-term target inflation rate

Source: TEI, Team Analysis

Figure 30: SOTP valuation (base case)

SOTP Valuation	Multiplier(a)	Book Value or EV(b)	Total Value(a*b)
Shin Kong Life(EV)	0.6	392.45	235.47
Shin Kong Bank	1.2	66.99	79.64
MasterLink Securities	0.8	26.91	21.53
Shin Kong PIA	1.0	0.10	0.10
Shin Kong Investment Trust	1.0	0.76	0.76
Shin Kong VC	1.0	1.52	1.52
Total Value			339.01
Holding Company Discount			33%
Shares(SKFH)			15.23
Value/Per share			\$7.27

Source: Team Analysis

Figure 31: Embedded Value

(B, NTD\$)	2020	2021	2022E	2023F
Adjusted NAV	208.10	220.80	204.00	210.06
VIF	192.50	234.00	277.47	322.08
Cost of Capital (COC)	91.10	113.60	115.87	118.19
EV	309.40	341.20	365.60	413.94

Source: Company Data, Team Analysis

Figure 32: Adjusted NAV

(B, NTD\$)	2020	2021	2022E	2023F
Adjusted Net Worth as of last year	196.90	208.10	220.80	196.44
profits	7.20	12.60	-4.80	-6.25
Unrealized Gains on Financial Assets	-8.10	-3.60	-25.42	-7.50
Other Adjustments	12.00	3.80	5.86	5.86
Adjusted Net Worth	208.10	220.80	196.44	188.56

Source: Company Data, Team Analysis

## VALUATION

We give SKFH a SELL rating with 12-month TP NTD\$7.27/per shares(Figure 30), implying 17.10% downside. Our valuation is mainly by SOTP method and supported by peers' multiples. To shed the light of ESG impact, we use the SPICE rating model to integrate SKFH's ESG performance, and the ESG-adjusted TP NTD\$6.26 also affirms our SELL rating.

### Sum-of-the-Parts Valuation (SOTP)

Compared to other financial sectors, the obvious valuation difference is existing in the insurance company. We believe SOTP method, rather than purely multiples, is more suitable and accurate for SKFH, as it contains three main pillars: Life, Bank, and Securities.

#### Life

Under the current accounting principles with asset-liability mismatching problems, BVPS of insurance companies are not informative when the bond yields skyrocket. Instead of BV, we affirm EV is more proper, as it estimates how much total value a company will have if liquidated at certain time and emphasizes the efficiency of the use of funds. We discount our EV to SKL by 40%, mainly because the profit volatility of the life insurance industry is less stable than that of banks, so the greater contribution from life insurance business to FHC, the lower FHC's P/EV will see.

#### Bank

SKB's P/BV Multiplier is estimated on the ROE-g/COE-g approach. The COE method is very reliable, as SKB's variables are stable. Regarding each parameter, we use CAPM to estimate COE, including the risk-free rate of 1.30% (Taiwan Bond 10-Year Treasury Bond Yield), beta of 0.87 (Regressed by share price in the past five years), and Rm of 9.9% (Taiwan's annualized return rate in the past five years) to get COE of 8.8%, g of 2% (banks are mature industries, so Taiwan's long-term target inflation rate is used as the growth rate estimate)(Figure 29). Given the slight NIM expansion will be offset by increasing operating expenses in our forecast, we estimate SKB's ROE to be 10.0% in 2023 (vs 9.4% in 2021, 9.0% in 2022E) and acquire 1.0X for SKB's P/BV Multiplier.

#### Securities

The listing numbers of securities sectors in Taiwan are adequate, supporting us to use relative multiples to value securities business. We estimate that the Average Daily Trading Value of Taiwan stocks will be about NTD\$240B in 2023, back to the transaction level in early 2020. Looking for 2023, there's a similar background in 2020 with uncertain market and economy. Therefore, we use P/BV Multiplier in 1Q20 to compare with ROE. We estimate that MasterLink Securities is affected by the capital market, brokerage and self-operated business will shrink in 2023. We give 0.8 P/BV Multiplier based on its ROE (5.6%).(Appendix 16.17)

#### Others

Shin Kong Investment Trust and Venture Capital Affected by the recent low momentum of the capital market, we give the multiplier 1 for the coming year. Shin Kong PIA mainly to enhance the efficiency of SKFH's integrated marketing, and the profit is stable, so it gives P/BV Multiplier of 1.

#### Key assumption:

**Holding Company Discount:** Based on SKFH's experience over the past five years, aggregate net worth of its major subsidiaries and average market capitalization has about 30-36% discount, and since SKFH has not made significant breakthroughs in cross-subsidiary cooperation in recent years, we have adopted an average of 33% as the future holding company discount. (Figure 30, Appendix 18)

**EV and Book Value:** SKL's EV is estimated through 1) Adjusted NAV, 2) VIF and 3) Cost of Capital (COC), and the biggest changes in Adjusted NAV are profits and unrealized gains on financial assets. Therefore, considering that profits of SKL are difficult to obtain excellent performance, and capital market volatility has led to unrealized gains on financial assets will have a significant book loss, we estimate 1) Adjusted NAV to be NTD\$188.56B. 2) The VIF is mainly estimated by VNB and Roll-forward of Time. Since SKL's FYP has not increased significantly, the VIF is estimated to be NTD\$322.08B. 3) Cost of Capital (COC) is adjusted to the average growth rate of the past five years, and finally can get SKL's EV (NTD\$392.45B in 2023F).(Figure31.32.33, Appendix 19) SKB has not significantly improved profitability and has deteriorate CIR, so we estimate that Book Value will be NTD\$66.99B. Book Value of other business units adjusted for the average growth rate of the past five years and the operating prospects of the coming year to obtain NTD\$26.91B of MasterLink Securities, NTD\$0.10B of Shin Kong Investment Trust, NTD\$0.76B of Shin Kong Venture Capital and NTD\$1.52B of Shin Kong PIA, respectively.

#### ESG Integration:

We also factor ESG into our valuation considerations. Referring to the SPICE rating of Principle of Responsible Investment (PRI), we will comprehensively evaluate financial holding companies with better ESG performance with SKFH. The results showed that of these companies, SKFH performed the worst and therefore had the largest beta increase (beta increase of 0.15). The adjustment method of Life EV Multiplier is proportional to the degree of ESG adjusted impact on the cost of capital, and the adjustment results in Multiplier 0.5 (vs 0.6 original beta), resulting in our ESG adjusted stock price of NTD\$6.26. (Appendix 20.21)

Figure 33: VIF

(B,NTD\$)	2020	2021	2022E	2023F
VIF as of last year	186.40	192.50	234.00	277.47
Model Changes	-0.10	0.50	0.50	0.50
Roll-forward of Time	25.50	21.30	21.30	21.30
Portfolio Changes	1.00	-1.90	-1.90	-1.90
Non-Economic Assumption Changes	0.20	-5.40	-5.40	-5.40
Economic Assumption Changes	-68.30	6.20	6.20	6.20
Change of Risk Discount Rate	22.20	-	-	-
New Business	25.80	20.70	22.77	23.91
VIF	192.50	234.00	277.47	322.08

Source: Company Data, Team Analysis

Figure 34: Sensitivity Analysis

		FED fund rate hike in 2023(bps)				
		0	25	50	75	100
Economic Growth of Taiwan	1.5%	7.27	7.22	7.16	7.11	7.06
	2.0%	7.32	7.27	7.22	7.16	7.11
	2.5%	7.38	7.33	7.27	7.22	7.17
	3.0%	7.43	7.38	7.33	7.27	7.22
	3.5%	7.49	7.44	7.38	7.33	7.28

