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Suncorp Group (SUN)

Travelled each and every highway

Recommendation

Buy (unchanged)

Price

\$14.55

Target (12 months)

\$15.50 (previously \$14.50)

Expected Return

Capital growth	6.5%
Dividend yield	6.0%
Total expected return	12.5%

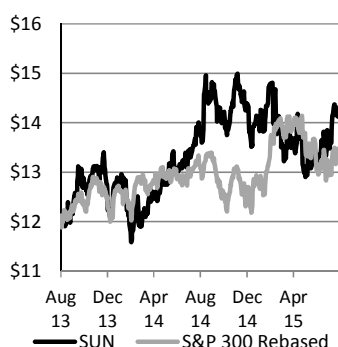
Company Data & Ratios

Enterprise value	n/m
Market cap	\$18,720m
Issued capital	1,287m
Free float	100%
Avg. daily val. (52wk)	\$63.9m
12 month price range	\$12.68 - \$15.08
GICS sector	Insurance

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	13.43	13.51	13.93
Absolute (%)	6.70	6.07	2.87
Rel market (%)	2.74	10.58	1.39

Absolute Price



SOURCE: IRESS

And still going strong

SUN's headline 2015 results were largely ahead of consensus. The key headline items were: (1) cash NPAT \$1,191m (BP \$1,185m, consensus \$1,143m); (2) cash EPS 93cps (BP 93cps, consensus 89cps); (3) final ordinary dividend 38cps and special dividend 12cps (BP 45cps and special dividend 15cps, consensus 33cps and special dividend 23cps) – all fully franked; (4) GWP \$8.9bn (BP \$8.8bn, consensus \$8.8bn); and (5) reported margin 11.4% (BP 9.7%, consensus 10.6%).

Cash NPAT was ahead of expectations due to better contributions from SUN Bank and General Insurance. Despite heavy claims costs in the latter, the General Insurance business still managed to record cash NPAT of \$756m (-25% on a PCP basis) as a result of stable GWP and cost discipline. SUN Bank improved on a PCP basis across all categories and increased cash NPAT by 55% on a PCP basis to \$354m. Although a small component of the Group, Life business cash NPAT increased by 36% on a PCP basis to \$125m as a result of favourable claims and lapse experience. Today's strong underlying performance reflects the company's successful transformation and de-risking since 2009. While we had expected more dividends in 2H15 (final dividend by 7cps and special dividend by 3cps), SUN's ability to pay a higher amount appears to be constrained by APRA's earnings test – with the statutory payout capped at 100%. We believe the other constraint relates to a change in SUN Bank's target CET1 capital – where Group surplus capital was reduced by \$156m in 2015. This is the equivalent of 12cps and explains the difference between actual 2H15 total dividends and our forecasts. Surplus capital is currently estimated at \$570m or around 45cps.

Price target increased to \$15.50, Buy rating maintained

We have made immaterial changes to overall Group earnings with little change in General Insurance numbers and upgrades in SUN Bank offsetting downgrades in the Life business. However, the price target is increased to \$15.50 (previously \$14.50) after lowering the discount rate from 11% to 10% in line with a lower risk free rate. The Buy rating is maintained for this rejuvenated "Cash and Growth" story.

Earnings Forecast

Year end 30 June	2015	2016e	2017e	2018e
NPAT (reported) (A\$m)	1,133	1,317	1,386	1,516
NPAT (adjusted) (A\$m)	1,191	1,387	1,450	1,550
EPS (adjusted) (Acps)	93	108	113	121
EPS growth (%)	-9%	16%	5%	7%
PER (x)	15.6	13.4	12.8	12.0
P/Book (x)	1.4	1.4	1.4	1.3
P/NTA (x)	2.4	2.3	2.3	2.2
Dividend (Acps)	88	92	86	90
Yield (%)	6.0%	6.3%	5.9%	6.2%
ROE (%)	8.9%	10.2%	10.5%	11.0%
ITR margin (%)	11.4%	13.5%	14.1%	14.9%
Franking (%)	100.0%	100.0%	100.0%	100.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Travelled each and every highway



And still going strong

SUN's headline 2015 results were largely ahead of consensus. The headline items were:

- Cash NPAT \$1,191m (BP \$1,185m, consensus \$1,143m);
- Cash EPS 93cps (BP 93cps, consensus 89cps);
- Final ordinary dividend 38cps and special dividend 12cps (BP 45cps and special dividend 15cps, consensus 33cps and special dividend 23cps) – all fully franked;
- ROE 8.9% (BP 8.7%, consensus 8.6%);
- GWP \$8.9bn (BP \$8.8bn, consensus \$8.8bn);
- Reported margin 11.4% (BP 9.7%, consensus 10.6%);
- Underlying margin 14.7% (BP 12.7%); and
- PCA 1.86 times and CET1 coverage ratio 1.40 times (vs. respective targets of 1.50 times and 1.05 times).