		TWD/USD in 2023				
		29.6	30.1	30.6	31.1	31.6
Economic Growth of Taiwan	1.5%	7.43	7.29	7.16	7.03	6.90
	2.0%	7.48	7.35	7.22	7.08	6.95
	2.5%	7.54	7.40	7.27	7.14	7.01
	3.0%	7.59	7.46	7.33	7.19	7.06
	3.5%	7.65	7.51	7.38	7.25	7.12

Source: Team Analysis

Table1: Life Insurance Control Group

	Mak Cap(B,NTD\$)	P/BV(x)				P/EV(x)		ROE(%)				EPS(NTD\$)			
	2022/12/31	2020A	2021A	2022E	2023F	2020A	2021A	2020A	2021A	2022E	2023F	2020A	2021A	2022E	2023F
SKF(a)	135.83	0.47	0.51	0.35	0.26	0.37	0.39	6.03	9	-1.17	-1.46	1.1	1.59	-0.31	-0.41
Fubon	697.85	0.58	0.86	0.93	0.82	0.56	0.82	13.03	16.73	11.73	12.76	8.54	12.02	8.64	8.48
Cathay	586.77	0.60	0.79	1.08	0.92	0.46	0.58	9.01	15.49	9.50	10.81	5.41	10.34	6.27	7.28
CDF	212.25	0.65	0.77	1.03	1.00	0.36	0.48	6.57	15.05	8.79	8.69	0.85	1.61	1.5	1.49
Median(life dominated)(b)	586.77	0.60	0.79	1.03	0.92	0.46	0.58	9.01	15.49	9.50	10.81	5.41	10.34	6.27	7.28
Discount(1-a/b)	0.77	0.21	0.35	0.66	0.72	0.19	0.33	0.33	0.42	1.12	1.14	0.80	0.85	1.05	1.06

Source: Bloomberg, Team Analysis

Figure 35: Risk Matrix

Probability	Impact		
	Low	Moderate	High
High			
Moderate			F1
Low		F2 M3 M4	M1 M2

Source: Team Analysis

## Peer comparison:

Equity Multiplier is from the market perspective, and we view give TP by key financial indicators. Because FHCs' assets and liabilities are mostly composed of monetary assets of the enterprise and highly reliable, we use P/BV, P/EV for verification. As for the selection of peers, Fubon, Cathay, and China Development FH are the listing life insurance control group. These four companies play a pivotal role in Taiwan, and their valuation vary according to the ROE level.

As the table 1 & Appendix 23, SKFH's P/BV and P/EV discount will follow the discount of ROE. We estimate that in the coming year, SKFH will be -1.46% of ROE, 0.26 of P/BV, and life insurance-based Financial Holdings median will be 10.81% of ROE, 0.92 of P/BV, the verification results affirm our valuation, and in line with the market consensus of the past. In addition, we estimate that SKB's ROE will be 10.0% in the coming year, which is about 1.12 to 1.60 compared with the bank-based holdings in the past, while we estimate SKB's P/BV to be 1.20, to reflect SKB's weakness of overseas development and higher cost of capital.

## Sensitivity Analysis

We exam the macro impacts on SKFH's valuation through sensitivity analysis. Due to SKFH's income is heavily dependent on foreign fixed income and equities, we chose to fed fund rate hike bps, exchange rate and Taiwan's economic growth rate in 2023 to test the impact of the overall economy on the SKFH. We found that when the rate hike is less than the 50 bps expected and Taiwan's economic growth rate increased by 100 bps, the stock price rise by NTD\$0.22, up 3.03% from our original valuation. In addition, if the TWD/USD is less than NTD\$1 expected and Taiwan's economic growth rate increased by 100 bps, the stock price rise by NTD\$0.38, up 5.23% from our original valuation.(Figure 34)

## Scenario Analysis

We conduct scenario analysis to assess the impact in economic conditions changes on our valuations. 1)Our bull market scenario assumes that the domestic economic environment is more favorable and that FED initiates rate cuts starting in 2023F (by 125bps for the whole year). Unrealized Gains on Financial Assets increased by NTD\$26.61B in 2023F, up from an EV of NTD\$426.34B (increased by 8.64%). SKB's ROE grow to 11.2%, while MLS was affected by a rebound in trading volume, with an estimated P/BV Multiplier of 0.9, and concluded that Bull Case was valued at NTD\$7.82, which was about 7.57% better than the original valuation. 2)Our bear market scenario assumes that the domestic economic environment is more terrible, and that FED keep rate hike policy in 2023 (by 75bps for the whole year). Unrealized Gains on Financial Assets will be NTD\$-3.8B in 2023F, EV is NTD\$383.49B, lower than the original forecast of 2.28%. SKB's ROE declined to 9.1% (vs formerly 10.0%), while MLS was affected by a decline in trading volume, with ROE maintained negative growth, and estimated P/BV Multiplier is 0.7. The Bear Case valuation we obtained was NTD\$7.05, which was about 3.03% inferior to the original valuation. (Appendix 22)

## INVESTMENT RISKS

## Firm Risk

## F1. M&amp;A

Taisin FH may acquire SKFH by way of cash and stock swap: In addition to referring to the past mergers and acquisitions in the financial industry, Taishin FH recently confirmed the acquisition of Prudential Life for TWD\$8.5B to fill the gap in its life insurance business, which shows its ambitions for positive growth. However, the scale of the new insurance business is still insufficient to compete with existing peers, and Taishin FH has recently disposed of a large number of Chang Hwa Commercial Bank's shares with at least TWD\$19B cash in hand that can be used in M&A. We expect currently the low shareholdings of Wu's family (around 5.2% as of 2022) and a relatives relation between Taishin's major shareholder and Wu's family will engage the possible M&A deal. In addition, due to the regulations of the authority, Financial Holdings shall not issue subordinated bonds for M&A. Because the issuance of special shares will affect the double leverage ratio, Taishin FH needs to make acquisitions in the form of cash mixed stock swap. (Appendix 14) **Valuation Impact:** Based on past M&A case in the financial industry, we expect the merger price to close at a 15% premium per share, upward the target price to \$10.09 NTD (39% upside from the target price)

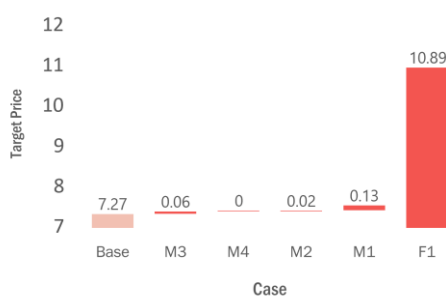
**Mitigant:** In fact, both SKFH and Taishin had M&A intention but finally failed in 2002. SKFH needed an additional reserve of TWD 19.6B to strength its financials at that time. Meanwhile, M&A threshold of FHC is high, including non-binding letter of intent with certain offers and condition, and special committee held by independent directors. We believe it takes time and will not occur in the near future.

Figure 36: Summary of Risks and Mitigant measures

Risks	Mitigant
<b>Firm Risk</b>	
F1. M&A	M&A threshold of FHC is high.
F2. corporate governance & operational performance improve	Mr. Wu Dongjin still strongly interferes with important internal decisions of the company after retreating.
<b>Market Risk</b>	
M1. Fed cut interest rate	The US labor market is still strong, so the Fed's monetary policy should maintain a hawkish stance.
M2. Bond evaluation loss reduces	The yield of treasury remains at high level and the credit risk has risen.
M3. Russian bond has little impact	Russian economic collapse will cause further losses.
M4. Rich exchange gains	The market is expected to enter the end of the rate rising cycle.

Source: Team Analysis

Figure 37: Risk impact of valuation



Source: Team Analysis

Figure 38: Risk Heat Map



Source: Team Analysis

## F2. SKFH improves corporate governance and operational performance

SKFH has not performed well in corporate governance for many years, there are many deficiencies and records of being punished by the competent authorities. If SKFH, like SinoPac FH, introduces external professional managers and family members leave the BOD, it will improve the company's operating strategy, polish the reputation, lift up investor confidence, and finally enhance SKFH's valuation. **Valuation Impact:** Referring to the model that we included ESG in the valuation, if SKFH improves its corporate governance, SKFH's SPICE rating will rise by one level, decrease the beta discount of SKL down to 0.1 in the SOTP model, upward the target price to \$6.59 NTD (5.01% upside from the ESG-adjusted target price)

**Mitigant:** Although the former director Mr. Wu Dongjin has retreated and replaced by his second daughter, Mr. Wu still strongly interferes with important internal decisions of the company, and was fined by the authorities in March this year, and the situation of SKFH being controlled by the family should be difficult to change in the near future.

## Market Risk

### M1. The economy enters a recession that causes the Fed to cut interest rate

Fed's overly hawkish may depress global economy from low-single digit growth rate into recession, causing the Fed to suspend interest rate hikes. If the interest rates enter to a flat or even step into decline cycle, it will lead to an easing of yield and a recovery in the bond market. In addition, investor's sentiment will no longer be pessimistic, and the stock market will bottom up. The interest rates cut will reduce the loss of SKFH's bonds, the net value will rebound, and the pressure to increase capital will be reduced; Taiwan-US spread is no longer widening, which also reduces the cost of hedging for SKL; The interest rate cut will also lift up loans demand growth, so that SKFH's loan volume will grow, and the growth of net handling-fee income will also be greatly improved. **Valuation Impact:** According to the investment strategy of SKL, if the Fed starts to cut interest rate, the unrealized FVOCI will increase by 16.5 Billion NTD, upward the target price to \$7.48 NTD (2.89% upside from the target price)

**Mitigant:** According to the US December Report, the number of new non-farm payrolls was 223,000, higher than the market expectation of 200,000, and the unemployment rate was also lower than expected, showing that the US labor market is still quite strong, so the Fed's monetary policy should continue to maintain a hawkish stance, and the chances of another interest rate hike at the end of the year are still high.

### M2. TWD continued to depreciate, bringing in rich exchange gains

The TWD has depreciated by more than 16% in 2022, and SKFH has 0.55% hedging gain for the first three quarters in 2022. Although the expansion of the Taiwan-US IRD will cause the CS, NDF hedging costs to rise, the amount of exchange gains is still greater than the cost of hedging. Overall, the depreciation of the TWD is a big plus for SKFH, if the TWD continue to depreciate, it will drive the SKFH's income to rise. **Valuation Impact:** Under the assumption of SKL's financial report, it will cause an increase in SKL's profit on exchange of \$2 Billion NTD, upward the target price to \$7.35 NTD (1.10% upside from the target price)

**Mitigant:** The market is expected to enter the end of the rate rising cycle, and will remain at a high grade interest rate by 2023, so the depreciation of the TWD will bring limited benefits to SKFH, and the exchange rate will be relatively stable.

### M3. The recovery of the bond market has enabled SKFH to reduce the credit loss of the bond

When the economy improves, the debtor's solvency rises, so that the credit risk of the bond decreases, allows the funds to return to the bond market and warm up the bond market. It will reduce the bond evaluation loss, recover the net value, and increase the stock price. **Valuation Impact:** The decline in bond credit risk will increase SKL's realized gain at most \$3.3 Billion NTD if happened, upward the target price to \$7.33 NTD (0.83% upside from the target price)

**Mitigant:** The yield of treasury remains at high level, the gloomy global economy has reduced companies' solvency in common, credit risk has risen, the market expects that FED and ECB will not cut interest rates in 2023, and the bond position of SKFH will continue to lose.

### M4. The Russian bond has little impact on SKFH

SKFH's Russian bond exposure is about NTD\$30B in response to the Russian bond downgrade has raised the expected credit loss of NTD\$3.16B, and the US has allowed Wall Street investment banks to restart the transaction of Russian sovereign bonds, and the price has gradually recovered, reflecting the market's expectation of confidence in the Russian economy. On the whole, the impact of the Russian bond crisis on SKFH is far less than the European bond crisis in 2010, if the investors excessive interpretation, which will cause the upside risk. **Valuation Impact:** As a result of minimizing the impact of the Russo-Ukrainian War, SKFH has written off 3.16 Billion NTD of its previously Russian bond holdings for expected credit losses. The reversion will lift up the target price to \$7.33 NTD (0.83% upside from the target price)

**Mitigant:** If furthermore serious conflict occurred in the Russo-Ukrainian War, the Russian economic collapse will cause default or bankruptcy, affect the Russian bond of SKFH, thus cause further losses.

## List of Appendix

Appendix 1: SKFH Income Statement .....	12
Appendix 2: SKFH Balance sheet .....	12
Appendix 3: SKL Income Statement.....	13
Appendix 4: SKL Income Statement.....	13
Appendix 5: SKB Income Statement .....	14
Appendix 6: SKB Income Statement .....	14
Appendix 7: MasterLink Income Statement .....	14
Appendix 8: MasterLink Income Statement .....	15
Appendix 9: Oversea investment position gradually go up.....	15
Appendix 10: Change of Transitioning to IFRS 17 and ICS2.0 in 2026.....	16
Appendix 11: Life insurers RBC .....	16
Appendix 12: Banks CET1 ratio .....	16
Appendix 13: Three tools of capital raising .....	16
Appendix 14: The way of M&A.....	16
Appendix 15: Overview of BoD .....	17
Appendix 16: Relative Mutiples to Value MLS.....	17
Appendix 17: Securities Control Group .....	17
Appendix 18: SKFH's Holding Company Discount over the past five years .....	17
Appendix 19: The calculation method for Embedded Value (EV) .....	18
Appendix 20: SPICE RATING calculation process .....	18
Appendix 21: SOTP Valuation (ESG-Adjusted) .....	18
Appendix 22: Scenario Analysis .....	19
Appendix 23: Bank Control Group .....	20



## Appendix 1: SKFH Income Statement

Income Statement (Billion NTD)	2020A	2021A	2022E	2023F	2024F
Interest Revenue	106.59	108.11	117.36	124.34	131.46
Interest Expense	6.31	5.13	5.59	7.36	7.68
Net Interest Income	100.29	102.98	111.77	116.98	123.77
Net Revenue Other than Interest	167.85	113.53	56.57	43.90	74.75
Net Fee Income	-2.24	3.24	7.77	7.52	8.36
Net Insurance Revenue	140.23	76.49	-86.76	33.37	51.67
Gains or Losses on Financial Assets (Liabilities) at FVPL	53.20	27.87	-235.25	-11.20	35.00
Realized Gain (Loss) on Financial Assets at FVOCI	9.20	8.53	6.90	3.10	8.50
Gains (Loss) Arising from Derecognition of Financial Assets Measured at AC	37.84	26.09	8.00	6.00	10.00
Gains (Loss) on Reclassification of Financial Assets	0.00	0.00	38.60	0.00	0.00
Gain (Loss) on Reclassification under The Overlay Approach	-4.58	6.17	88.98	2.97	-2.97
Foreign Exchange Gain (Loss)	-72.11	-41.70	135.00	-5.00	-38.00
Share of Profit (Loss) of Associates and Joint Ventures Accounted for Using Equity Method	-0.19	-0.21	88.98	2.97	-2.97
Net Other Revenue Other Than Interest Income	0.57	0.65	4.36	4.17	5.15
Net Revenue	268.14	216.51	168.34	160.88	198.52
Bad Debts Expense, Commitment and Guarantee Liability Provision	1.43	1.48	1.14	1.37	1.28
Net Change in Provisions for Insurance Liabilities	231.25	167.18	135.59	127.14	139.96
Operating Expenses	26.96	29.41	26.53	26.62	30.83
EBT	8.49	18.44	5.08	5.75	26.45
Income Tax Expense	-5.97	-4.29	3.05	3.75	-6.01
Net Income	14.46	22.73	2.03	2.00	32.46
Other Comprehensive Income	-7.16	-5.37	-48.22	8.07	11.96
Total Comprehensive Income	7.30	17.36	-46.19	10.07	44.43
EPS	1.12	1.67	0.13	0.13	2.11