SUN's 2015 cash NPAT was ahead of expectations due to better contributions from SUN Bank and General Insurance. Despite heavy claims costs in the latter (\$1,068m net costs vs. \$595m allowance) especially in 2H15, the General Insurance business still managed to record cash NPAT of \$756m (-25% on a PCP basis) as a result of stable GWP and cost discipline. In addition, SUN Bank improved on a PCP basis across all categories (e.g. NIM, costs, asset quality and capital) and increased cash NPAT by 55% on a PCP basis to \$354m. Although a small component of the Group, Life business cash NPAT increased by 36% on a PCP basis to \$125m as a result of favourable claims and lapse experience following significant remedial action in 2014.

Another pleasing aspect of the 2015 results was SUN's better than expected top line growth in long tail GWP classes (+1.9% on a PCP basis) and where there is adequate momentum now across the Group. We believe today's strong underlying performance reflects the successful transformation and de-risking since 2009 (Figure 1) – having divested the Non-core Bank, remediated the Life business, improved productivity and efficiency within the General Insurance business (Figure 2, next page) and returned surplus capital amounting to 77cps since 2012.

Figure 1 – A different company today

Suncorp Group business line NPAT (\$m)

Profit diversification

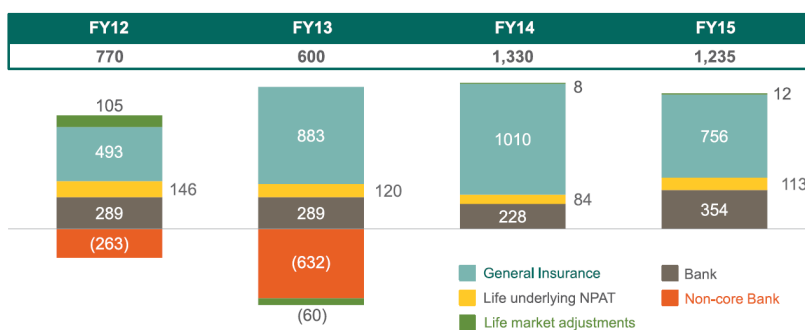
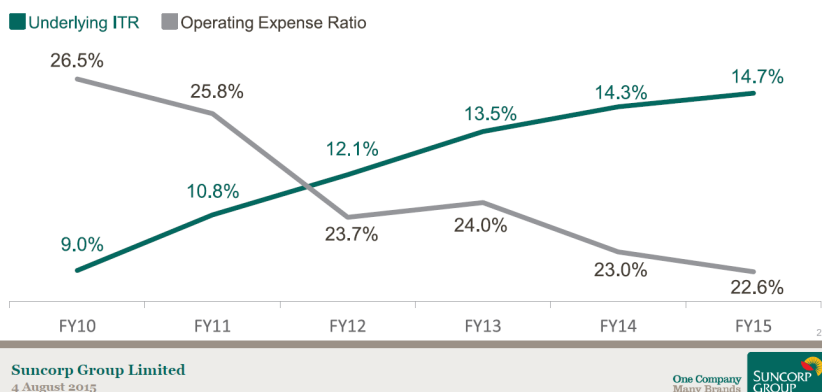


Figure 2 – Enhanced General Insurance platform

Underlying ITR and Operating Expense Ratio

Building Blocks and Simplification continuing to deliver



SOURCE: COMPANY DATA

The 38cps final dividend was unchanged from the interim dividend while a 12cps special dividend was also announced, bringing the full year dividend to 88cps. While we had expected more on both sides of the equation (final dividend by 7cps and special dividend by 3cps), SUN's ability to pay a higher amount this time appears to be constrained by APRA's earnings test – that is, its statutory payout is technically capped at 100%. We believe the other matter that has influenced this outcome relates to a change in SUN Bank's target CET1 capital. As a measure of conservatism going forward in this space, the Group's surplus capital as at 30 June 2015 was reduced by \$156m. This is the equivalent of 12cps and, in our view, explains the difference between actual 2H15 total dividends and our forecasts.

SUN reaffirmed its 60-80% target dividend payout ratio and the return of capital that is deemed surplus to business requirements. This is currently estimated at \$570m or the equivalent of 45cps (surplus across all businesses, Figure 3) after paying the final and special dividends and with \$152m franking credits to spare. As a result and all else being equal, we forecast another 12cps special dividend in 2H16.

SUN has also reaffirmed its other medium term targets, namely: (1) above-system growth in key target markets; (2) optimisation benefits of \$170m by 2018; (3) minimum underlying insurance margin of 12%; and (4) sustainable Group ROE of at least 10%. Variance analysis of the 2015 results by segment is found in Table 1 on the next page.

Figure 3 – Surplus capital at \$570m or ~45cps

Suncorp capital at 30 June 2015

\$570m excess CET1 on a post-dividend basis

\$m	General Insurance	Bank	Life	NOHC and other entities	Suncorp Group total
CET1	3,069	2,802	438	320	6,629
CET1 target	2,298	2,678	334	106	5,416
Excess (pre-div)	771	124	104	214	1,213
Dividend					(643)
Excess (post-div)					570
CET1 coverage ratio (pre-div)	1.40x	9.15%	1.77x		
CET1 targets	1.05x	8.75%	Amount equal to sum of PCA plus a target excess		

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SOURCE: COMPANY DATA

Table 1 – Variance analysis

Suncorp Group Y/e June 30 (\$m)	2015	BP	Variance	Consensus	Comments
Banking					
Net interest income	1,103	1,122	-2%	1,114	Better NIM offset by slightly lower volumes
Other income	107	108	-1%	107	Broadly in line with expectations
Total banking income	1,210	1,230	-2%	1,221	
Operating expenses	-646	-655	1%	-643	Better cost control
Impairment expenses	-58	-85	46%	-84	Reflects improvements in credit quality especially in the agribusiness space
One-off items	0	0		0	
Contribution before tax	506	491	3%	494	Positive variance due to lower costs and BDD charge
General Insurance					
Gross written premium (GWP)	8,872	8,829	0%	8,833	Broadly in line with expectations
Less: Gross unearned premium	3	-6	n/m	-	
Less: Outwards reinsurance expense	-1,010	-995	-2%	-	Broadly in line with expectations
Net earned premium (NEP)	7,865	7,828	0%	7,876	
Claims expense	-7,581	-7,509	-1%	-	Broadly in line with expectations
Reinsurance and other recoveries	1,994	1,696	18%	-	Better reinsurance outcome
Net incurred claims	-5,587	-5,813	4%	-5,652	
Acquisition expenses	-1,127	-1,107	-2%	-	Broadly in line with expectations
Other underwriting expenses	-656	-660	1%	-	Broadly in line with expectations
Underwriting result	495	248	99%	439	Positive variance due to lower net claims
Inv. income - insurance funds	399	514	-22%	396	Negative variance due to lower yields
Insurance trading result (ITR)	894	762	17%	835	Positive variance due to lower net claims
Mgd. schemes net contribution	23	31	n/m	35	
JV and other income	6	8	n/m	0	
Inv. income - s'holders' funds	163	181	-10%	152	
Capital funding	-26	-28	8%	-28	
Contribution before tax	1,060	954	11%	994	Positive variance due to lower net claims
Wealth contb'n before tax	179	273	-35%	184	Lower planned profit release and negative impact of rates on liabilities
Other					
- LJ Hooker	0	0	n/m	0	
- Consolidation/adjustments	0	0	n/m	0	
Profit before tax & adjustments	1,745	1,718	2%	1,672	Largely due to better Bank and General Insurance contributions
Intangible adjustments	-91	-80	n/m	-78	
DAC adjustment & other	0	0	n/m	-28	
Integration costs	0	0	n/m	0	
Income tax	-521	-509	-2%	-482	
Minority interests	0	0	n/m	0	
NPAT (statutory basis)	1,133	1,129	0%	1,085	Largely due to better Bank and General Insurance contributions
Non cash adjustments	58	56	3%	58	
NPAT (cash basis)	1,191	1,185	1%	1,143	Largely due to better Bank and General Insurance contributions
DPS (cps)	88	98	-10%	94	Capped by 100% statutory payout ratio (APRA's earnings test)
EPS (cash basis) (cps)	93	93	1%	89	Largely due to better Bank and General Insurance contributions
ROE	8.9%	8.7%	0.2%	8.6%	Largely due to better Bank and General Insurance contributions
Insurance margin	11.4%	9.7%	1.6%	10.6%	Largely due to better Bank and General Insurance contributions

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Other observations

GENERAL INSURANCE UNDERLYING FUNDAMENTALS SOUND

Cash NPAT was 25% lower on a PCP basis to \$756m, impacted by a series of high impact weather events that led to SUN's worst year for natural hazard events (claims expense +15% on a PCP basis to \$7.6bn offset by higher reinsurance recoveries leading to +7% PCP higher net claims). The insurance margin would have been lower than 11.4% if not for a credible effort in maintaining GWP and cost discipline. Contributing to this was a reserve release of \$427m (5.4% of NEP), higher than the long term expectation of 1.5% of NEP but one that also reflects pro-active management of long tail claims and a benign wage and super-imposed inflation environment. The underlying margin of 14.7% exceeded guidance of at least 12%. SUN has conservatively increased its full year

allowance to \$670m and its 2016 catastrophe reinsurance program (plus additional multi-year covers) has been purchased on favourable terms relative to the 2015 program. Capital adequacy remains strong with a CET1 coverage ratio (pre-dividend) of 1.40 times (vs. target of 1.05 times and peer group range of 1.04-1.28 times).

Table 2 – General Insurance trends

Y/e June 30 (\$m)	1H08	2H08	1H09	2H09	1H10	2H10	1H11	2H11	1H12	2H12	1H13	2H13	1H14	2H14	1H15	2H15
Group Insurance																
Growth in GWP	2%	4%	6%	6%	4%	2%	2%	5%	8%	10%	10%	6%	4%	3%	-1%	1%
Gross unearned premium movement	0%	3%	3%	5%	2%	2%	0%	5%	3%	6%	3%	3%	0%	2%	-2%	2%
Outwards reinsurance / GWP	6%	7%	8%	9%	8%	8%	8%	14%	10%	10%	12%	12%	12%	12%	11%	11%
Loss ratio (net claims expense / NEP)	74%	65%	92%	62%	70%	77%	70%	82%	84%	75%	64%	71%	67%	68%	71%	71%
Expense ratio (expense / NEP)	27%	28%	28%	27%	26%	27%	24%	27%	23%	24%	24%	24%	23%	23%	23%	22%
- Commission ratio	18%	17%	19%	17%	14%	16%	14%	15%	13%	14%	14%	12%	13%	14%	14%	14%
- Underwriting ratio	9%	12%	9%	9%	12%	11%	11%	12%	10%	11%	11%	12%	10%	9%	9%	8%
Return on technical reserves	2%	3%	10%	0%	3%	4%	2%	4%	5%	4%	3%	1%	2%	3%	3%	1%
Growth in NEP	3%	2%	1%	2%	5%	6%	4%	-5%	3%	14%	7%	7%	7%	4%	2%	1%
Insurance margin	5%	16%	5%	10%	13%	6%	11%	2%	4%	11%	19%	8%	14%	17%	13%	10%
Underlying margin	-	-	-	-	9%	9%	10%	11%	11%	13%	13%	14%	14%	15%	15%	15%
Underwriting profit	-37	189	-606	335	141	-138	187	-283	-244	37	414	212	358	352	240	255
Insurance profit	151	456	158	304	401	204	356	56	129	382	669	290	537	658	506	388