Source: Company Data, Team Analysis

## Appendix 2: SKFH Balance sheet

Balance Sheet (Billion NTD)	2020A	2021A	2022E	2023F	2024F
Asset					
Cash & Cash Equivalent	127.05	85.24	71.73	94.83	196.10
Financial Assets at FVPL	588.11	532.00	464.63	492.98	536.00
Financial Assets at FVOCI	468.43	469.72	337.80	370.16	459.90
Receivables	89.64	89.06	30.47	32.30	38.04
Loans discounted	793.22	863.50	761.20	803.06	854.46
Financial Assets at AC	1886.32	2200.26	2747.04	2799.69	2850.30
Investment Property	180.51	182.59	200.00	210.00	220.00
Property, Plant and Equipment	33.01	40.08	4.97	5.26	5.58
Other Asset	190.83	222.81	363.93	369.68	378.86
Total Asset	4357.12	4685.26	4981.76	5177.97	5539.23
Liabilities					
Financial Liabilities at FVPL	9.58	10.98	11.69	11.46	12.42
Bills & Bonds Sold under Repurchase Agreements	39.29	36.29	26.07	30.59	36.52
Payables	51.51	57.63	24.16	25.59	25.66
Deposits & Remittance	839.81	992.40	1064.80	1139.34	1219.09
Bank Debenture Issued/Bonds Payable	64.33	55.90	29.80	29.80	29.80
Provision	2995.08	3137.94	3136.48	3230.57	3456.71
Other Liabilities	115.95	130.73	191.37	190.11	197.33
Total Liabilities	4115.54	4421.88	4484.37	4657.46	4977.54
Equity					
Common Stock	130.20	140.42	155.30	155.30	155.30
Preferred Stock	2.97	2.97	2.97	2.97	2.97
Capital Stock	133.17	144.43	158.27	158.27	158.27
Additional Paid-In Capital	20.50	19.14	16.76	19.20	21.31
Retained Earnings	81.02	98.34	124.49	124.10	139.79
Other Equity Interest	6.60	1.07	39.18	60.25	83.64
Total Equity Attributable to Owners of Parent	241.18	262.97	496.98	520.10	561.28
Non-Controlling Interests	0.40	0.41	0.41	0.41	0.41
Total Equity	241.58	263.38	497.39	520.51	561.70
Total Liabilities & Equity	4357.12	4685.26	4981.76	5177.97	5539.23

Source: Company Data, Team Analysis

## Appendix 3: SKL Income Statement

Income Statement (Billion NTD)	2020A	2021A	2022E	2023F	2024F
Retained Premiums Eamed	294.30	232.34	183.23	171.81	189.13
Reinsurance Commission Income	0.32	0.32	0.34	0.34	0.34
Processing Service Fees Income	0.53	0.53	0.49	0.49	0.49
Interest Income	89.09	90.12	97.32	101.22	107.29
Gains (Loss) on Financial Assets (Liabilities) at Fair Value through Profit or Loss	51.65	25.12	-235.25	-1.50	35.00
Realized Gain or Losses on FVOCI Financial Assets	7.61	6.93	6.90	3.10	8.50
Gains (Loss) Arising from Derecognition of Financial Assets Measured at AC	37.84	26.09	8.00	6.00	10.00
Foreign Exchange Gain or Loss	-72.63	-42.34	135.00	-5.00	-38.00
Net Change in Reserve for Foreign Exchange Valuation	-3.08	2.46	0.08	0.08	0.08
Gains (loss) on Reclassification Under the Overlay Approach	-4.58	6.17	88.98	2.97	-2.97
Other Investment Income	6.21	6.34	5.40	5.40	5.40
Net Investment Income	112.11	120.88	106.44	112.27	125.31
Other Operating Revenue	0.97	1.06	0.98	0.98	0.98
Separate Account Products Revenues	5.18	6.26	-0.50	2.00	4.00
Operating Revenue	413.40	361.39	290.98	287.88	320.25
Retained Benefits & Claims Paid	150.20	157.74	128.26	125.42	132.39
Net Change in Provisions for Insurance Liabilities	231.25	167.17	135.59	127.14	139.96
Other Operating Costs	17.46	15.41	18.58	18.00	18.34
Operating Costs	398.91	340.32	282.44	270.56	290.69
Gross Profit	14.50	21.06	8.54	17.32	29.56
Operating Expenses	14.34	13.89	11.64	12.09	14.09
Operating Profit (Loss)	0.16	7.17	-3.10	5.23	15.47
Total Non-operating Revenue	0.17	-0.01	-0.10	-0.10	-0.10
EBT	0.33	7.16	-3.20	5.13	15.37
Income Tax Expense	-6.91	-5.50	1.60	-2.56	-7.68
Net Income	7.24	12.66	-4.80	7.69	23.05
Other Comprehensive Income	-7.90	-0.53	-32.42	5.67	13.64
Total Comprehensive Income	-0.66	12.13	-37.22	13.37	36.69
EPS	1.14	1.86	-0.67	1.07	3.21

Source: Company Data, Team Analysis

## Appendix 4: SKL Income Statement

Balance Sheet (Billion NTD)	2020A	2021A	2022E	2023F	2024F
Asset					
Cash & Cash Equivalent	188.53	94.10	62.70	85.86	188.49
Financial Assets at FVPL	418.48	363.37	316.26	323.82	338.77
Financial Assets at FVOCI	314.59	273.23	142.32	161.91	237.14
Financial Assets at AC	1865.29	2177.35	2704.03	2752.48	2811.78
Investment Property	188.17	190.31	200.00	210.00	220.00
Total Loans	148.75	153.43	159.13	159.13	159.13
Other Investment	1.23	2.61	2.06	2.71	3.57
Net Investment	2936.51	3160.30	3523.79	3610.05	3770.38
Other Asset	14.59	17.11	17.90	17.90	17.90
Assets on Insurance Product, Separated Account	41.93	41.68	42.68	42.68	42.68
Total Asset	3262.89	3418.06	3647.07	3756.48	4019.44
Liabilities					
Financial liabilities at FVPL	2.10	0.37	1.27	1.27	1.27
Provisions for Insurance	2990.25	3135.13	3136.48	3230.57	3456.71
Other Liabilities	68.33	59.67	55.36	55.36	55.36
Liabilities on Insurance Product, Separated Account	41.93	41.68	42.68	42.68	42.68
Total Liabilities	3102.61	3236.87	3235.78	3329.88	3556.02
Equity					
Capital Stock	66.63	69.98	74.21	74.21	74.21
Additional Paid-In Capital	11.12	16.62	14.10	16.53	18.65
Retained Earnings	80.42	94.18	91.77	95.62	107.15
Other Equity Interest	1.71	0.00	-32.42	-26.74	-13.11
Total Equity Attributable to Owners of Parent	159.88	180.78	147.66	159.61	186.89
Non-Controlling Interests	0.40	0.41	0.41	0.41	0.41
Total Equity	160.28	181.19	148.07	160.03	187.31
Total Liabilities & Equity	3262.89	3418.06	3647.07	3756.48	4019.44

Source: Company Data, Team Analysis

## Appendix 5: SKB Income Statement

Income Statement (Billion NTD)	2020A	2021A	2022E	2023F	2024F
Interest Revenue	16.31	16.55	20.03	23.12	24.16
Interest Expense	5.07	3.95	5.59	7.36	7.68
Net Interest Income	11.25	12.60	14.45	15.76	16.48
Net Fee Income	3.36	3.47	3.33	3.36	3.47
Net Other Revenue Other than Interest Income	2.33	2.46	1.03	0.81	1.68
Net Revenue Other than Interest	5.70	5.93	4.36	4.17	5.15
Net Revenue	16.94	18.53	18.81	19.94	21.63
Bad Debts Expense, Commitment and Guarantee Liability Provision	1.16	1.47	1.14	1.37	1.28
Operating Expenses	9.11	9.61	9.78	10.37	11.25
EBT	6.68	7.45	7.89	8.20	9.10
Income Tax Expense	0.74	0.90	1.42	1.48	1.46
Net Income	5.94	6.55	6.47	6.73	7.64
Other Comprehensive Income	0.42	-5.00	-15.50	-5.00	0.50
Total Comprehensive Income	6.36	1.55	-9.03	1.73	8.14
EPS	1.28	1.38	1.34	1.35	1.39

Source: Company Data, Team Analysis

## Appendix 6: SKB Income Statement

Balance Sheet (Billion NTD)	2020A	2021A	2022E	2023F	2024F
<b>Asset</b>					
Loans discounted	644.47	710.07	761.20	803.06	854.46
Financial Assets at AC	20.40	20.92	41.55	45.76	37.06
Financial Assets at FVOCI	154.62	195.00	189.39	201.79	215.92
Financial Assets at FVPL	120.94	117.96	107.52	121.07	146.27
Investment Property	295.96	333.87	338.46	368.62	399.24
Other Asset	99.99	129.77	122.18	130.19	139.30
Total Asset	1040.42	1173.72	1221.84	1301.87	1393.00
<b>Liabilities</b>					
Deposits & Remittance	910.10	1043.92	1064.80	1139.34	1219.09
Bank Debenture Issued/Bonds Payable	27.50	27.00	29.80	29.80	29.80
Other Liabilities	32.97	33.35	67.09	65.74	71.20
Total Liabilities	970.57	1104.27	1161.69	1234.88	1320.09
<b>Equity</b>					
Capital Stock	46.33	47.59	49.82	49.82	49.82
Additional Paid-In Capital	1.73	1.78	2.61	2.61	2.61
Retained Earnings	18.74	21.27	24.86	27.06	30.60
Other Equity Interest	3.05	-1.19	-17.13	-12.49	-10.10
Total Equity	69.85	69.45	60.15	66.99	72.92
Total Liabilities & Equity	1040.42	1173.72	1221.84	1301.87	1393.00

Source: Company Data, Team Analysis

## Appendix 7: MasterLink Income Statement

Income Statement (Billion NTD)	2020A	2021A	2022E	2023F	2024F
Brokerage Handling Fee Revenue	3.58	5.63	3.94	3.67	4.40
Security Lending Income	0.14	0.27	0.30	0.33	0.37
Underwriting Business Revenue	0.27	0.17	0.15	0.17	0.18
Wealth Management Revenue	0.04	0.07	0.07	0.08	0.10
Other Operating Revenue	2.93	4.46	0.69	1.69	2.08
Total Revenue	6.96	10.60	5.16	5.94	7.13
Fee Expense	0.42	0.65	0.54	0.62	0.74
Employee Benefit Expense	2.71	3.71	2.46	2.83	3.39
Depreciation & Amortization Expense	0.31	0.32	0.32	0.32	0.32
Other Operating Expense	1.72	1.95	1.79	0.80	1.03
Total Expenses	5.17	6.63	5.11	4.57	5.49
Operating Income	1.80	3.96	0.05	1.37	1.64
Nonoperating Income	0.36	0.41	0.34	0.34	0.34
EBT	2.16	4.37	0.39	1.71	1.98
Income Tax Expense	0.25	0.45	0.03	0.19	0.22
Net Income	1.90	3.92	0.36	1.52	1.76
Other Comprehensive Income	0.27	0.18	-0.30	0.43	-2.17
Total Comprehensive Income	2.18	4.11	0.06	1.95	-0.41
EPS	1.19	2.44	0.23	0.94	1.10