SOURCE: COMPANY DATA

BANK THE STAR PERFORMER

SUN Bank was the star performer in 2015 with across-the-board PCP improvements driven by higher NIM, lower loan losses (primarily in the agribusiness space – e.g. good rainfalls in the Central Highlands and valuations helped by strong demand for good land with access to water – but also aided by a sound QLD economy), cost discipline and a higher return on regulatory capital. Cash NPAT increased by 55% on a PCP basis to \$354m and we expect further strengthening of NIM in the current year from asset repricing. The medium targets were reaffirmed: (1) NIM in the 175-185bp range; (2) cost-to-income ratio to fall to 50%; (3) sustainable retail lending growth of 1.0-1.3 times system growth; and (4) retail deposit to loan ratio of 60-70%. The 9.15% CET1 capital ratio (target 8.75%) remains ahead of those of its major and regional bank peers.

Table 3 – Bank trends

Y/e June 30 (\$m)	1H08	2H08	1H09	2H09	1H10	2H10	1H11	2H11	1H12	2H12	1H13	2H13	1H14	2H14	1H15	2H15
Bank																
Growth in NIE	-	-	26%	-31%	-39%	1%	8%	14%	10%	4%	7%	11%	5%	3%	12%	6%
Growth in total income	-	-	31%	-36%	-39%	9%	0%	10%	11%	3%	4%	5%	-1%	9%	21%	3%
Growth in operating expenses	-	-	20%	-33%	-24%	15%	7%	11%	8%	7%	6%	4%	12%	14%	6%	2%
Growth in PBT before BDD	-	-	39%	-39%	-50%	2%	-6%	8%	14%	-1%	2%	6%	-16%	4%	43%	5%
Growth in loans	-	-	11%	-1%	-3%	-6%	-6%	-5%	-5%	1%	2%	-3%	0%	4%	2%	4%
Growth in deposits	-	-	17%	-30%	-44%	-6%	14%	5%	5%	10%	12%	9%	13%	7%	1%	2%
NIM (175-185bp)	-	2.05%	2.18%	1.61%	1.77%	1.82%	1.85%	1.97%	1.92%	1.90%	1.83%	1.89%	1.66%	1.78%	1.86%	1.83%
Cost-to-income ratio (<50%)	43%	46%	40%	48%	50%	51%	53%	52%	52%	54%	53%	53%	60%	55%	52%	55%
Cost / average assets	0.46%	0.50%	0.48%	0.49%	0.60%	0.58%	0.59%	0.61%	0.60%	0.59%	0.57%	0.57%	0.58%	0.61%	0.60%	0.60%
Tier 1 capital ratio	7.7%	8.0%	8.8%	11.3%	12.0%	13.2%	13.7%	9.6%	9.9%	9.6%	10.1%	9.2%	9.7%	10.0%	10.3%	10.6%
impairment expense / GLA	0.06%	0.20%	1.27%	0.19%	0.01%	0.26%	0.22%	0.04%	0.04%	0.15%	0.14%	0.13%	0.24%	0.32%	0.17%	0.06%
Total provisions + GRCL / RWA	1.15%	1.40%	2.94%	1.12%	0.96%	1.22%	1.32%	1.18%	1.24%	1.54%	1.44%	1.43%	2.08%	1.95%	1.71%	1.60%

SOURCE: COMPANY DATA

LIFE STILL A PRIME CANDIDATE FOR DIVESTMENT

This continues to be a small segment for SUN with a 5% market share and contributing to only 10% of Group cash NPAT. Following remedial action in the past 12-18 months, there have been significant improvements in the divisional underlying fundamentals – having increased cash NPAT by 36% on a PCP basis to \$125m based on favourable claims and lapse experience.

COST-OUTS TO SUSTAIN GROWTH

As alluded to earlier, SUN reaffirmed its target of sustainable \$170m pre-tax Optimisation (largely revenue-based) benefits by 2018 (with \$75m one-off costs absorbed in the current budget). Sourced from claims transformation, ongoing SMART rollout, Super

Simplification, Business Intelligence and Technology and Procurement, this would strengthen the platform for SUN to enhance its “Cash” story and prolong its “Growth” story.