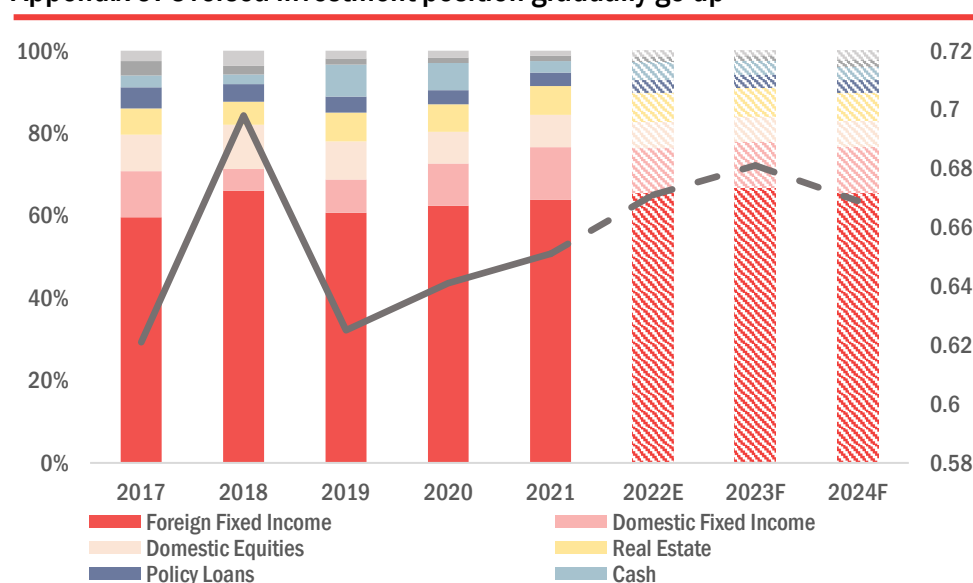
Source: Company Data, Team Analysis

## Appendix 8: MasterLink Income Statement

Balance Sheet (Billion NTD)	2020A	2021A	2022E	2023F	2024F
<b>Asset</b>					
Cash & Cash Equivalent	4.67	7.01	9.03	8.97	7.61
Financial Assets at FVPL (Current)	49.17	50.62	40.62	47.85	50.72
Financial Assets at FVOCI (Current)	2.06	4.03	3.39	3.59	3.80
Financial Assets at AC	1.15	1.43	1.46	1.46	1.46
Receivable Amount for Margin Loans	13.52	20.09	13.54	14.35	15.21
Customer margin account	7.87	9.74	9.03	9.57	10.14
Receivables	26.33	25.97	16.93	17.94	22.82
Other Current Assets	15.34	21.69	10.96	7.51	6.40
Current Assets	120.10	140.57	104.94	111.24	118.17
Financial Assets at FVPL (Non-current)	0.24	0.32	0.23	0.24	0.25
Financial Assets at FVOCI (Non-current)	2.49	2.78	2.71	2.87	3.04
Property, Plant and Equipment	2.04	2.01	1.97	1.97	1.97
Other Non-current assets	2.67	2.80	2.99	3.29	3.61
Non-current assets	7.44	7.91	7.90	8.37	8.88
<b>Total Asset</b>	<b>127.54</b>	<b>148.48</b>	<b>112.84</b>	<b>119.61</b>	<b>126.79</b>
<b>Liabilities</b>					
Financial liabilities at FVPL	6.76	9.19	10.43	10.20	11.16
Bonds Sold Under Repurchase Agreement	38.29	33.36	26.07	30.59	36.52
Futures Traders' Interests	7.86	9.73	9.56	8.99	9.13
Payables	25.65	26.14	16.07	16.69	18.26
Other Current Liabilities	22.57	40.53	24.16	25.59	25.66
Current Liabilities	101.13	118.95	86.28	92.05	100.72
Long-term Liabilities	0.61	0.83	0.61	0.65	0.71
<b>Total Liabilities</b>	<b>101.75</b>	<b>119.78</b>	<b>86.89</b>	<b>92.70</b>	<b>101.43</b>
<b>Equity</b>					
Capital Stock	16.10	16.10	16.10	16.10	16.10
Additional Paid-In Capital	0.03	0.05	0.05	0.05	0.05
Retained Earnings	7.99	10.31	7.86	8.39	9.01
Other Equity Interest	1.68	2.24	1.94	2.37	0.20
<b>Total Equity</b>	<b>25.80</b>	<b>28.70</b>	<b>25.95</b>	<b>26.91</b>	<b>25.36</b>
<b>Total Liabilities &amp; Equity</b>	<b>127.54</b>	<b>148.48</b>	<b>112.84</b>	<b>119.61</b>	<b>126.79</b>

Source: Company Data, Team Analysis

## Appendix 9: Oversea investment position gradually go up



Source: Company Data, Team Analysis



## Appendix 10: Change of Transitioning to IFRS 17 and ICS2.0 in 2026

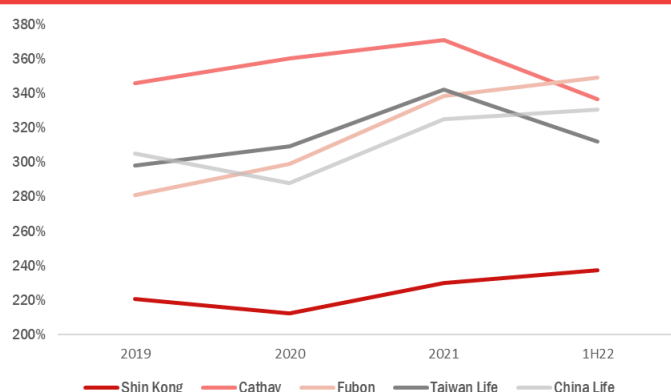
	Now	IFRS17 & ICS2.0
Policy Reserves	Recognized by Cost	Recognized by market price
Stock & Fund Investment	Recognized by Overlay ; Realized : Profit & Loss ; Fluctuation : Equity	Recognized by OCI ; Realized: Distributed Profit ; Fluctuation : Equity
Interest Rate Risk	Counted for one year	Apply pressure test all the time and the risk will increase
Owned Capital	Not grading the capital quality	Dividing capital into Tier1 and Tier2 and CSM is included
Loss from Interest Rate Difference	Not recognized	Net income and interest expenses will be included in the consolidated IS

Taiwan will be in line with IFRS17 and ICS2.0 in 2026. The policy reserves on the liability side were originally listed at cost. After the integration, the market price will be calculated according to the risk-free interest rate plus a discount. The original "overlay" subject will be removed. The realized profit will be in the distributed earnings, and the fluctuation will be in net worth.

The impact for Shin Kong is that the surplus cannot be handed to Financial Holdings because of substantial capital considerations, indicating the ability to pay dividend is limited.

Source: Company Data, Team Analysis

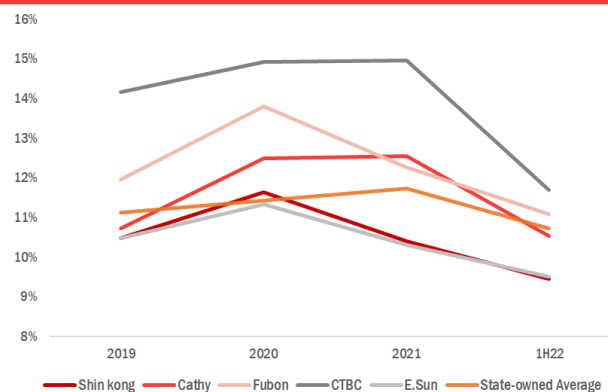
## Appendix 11: Life insurers RBC



We can say that the risk management of SKL needs to be improved according to RBC, it performed the worst among the competitors. The gap is quite large.

Source: Company Data, Team Analysis

## Appendix 12: Banks CET1 ratio



SKB's CET 1 ratio performed worse than the peers, which means that its ability to withstand financial distress is absolutely low.

Source: Company Data, Team Analysis

## Appendix 13: Three tools of capital raising

	Common Stock	Preferred Stock	Convertible Bond
Par Value	NA	NA	100 thousand
Price	6.9NTD	45NTD	100.1% of the par value on the issue date
Shares	6,153,846,154	888,888,889	NA
Total Amount	40bn	40bn	40bn
Equity Dilution	30%	6%	NA

Source: Company Data, Team Analysis

There are three kinds of capital raising tools that SKFH had been used before. We calculated the capital needed for SKFH and divided into three ways, common stock, preferred stock and convertible bond. Also, we measured the amount of equity diluted in possible situations.

We believe that the issuance of common stock would be the best way for SKFH to increase its capital although it would dilute EPS. Because common stock is helpful for its qualified capital.

## Appendix 14: The way of M&A

		Taisin FH acquire SKFH	SKFH acquire Taisin FH
Scale		The assets will reach 7.3 trillion NTD, becoming the third largest financial holdings in Taiwan; after the merger of its subsidiaries Taishin Bank and Shin Kong Bank, the total assets will reach 3.5 trillion NTD, making it the eighth largest bank in Taiwan.	
Price	Premium		15%-20%
	P/B	0.94-1.5	1-1.5
Synergy	Market share	8-9%(insurance)	5-6%(banking)
	Channel	Expansion of life insurance channels	Shin Kong Bank will expand the banking channels of corporate financial loans & personal financial loans, and its lending business is expected to become the top five private banks
Money		Sold 1.05B Chang Hwa Commercial Bank's shares with at least NTD\$19B cash in hand	Capital raising
Possibility		Possible	

From the perspective of price, money and synergy effect, we believe that it's more likely that Taisin FH acquire SKFH. Its insurance business division will be stronger.

Source: Company Data, Team Analysis

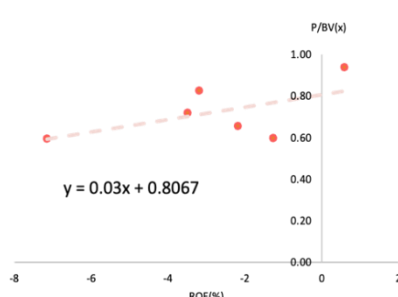
## Appendix 15: Overview of BoD

Name	Title	Gender	Number of Shares%		Education background	Represented Corp.	Corp.'s Direct Contoller's SK-Wu Family or not	Professional Competencies
Victor Hsu	Chairman	M	1,233,012	0	Institute of Actuarial Science, University of Georgia	Shin Kong Wu Ho Su Culture and Education Foundation	Y	Insurance
Te-Cheng Chiu	Director	M	0	0	MBA, National Chengchi University	Shin Kong Wu Tung Chin Foundation	Y	business,Insurance, securities,finance
Hsin-Ta Wu	Director	M	0	0	MBA, University of California, Los Angeles; Master of Architecture, University of Southern California.	Shin Kong Mitsukoshi Department Store Co.,Ltd.	Y	business,Insurance
Yun-Wan Yeh	Director	M	75,000	0	Department of Accounting, Soochow University	Shin Kong Mitsukoshi Department Store Co.,Ltd.	Y	business, Insurance,accounting,IT
Shih-Chi Hung	Director	M	86,363	0	MBA, Chaminade University of Honolulu	Shin Po Co., Ltd	Y	business,Insurance, accounting,IT
Tung-Ming Wu	Director	M	12,507	0	Western Illinois University Master of Accounting	Shin Po Co., Ltd	Y	business,Insurance, accounting,IT
Po-Han Lin	Director	M	260,791	0	MBA, Meiji University, Japan	Shin Po Co., Ltd	Y	business,Insurance,banking
Tseng-Chang, Lee	Director	M	3,233,528	0	EMBA, National Sun Yat- sen University	Shin Kong Wu Ho Su Culture and Education Foundation	Y	business,Insurance,banking
Min-Wei Wu	Director	M	0	0	Tamkang College of Arts and Sciences	Shin Cheng Investment Co., Ltd.	Y	business
Benson Wu	Director	M	2,112,986	0	MBA, University of Southern California, U.S.	Wu Chia Lu Insurance Culture and Education Foundation	Y	business,Insurance
Chi-Ming Su	Director	M	1,037,370	0	Taipei Commercial Vocational Senior High School	N	Y	business,Insurance
Po-Tsung Pan	Director	M	833,901	0	NTU College of LAW	N	Y	business,Insurance,law
Yung-Ming Shiu	Independent Director	M	0	0	Ph.D. in School of Management, University of Edinburgh	N	N	risk management,insurance
Chi-Ming Wu	Independent Director	M	0	0	Ph.D. in Finance, Mississippi State University, USA	N	N	Securities,IT,finance
Mei-Hwa Lin	Independent Director	F	34,259	0	Ph.D in Accounting, Drexel University, USA	N	N	accounting

## Appendix 16: Relative Mutiples to Value MLS

Source: Company Data

CODE	ROE(Q122)	P/BV(Q122)
6021	0.59	0.94
6016	-1.26	0.60
6005	-2.18	0.66
6020	-3.2	0.83
2855	-3.5	0.72
6015	-7.16	0.60



For the part of MasterLink Securities, we estimate that the Average Daily Trading Value of Taiwan stocks will be about NTD\$240B in 2023, back to the transaction level in early 2020. Looking for 2023, there's a similar background in 2020 with uncertain market and economy. Therefore, we use P/BV Multiplier in 1Q20 to compare with ROE and we get 0.8 of the PB through the formula which is regressed by ROE and PB of five securities company (6021: Good Finance Securities Co., Ltd., 6016: Concord Securities Co.,Ltd., 6005: Capital Securities Corporation, 6020: Tachan Securities Co., Ltd., 2855: President Securities Corporation, 6015: Horizon Securities Co., Ltd.).

Source: Company Data, Team Analysis

## Appendix 17: Securities Control Group

In the part of the robustness test of MasterLink Securities, we chose Yuanta Financial Holdings to proceed peer comparison, and found that Yuanta's ROE is 1.73 times than MasterLink's so we can see that the PB multiplier we give is quite loose for MasterLink Securitie.

	Mak Cap(B,NTD\$)	P/BV(x)				ROE(%)				EPS(NTD\$)			
		2020A	2021A	2022E	2023F	2020A	2021A	2022E	2023F	2020A	2021A	2022E	2023F
Yuanta	271.28	0.87	1.09	0.9	0.84	9.92	13.22	8.87	9.79	1.99	2.87	1.94	2.16
MasterLink	-	-	-	-	0.8	-	-	-	5.65	-	-	-	0.94
Median	271.28	0.87	1.09	0.90	0.82	9.92	13.22	8.87	7.72	1.99	2.87	1.94	1.55

Source: Company Data, Team Analysis

## Appendix 18: SKFH's Holding Company Discount over the past five years

In recent years, SKFH has not shown significant performance in cross-departmental cooperation, and there is still a lot of room for improvement compared with other competitors, such as Cathay's launch of cross-border financial services "Interest Revenue become Insurance", the first to convert fixed deposit interest into accidental death and actual payment injury medical protection and improve the overall efficiency of banks and life insurance departments. Fubon's acquisition of Jihsun Financial Holdings strengthens its securities business and reduces its dependence on the life insurance business unit for profits. The poor synergy effect of SKFH has also caused the market share of the life insurance business to decline in recent years, with a market share of 8.06% in 2021, which has been declining for two consecutive years since 2019 and has lost about 1% of the market share. Because SKFH's holding company discount has long been maintained at about 30-36% discount, without significant breakthrough, therefore we took an average of 33% as the future holding company discount.

(B, NTD\$)		2017	2018	2019	2020	2021	Future
Average market cap(a)	SKFH	107.53	109.98	130.41	114.71	156.31	
EV	Shin Kong Life	253.60	246.30	292.70	309.40	341.20	
Net Worth	Shin Kong Bank	52.49	59.53	65.12	69.85	69.45	
	MasterLink Securities	21.51	22.86	24.43	25.80	28.70	
	Shin Kong PIA	0.08	0.08	0.09	0.10	0.10	
	Shin Kong Investment Trust	0.63	0.63	0.66	0.68	0.71	
	Shin Kong VC	1.52	1.57	1.50	1.48	1.52	
Total(b)		329.82	330.99	384.50	407.31	441.68	
Discount(a/b)		32.60%	33.23%	33.92%	28.16%	35.39%	32.66%

Source: Company Data, Team Analysis

## Appendix 19: The calculation method for Embedded Value (EV)

(B,NTD\$)	2020	2021	2022	2023	(B,NTD\$)	2020	2021	2022	2023
VIF as of last year	186.4	192.5	234	277.47	Adjusted NAV	208.1	220.8	196.44	188.56
Model Changes	-0.1	0.5	0.5	0.5	VIF	192.5	234	277.47	322.08
Roll-forward of Time	25.5	21.3	21.3	21.3	Cost of Capital (COC)	91.1	113.6	115.87	118.19
Portfolio Changes	1	-1.9	-1.9	-1.9	EV	309.4	341.2	358.04	392.45
Non-Economic Assumption Change	0.2	-5.4	-5.4	-5.4	SKL's EVs are estimated through Adjusted NAV, VIF and Cost of Capital (COC), and we estimate Adjusted NAV to be the most important factor influencing SKL's EV trajectory in the coming year. The largest changes in Adjusted NAV are profits and Unrealized Gains on Financial Assets, so considering SKL's difficulty in obtaining new money, accounting standards and market conditions have put investment positions in trouble, profits are estimated at NTD\$-6.25B in 2023F (vs NTD\$12.60B in 2021, NTD\$-4.8B in 2022E), Unrealized Gains on Financial Assets is NTD\$-7.50B (vs NTD\$-3.60B in 2021, NTD\$-25.42B in 2022E). The largest change in VIF is New Business, we estimate New Business will to be NTD\$23.91B in 2023F by the FYP growth rate and the final EV is 392.45B.				
Economic Assumption Changes	-68.3	6.2	6.2	6.2					
Change of Risk Discount Rate	22.2								
New Business	25.8	20.7	22.77	23.909					
VIF	192.5	234	277.47	322.08					
(B,NTD\$)	2020	2021	2022	2023					
Adjusted Net Worth as of last year	196.9	208.1	220.8	196.44					
profits	7.20	12.6	-4.803	-6.245					
Unrealized Gains on Financial Asset	-8.10	-3.6	-25.42	-7.497					
Other Adjustments	12.00	3.8	5.86	5.86					
Adjusted Net Worth	208.10	220.8	196.44	188.56					

Source: Company Data, Team Analysis

## Appendix 20: SPICE RATING calculation process

The selection of the seven indicators was based on the sustainability reports published by each financial holding company in 2021, and in view of the industrial particularity of financial holding companies, it was selected according to the material map of each company and the SASB. Among them, three are environmental, three are social, and one is governance, and governance is the most divergent measurement indicators of each company, so it hard to analysis quantitatively, we mainly discuss the performance of Shin Kong Financial Holdings in corporate governance in qualitative way.