ADJACENT REVENUE POOL

This is via SUN’s motor vehicle repair venture with Capital SMART that provides repair services through 25 locations nationwide (mainly in NSW – SUN’s share in this state is ~10% – and VIC) and carries out ~125,000 repairs per year. We estimate that SUN’s share of Capital SMART’s operating profit is up to \$20m per year (~2% of general insurance cash NPAT). Organic growth outside NSW and VIC and in New Zealand should see volumes increase to ~160,000 cars by the end of 2016 and ~200,000 cars within the next two years, and these would increase the share of annual after tax profits to over \$30m. All else being equal, this venture could contribute to over 5% of general insurance cash NPAT in the next 3-5 years – a welcome annuity income stream for SUN.

Price target increased to \$15.50, Buy rating maintained

We have made immaterial changes to Group earnings across the forecast horizon, with little change to General Insurance contributions and upgrades in SUN Bank offsetting downgrades in the Life business (Table 4 and Table 7 on the next page). However, the price target that is based on a composite valuation (Table 5) is increased to \$15.50 (previously \$14.50) after lowering the discount rate from around 11% to 10% in line with a lower risk free rate. The Buy rating is maintained for this rejuvenated “Cash and Growth” story.

Table 4 – Impact of estimate changes on shareholder value metrics

(A\$m)	2016e		2017e		2018e		2019e	
	New	Change	New	Change	New	Change	New	Change
NPAT (cash)	1,387	1%	1,450	0%	1,550	0%	1,647	1%
ITR margin	13.5%	0.2%	14.1%	0.1%	14.9%	0.1%	15.8%	0.1%
EPS (cash) (cps)	108	1%	113	0%	121	0%	129	1%
EPS growth (%)	16%	0%	5%	-1%	7%	1%	6%	1%
DPS (cps)	92	-8%	86	-1%	90	-1%	94	-1%
ROE (%)	10.2%	0.0%	10.5%	-0.1%	11.0%	-0.1%	11.3%	0.0%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 5 – Composite valuation

Composite Valuation	Value (\$m)	Per share	Weighting	Composite value per share
DCF (plus XS capital)	22,590	\$17.56	40%	\$7.02
Dividend yield (sustainable)	17,545	\$13.64	20%	\$2.73
ROE (sustainable)	17,781	\$13.82	20%	\$2.76
Sum-of-Parts	18,748	\$14.57	20%	\$2.91
Total				\$15.43

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 6 – SOTP valuation (conservative)

SOTP	2016e NPAT	Pros. PE (times)	Value (\$m)	Per share
Core Bank	366	13.5	4,961	\$3.86
Non-core Bank	0	nm	0	\$0.00
General Insurance	878	13.3	11,628	\$9.04
Life	143	9.0	1,285	\$1.00
Adjustments & NOHC surplus capital	0	nm	874	\$0.68
Total	1,387	13.5	18,748	\$14.57

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Table 7 – Estimate changes

Suncorp Group Y/e June 30 (\$m)	2016e			2017e			2018e			2019e		
	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change	Current	Previous	Change
Banking												
Net interest income	1,124	1,150	-2%	1,192	1,219	-2%	1,271	1,298	-2%	1,356	1,383	-2%
Other income	115	117	-2%	123	125	-2%	132	134	-2%	141	144	-2%
Total banking income	1,239	1,267	-2%	1,315	1,344	-2%	1,403	1,432	-2%	1,497	1,527	-2%
Operating expenses	-639	-649	2%	-665	-696	5%	-699	-746	7%	-750	-799	7%
Impairment expenses	-77	-111	44%	-118	-125	6%	-140	-141	1%	-164	-165	1%
One-off items	0	0		0	0		0	0		0	0	
Contribution before tax	523	507	3%	532	523	2%	564	546	3%	584	563	4%
General Insurance												
Gross written premium (GWP)	8,930	8,952	0%	9,079	9,079	0%	9,279	9,244	0%	9,486	9,359	1%
Less: Gross unearned premium	3	-6	-287%	3	-6	-279%	3	-6	-315%	4	-5	-249%
Less: Outwards reinsurance expense	-995	-1,012	2%	-1,012	-1,026	1%	-1,036	-1,043	1%	-1,060	-1,048	-1%
Net earned premium (NEP)	7,938	7,934	0%	8,070	8,047	0%	8,247	8,195	1%	8,429	8,306	1%
Claims expense	-7,047	-7,046	0%	-7,083	-7,069	0%	-7,166	-7,132	0%	-7,251	-7,167	-1%
Reinsurance and other recoveries	1,514	1,443	5%	1,469	1,442	2%	1,501	1,469	2%	1,534	1,490	3%
Net incurred claims	-5,532	-5,602	1%	-5,614	-5,627	0%	-5,665	-5,663	0%	-5,718	-5,678	-1%
Acquisition expenses	-1,110	-1,089	-2%	-1,090	-1,098	1%	-1,115	-1,117	0%	-1,142	-1,126	-1%
Other underwriting expenses	-627	-641	2%	-637	-665	4%	-651	-677	4%	-666	-686	3%
Underwriting result	670	601	11%	729	657	11%	815	738	10%	904	816	11%
Inv. income - insurance funds	403	457	-12%	410	475	-14%	417	482	-13%	426	490	-13%
Insurance trading result (ITR)	1,072	1,058	1%	1,139	1,132	1%	1,232	1,220	1%	1,330	1,306	2%
Mgd. schemes net contribution	23	31	n/m	23	31	n/m	23	31	n/m	23	31	n/m
JV and other income	4	8	n/m	4	8	n/m	4	8	n/m	4	8	n/m
Inv. income - s'holders' funds	178	176	1%	180	180	0%	184	184	0%	189	189	0%
Capital funding	-24	-28	17%	-24	-28	n/m	-24	-28	n/m	-24	-28	n/m
Contribution before tax	1,254	1,245	1%	1,322	1,322	0%	1,419	1,415	0%	1,522	1,506	1%
Wealth cont'b'n before tax	204	217	-6%	218	232	-6%	232	246	-6%	246	261	-6%
Other												
- LJ Hooker	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
- Consolidation/adjustments	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
Profit before tax & PMN items	1,981	1,970	1%	2,072	2,077	0%	2,215	2,207	0%	2,352	2,330	1%
Amortisation of PMN intangibles	-99	-78	n/m	-91	-42	n/m	-49	-6	n/m	-47	-6	n/m
DAC adjustment	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
Integration costs	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
Income tax	-565	-568	1%	-594	-610	3%	-650	-660	2%	-692	-697	1%
Minority interests	0	0	n/m	0	0	n/m	0	0	n/m	0	0	n/m
NPAT (statutory basis)	1,317	1,324	-1%	1,386	1,424	-3%	1,516	1,541	-2%	1,614	1,627	-1%
Non cash adjustments	69	55	27%	64	29	117%	34	4	711%	33	4	686%
NPAT (cash basis)	1,387	1,379	1%	1,450	1,454	0%	1,550	1,545	0%	1,647	1,631	1%

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Suncorp Group

Company description

SUN is QLD's largest listed corporation with over 228,000 shareholders. It is also Australia's largest general insurer (following the acquisitions of GIO and AMP's general insurance business in 2001 and Promina in 2007) as well as the 5th largest bank in terms of footings. SUN currently provides services to 9m insurance and banking customers through 237 retail and business banking outlets and other intermediary channels.

Investment strategy

SUN represents exceptional value in terms of: (1) a quality Bank with rising market shares and NIM; (2) underlying General Insurance margin of at least 12% from process/efficiency gains that should lift core Group ROE above 10%; (3) enhanced reputation since the 2011 QLD floods in terms of processing claims; and (4) ongoing strategic appeal as a three-way breakup play – General Insurance, Bank and Life Insurance.

Valuation

The price target is closely aligned to the composite valuation as follows:

1. DCF value of \$17.56 per share (comprising 10% hurdle rate, 9.0% Tier 1 requirement for the Bank and 3% terminal growth rate; 40% weight) including surplus capital;
2. Dividend yield (sustainable) of \$13.64 per share (required risk-adjusted dividend yield 5.5%, 20% weight);
3. Price / book valuation (given a sustainable/normalised ROE of 10%+ consistent with that of a pure General Insurance company) of \$13.82 per share (20% weight); and
4. Sum-of-Parts valuation of \$14.57 per share (20% weight).

Table 8 – Composite valuation					Table 9 – SOTP valuation (conservative)				
Composite Valuation	Value (\$m)	Per share	Weighting	Composite value per share	SOTP	2016e NPAT	Pros. PE (times)	Value (\$m)	Per share
DCF (plus XS capital)	22,590	\$17.56	40%	\$7.02	Core Bank	366	13.5	4,961	\$3.86
Dividend yield (sustainable)	17,545	\$13.64	20%	\$2.73	Non-core Bank	0	nm	0	\$0.00
ROE (sustainable)	17,781	\$13.82	20%	\$2.76	General Insurance	878	13.3	11,628	\$9.04
Sum-of-Parts	18,748	\$14.57	20%	\$2.91	Life	143	9.0	1,285	\$1.00
					Adjustments & NOHC surplus capital	0	nm	874	\$0.68
Total				\$15.43	Total	1,387	13.5	18,748	\$14.57

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

SWOT analysis

Strengths

1. Cross-sell expertise (averaging around four products per customer vs. 2-2.5 for the major banks);
2. General insurance scale and iconic brands; and
3. Loyal following and scale (footings and distribution) in QLD and NSW.

Weaknesses

1. General Insurance risk diversification issue – exposure to a single geography (although partially mitigated by 30% QLD quota share); and
2. Sub-scale in banking and life insurance segments.

Opportunities

1. \$170m pre-tax Optimisation (largely revenue-based) benefits by 2018, sourced from claims transformation, ongoing SMART rollout, Super Simplification, Business Intelligence and Technology and Procurement, and with ~60% of the benefits arising from Personal Insurance;
2. Unlocking value through company breakup as per investment strategy (see previous pages) including price re-rating with removal of conglomerate discount; and
3. Leveraged to eventual economic rebound in QLD (with post flood rebuilding) and NSW.

Threats

1. Macroeconomic factors such as higher unemployment and slowing credit growth (although the risk is dissipating given the resilience of the local economy);
2. Changes in regulatory environment, especially the potential capping of funds management and advice fees that would crimp wealth management earnings growth; and
3. Increased competition specifically from the major banks (retail and wholesale banking and life insurance) and offshore general insurers.