SPICE RATING	Sustainable Credit	Portfolio Carbon emission	carbon reduction	retention rate	Gender payment ratio	utility expenditures	directors remuneration	Index average ranking	Final ranking	credit rating ranking	Ranking average	Comprehensive ranking	BETA-adjusted
Cathay	3	6	6	2	5	2	1	3.57	2	1	1.5	1	-0.15
E.SUN	1	5	5	4	3	3	2	3.29	1	2	1.5	1	-0.15
First	5	1	1	1	7	7	5	3.86	3	5	4	3	-0.05
Yuanta	4	2	3	4	4	4	6	3.86	3	7	5	4	0
CTBC	2	7	7	6	2	1	3	4.00	5	6	5.5	5	0.05
CDF	6	4	4	7	1	5	7	4.86	7	7	7	6	0.1
SKF	7	3	2	3	6	6	4	4.43	6	12	9	7	0.15

Source: Company Data, Team Analysis

## Appendix 21: SOTP Valuation (ESG-Adjusted)

SOTP Valuation (ESG-adjusted)	Multiplier(a)	Book Value or EV(b)	Total Value(a*b)
Shin Kong Life(EV)	0.5	392.45	200.90
Shin Kong Bank	1.0	66.99	66.91
MasterLink Securities	0.8	26.91	21.53
Shin Kong PIA	1.0	0.10	0.10
Shin Kong Investment Trust	1.0	0.76	0.76
Shin Kong VC	1.0	1.52	1.52
Total Value			291.71
Holding Company Discount			33%
Shares(SKFH)			15.23
Value/Per share			\$6.26

Source: Company Data, Team Analysis

We also factor ESG into our valuation considerations. Referring to the SPICE rating of Principle of Responsible Investment (PRI), we will comprehensively evaluate financial holding companies with better ESG performance with SKFH. The results showed that of these companies, SKFH performed the worst and therefore had the largest beta increase (beta increase of 0.15). The adjustment method of Life EV Multiplier is proportional to the degree of ESG adjusted impact on the cost of capital, and the adjustment results in Multiplier 0.5 (vs 0.6 original beta), resulting in our ESG adjusted stock price of NTD\$5.39.

## Appendix 22: Scenario Analysis



Source: TEI, Team Analysis

**Bull Case:** In bull market scenario, we simulate an optimistic outlook for the economy, anticipating that the economic environment will smoothly control inflation and make a soft landing from cycle of rate hike, and initiating interest rate cuts starting in 2023 (estimated to cut interest rates by 125 bps for the whole year). In our SOTP model, we assume (1) SKL's FYP will be NTD\$61.95B (5% better than expected) due to the improvement of the business, and the profit estimate was NTD\$3.09B, which is higher than the original estimate of 6.92% (2) SKL's investment were affected by the interest rate cut, Unrealized Gains on Financial Assets was NTD\$20.39B in 2023F, and EV was NTD\$322.73B, higher than the original estimate of 4.91%. (3) SKB was affected by the improvement of the economy, with the interest income increasing by 5% to NTD\$20.03B in 2023F, the net income increased to be 6.45B, and the ROE increased to 9% (vs. the original 8.8%) (4) MLS was affected by the recovery in trading volume (estimated to rise to NTD\$300B), the estimated brokerage fee income was NTD\$3.5B, driving the ROE back to positive growth, and the estimated P/BV Multiplier was 0.8. The Bull Case valuation we obtained was NTD\$6.45, which is about 4.54% better than the original valuation.

**Bear Case:** In our bear market scenario, we simulate a pessimistic outlook for the overall economy, anticipating that the economic environment will not be able to make a smooth soft landing and the inflation problem will still be difficult to solve, and that another 75bps of interest rates will be needed in 2023 to fully solve the inflation problem. In our SOTP model, we assume that (1) SKL's willingness to enter the life insurance market is reduced due to poor economic conditions, with a lower-than-expected FYP of NTD\$56.05B and an estimated profit of NTD\$2.35B, which is lower than the original estimate of 18.69%, and (2)SKL's investment are affected by the interest rate cut, Unrealized Gains on Financial Assets will be NTD\$-12.23B in 2023F, EV is NTD\$289.90B, lower than the original forecast of 5.77%(3) SKB suffered a recession, lending amount and fee income steady in 2023F, ROE declined to 8.5% (vs formerly 8.8%) (4) MLS suffered a continuous decline in trading volume (expected to decline to NTD\$200B), estimated brokerage fee income was NTD\$2.5B, ROE maintained negative growth, and estimated P/BV Multiplier is 0.65. The Bear Case valuation we obtained was NTD\$5.85, which was about 5.19% inferior to the original valuation.



## Appendix 23: Bank Control Group

In the part of the robustness test of Shin Kong Bank, we use ROE forecast of 2023 and PB forecast of 2023 to observe the trend and how reasonable the PB we given is. From ranking perspective, compared with the bank-dominated financial holding, the ROE of Shin Kong Bank in 2023 is about 10.04% (our reference range of peers is  $\pm 1.5\%$ ), the reference PB of the peer is about 1.12 to 1.60, and the PB we given falls in this range. When it comes to CTBC, its PB is relatively lower than other bank-dominated financial holdings, we think the main reason is that CTBC's profit partly comprise of Taiwan Life Insurance Co., Ltd. which life and P&C insurance sector is regarded as fluctuate subsidiary, so it usually been given worse PB by investors.

	Mak Cap(B,NTD\$)	P/BV(x)				ROE(%)				EPS(NTD\$)			
		2020A	2021A	2022E	2023F	2020A	2021A	2022E	2023F	2020A	2021A	2022E	2023F
CTBC	432.81	0.97	1.03	1.04	0.93	10.9	12.59	11.37	13.44	2.15	2.73	2.47	2.88
First	350.42	1.27	1.29	1.42	1.32	7.62	8.86	9.70	11.32	1.31	1.52	1.66	1.91
Sinopac	190.68	0.83	0.93	1.16	1.12	8.05	10.17	10.27	11.31	1.09	1.44	1.47	1.62
E.Sun	343.32	1.85	1.81	1.72	1.60	10.17	10.95	9.66	10.97	1.42	1.54	1.29	1.47
SKB	-	-	-	-	1.19	-	-	-	10.04	-	-	-	1.35
Mega	423.07	1.25	1.33	1.31	1.23	7.69	7.86	6.74	8.95	1.84	1.89	1.6	2.1
Taishin	180.81	0.81	0.95	0.95	0.88	7.94	10.57	6.41	8.27	1.17	1.63	0.91	1.29
Median	346.87	1.11	1.16	1.24	1.19	8.00	10.37	9.68	10.97	1.37	1.59	1.54	1.62

Source: Company Data, Team Analysis