Table 10 – Financial summary

Suncorp Group						Share Price (A\$)						14.55
As at	4-Aug-15					Market Cap (A\$M)						18,720
PROFIT AND LOSS												
Y/e June 30 (\$m)	2014	2015	2016e	2017e	2018e							
Banking												
Net interest income	1,011	1,103	1,124	1,192	1,271							
Other income	76	107	115	123	132							
Total banking income	1,087	1,210	1,239	1,315	1,403							
Operating expenses	-624	-646	-639	-665	-699							
Impairment expenses	-137	-58	-77	-118	-140							
One-off items	0	0	0	0	0							
Contribution before tax	326	506	523	532	564							
General Insurance												
Gross written premium (GWP)	8,870	8,872	8,930	9,079	9,279							
Less: Gross unearned premium	-84	3	3	3	3							
Less: Outwards reinsurance expense	-1,060	-1,010	-995	-1,012	-1,036							
Net earned premium (NEP)	7,726	7,865	7,938	8,070	8,247							
Claims expense	-6,595	-7,581	-7,047	-7,083	-7,166							
Reinsurance and other recoveries	1,355	1,994	1,514	1,469	1,501							
Net incurred claims	-5,240	-5,587	-5,532	-5,614	-5,665							
Acquisition expenses	-1,063	-1,127	-1,110	-1,090	-1,115							
Other underwriting expenses	-713	-656	-627	-637	-651							
Underwriting result	710	495	670	729	815							
Investment income - insurance funds	485	399	403	410	417							
Insurance trading result (ITR)	1,195	894	1,072	1,139	1,232							
Managed schemes net contribution	20	23	23	23	23							
JV and other income	5	6	4	4	4							
Investment income - s'holders' funds	246	163	178	180	184							
Capital funding	-32	-26	-24	-24	-24							
Contribution before tax	1,434	1,060	1,254	1,322	1,419							
Life contribution before tax												
Other	131	179	204	218	232							
- LJ Hooker	0	0	0	0	0							
- Consolidation & other adjustments	0	0	0	0	0							
Profit before tax & PMN items	1,891	1,745	1,981	2,072	2,215							
Intangible adjustments	-620	-91	-99	-91	-49							
DAC adjustment	0	0	0	0	0							
Integration costs	0	0	0	0	0							
Income tax	-541	-521	-565	-594	-650							
Minority interests	0	0	0	0	0							
NPAT (statutory basis)	730	1,133	1,317	1,386	1,516							
Non cash adjustments/non-core items	574	58	69	64	34							
NPAT (cash basis)	1,304	1,191	1,387	1,450	1,550							
CASHFLOW												
Y/e June 30 (\$m)	2014	2015	2016e	2017e	2018e							
NPAT (cash basis)	1,304	1,191	1,387	1,450	1,550							
Increase in loans	-1,782	-1,929	-3,847	-4,114	-4,399							
Increase in other assets	2,343	1,078	-66	-177	-2,927							
Capital expenditure	7	14	-6	-6	-6							
Investing cashflow	568	-838	-3,919	-4,297	-7,332							
Increase in interest bearing liabilities	-1,727	2,160	8,533	3,693	6,461							
Increase in insurance liabilities	182	83	-4,873	335	438							
Equity raised	0	2	0	0	0							
Other	-826	-2,277	-1,128	-1,182	-1,118							
Financing cashflow	-2,371	-32	2,532	2,846	5,781							
Net change in cash	-499	321	0	0	0							
Cash at end of period	895	1,216	1,216	1,216	1,216							
BALANCE SHEET												
Y/e June 30 (\$m)	2014	2015	2016e	2017e	2018e							
Cash and liquid assets	895	1,216	1,216	1,216	1,216							
Divisional gross loans	50,007	51,918	55,781	59,911	64,328							
Provisions	-226	-208	-223	-240	-258							
Core Bank interest earning assets	9,354	8,875	8,875	8,875	8,875							
Non-core Bank interest earning assets	0	0	0	0	0							
Intangibles	5,720	5,783	5,684	5,593	5,544							
PP&E	205	191	197	203	209							
Insurance assets	7,465	6,856	6,922	7,098	10,025							
Other assets	21,010	21,020	21,020	21,020	21,020							
Total assets	94,429	95,651	99,470	103,676	110,959							
Interest bearing liabilities	57,373	59,533	68,066	71,759	78,220							
Insurance liabilities	20,547	20,630	15,757	16,092	16,530							
Other liabilities	2,710	1,970	1,970	1,970	1,970							
Total liabilities	80,630	82,133	85,793	89,822	96,721							
Ordinary share capital	12,682	12,684	12,684	12,684	12,684							
Other equity instruments	0	0	0	0	0							
Reserves	206	167	167	167	167							
Retained profits	885	632	791	968	1,353							
Minority interests	26	35	35	35	35							
Total shareholders' equity	13,799	13,518	13,677	13,854	14,239							
Total sh. equity & liabs.	94,429	95,651	99,470	103,676	110,959							
WANOS - statutory (m)	1,278	1,279	1,279	1,279	1,279							
WANOS - cash (m)	1,278	1,279	1,279	1,279	1,279							
VALUATION DATA												
Y/e June 30	2014	2015	2016e	2017e	2018e							
NPAT (cash basis) (\$m)	1,304	1,191	1,387	1,450	1,550							
EPS (statutory basis) (cps)	57	89	103	108	119							
- Growth	48%	55%	16%	5%	9%							
EPS (cash basis) (cps)	102	93	108	113	121							
- Growth	126%	-9%	16%	5%	7%							
P / E ratio (times)	14.3	15.6	13.4	12.8	12.0							
P / Book ratio (times)	1.4	1.4	1.4	1.4	1.3							
P / NTA ratio (times)	2.3	2.4	2.3	2.3	2.2							
Net DPS (cps)	105	88	92	86	90							
Yield	7.2%	6.0%	6.3%	5.9%	6.2%							
Franking	100%	100%	100%	100%	100%							
Payout (cash) (target 60-80%)	103%	94%	85%	76%	74%							
Effective tax rate	30%	31%	30%	30%	30%							
CAPITAL ADEQUACY												
Y/e June 30	2014	2015	2016e	2017e	2018e							
Risk weighted assets (\$m)	30,997	30,610	32,887	35,323	37,926							
Average risk weight	62%	59%	59%	59%	59%							
Tier 1 ratio	10.0%	10.6%	11.0%	11.3%	11.5%							
Core Tier 1 ratio (Bank)	8.5%	9.1%	9.6%	10.0%	10.4%							
Total capital ratio (Bank)	13.2%	13.8%	14.0%	14.1%	14.1%							
Equity ratio	14.6%	14.1%	13.8%	13.4%	12.8%							
General insurance PCA (x)	2.16	1.86	1.94	2.00	2.06							
PROFITABILITY RATIOS												
Y/e June 30	2014	2015	2016e	2017e	2018e							
Return on assets	1.4%	1.3%	1.4%	1.4%	1.4%							
Return on equity	9.4%	8.9%	10.2%	10.5%	11.0%							
Leverage (times)	7	7	7	7	8							
Net interest margin	1.72%	1.84%	1.85%	1.84%	1.84%							
Cost / income ratio	57%	53%	52%	51%	50%							
Cost / average assets	1.06%	1.08%	1.05%	1.03%	1.01%							
Growth in contribution before tax	120%	-8%	14%	5%	7%							
ITR margin	15.5%	11.4%	13.5%	14.1%	14.9%							
Combined ratio	91%	94%	92%	91%	90%							
GWP growth	3.3%	0.0%	0.7%	1.7%	2.2%							
ASSET QUALITY												
Y/e June 30	2014	2015	2016e	2017e	2018e							
Impairment expense / GLA	0.27%	0.11%	0.14%	0.20%	0.22%							
Impairment expense / RWA	0.44%	0.19%	0.23%	0.33%	0.37%							
Total provisions (\$m)	377	354	369	386	404							
Total provisions / RWA	1.22%	1.16%	1.12%	1.09%	1.06%							
Indiv ass prov / gross imp assets	32%	38%	38%	38%	38%							
Total provisions + GRCL / RWA	1.22%	1.16%	1.12%	1.09%	1.06%							
DIVISIONAL												
Y/e June 30 (\$m)	2014	2015	2016e	2017e	2018e							
Core Banking												
Net interest income	1,011	1,103	1,124	1,192	1,271							
Other income	76	107	115	123	132							
Total banking income	1,087	1,210	1,239	1,315	1,403							
Operating expenses	-624	-646	-639	-665	-699							
Impairment expenses	-137	-58	-77	-118	-140							
Contribution before tax	326	506	523	532	564							
Home loans	39,001	41,785	44,587	47,570	50,747							
Other loans	11,006	10,133	11,194	12,341	13,580							
Interest bearing liabilities	55,333	56,700	60,669	64,916	69,460							
Risk weighted assets (RWA)	30,997	30,610	32,887	35,323	37,926							
- Average risk weight	62%	59%	59%	59%	59%							
Collective provisions	120	126	135	145	156							
- As % of RWA	0.39%	0.41%	0.41%	0.41%	0.41%							
Gross impaired assets	333	218	234	252	270							
- As % of gross loans	0.7%	0.4%	0.4%	0.4%	0.4%							
GRCL	151	146	146	146	146							
Individually assessed provisions	106	82	88	95	102							
- As % of gross impaired assets	32%	38%	38%	38%	38%							
Non-core Banking												
Net interest income	0	0	0	0	0							
Other income	0	0	0	0	0							
Total banking income	0	0	0	0	0							
Operating expenses	0	0	0	0	0							
Impairment expenses	0	0	0	0	0							
Contribution before tax	0	0	0	0	0							
Loans	0	0	0	0	0							
Other interest earning assets	0	0	0	0	0							
Interest bearing liabilities	0	0	0	0	0							
Risk weighted assets (RWA)	0	0	0	0	0							
- Average risk weight	0%	0%	0%	0%	0%							
Collective provisions	0	0	0	0	0							
- As % of RWA	0.00%	0.00%	0.00%	0.00%	0.00%							
Gross impaired assets	0	0	0	0	0							
- As % of gross loans	0.0%	0.0%	0.0%	0.0%	0.0%							
GRCL	0	0	0	0	0							
Individually assessed provisions												

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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