

Aflac Inc.

Buy Trade – Position Open

USA | FINANCE | TRADING NOTE

21 February 2017

Description

Aflac Incorporated engages in supplemental health and life insurance. Their main insurance business consists of two segments, Aflac Japan and Aflac US. Aflac Japan sells voluntary supplemental insurance products, including cancer plans, general medical indemnity plans, medical/sickness riders, ordinary life insurance plans and annuities. Aflac US sells supplemental insurance products, including products designed to protect individuals from depletion of assets, such as accident, cancer, critical illness/care, hospital intensive care, hospital indemnity, fixed-benefit dental, and vision care plans and loss-of-income products.

Source: Thomson Reuters

Investment Action

We are bullish on AFL on the company's market share in Japan, as well as its strong balance sheet and strong dividend history. The current trend for dollar/yen is in favor for AFL's operations and should continue for a while. Japan's demographics should lead to rising demand for medical needs and hence greater demand for medical insurance. The company has projected a 3-5% CAGR for its US operations and a 4-6% CAGR for its Japanese operations for the next 2 years until 2019. We believe that AFL makes for a solid investment on the back of its strong financials and current valuations.

AFL recently reported its earnings at the start of February. They reported an EPS of US\$1.54 compared to consensus estimates of US\$1.65 and down yoy from US\$1.56. Revenue was strong, increasing 12% yoy to US\$6.0 bn due to stronger yen/dollar exchange rates. Following the announcement of results, AFL fell about 3% post earnings but has since shown signs of recovery.

We believe that AFL is well positioned to take advantage of certain growth catalyst in the future. As an insurer, AFL generates income in two ways; policy premiums and investment income from invested premiums.

Since AFL derives about 75% of its revenue from Japan, and due to the demographics of the country, namely the aging population, we believe that the need for medical services will only increase going forward. As such, the demand for medical related insurances should also increase, and AFL, with its market share of the Japanese market, should be able to capture this growing demand to increase premium income. AFL is also trying to increase its US business, and have started leveraging its One Day Pay scheme, which promises to pay out claims within the same day as the claim, to increase customer satisfaction and increase brand awareness and account penetration.

Additionally, interest rates are expected to be raised about 3 times in 2017, and each hike is a potential catalyst for AFL to grow. AFL ended the year 2016 with US\$ 116 bn in total cash and investments, a 9.9% increase yoy. AFL's net investment income for 2016 was about US\$3.3 bn. When interest rates rise, AFL will be able to generate a higher return on its investments and hence report higher earnings.

Postive

| | |
|--------------------|------------|
| CLOSING PRICE | USD 71.10 |
| ENTRY PRICE | USD 71.44 |
| STOP LOSS | USD 66.40 |
| TARGET PRICE | USD 77.00 |
| PERCENTAGE UPSIDE | 7.78% |
| RISK/REWARD | 1.1 |

COMPANY DATA

| | |
|--------------------------------|---------------|
| O/S SHARES (MN) : | 408 |
| MARKET CAP (USD mn / SGD mn) : | 29016 / 29016 |
| 52 - WK HI/LO (USD) : | 74.5 / 58.46 |
| 3M Average Daily T/O (mn) : | 2.33 |

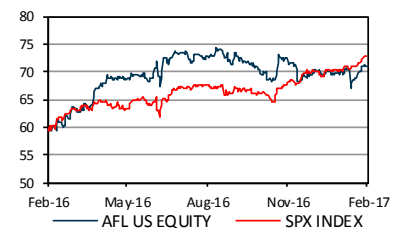
MAJOR SHAREHOLDERS (%)

| | |
|--------------------|-------|
| VANGUARD GROUP INC | 7.58% |
| BLACKROCK | 6.42% |
| STATE STREET CORP | 5.23% |

PRICE PERFORMANCE (%)

| | 1M TH | 3 M TH | 1Y R |
|------------|-------|--------|-------|
| COMPANY | 2.4 | (12) | 23.2 |
| SPX RETURN | 3.90 | 8.06 | 24.67 |

PRICE VS. SPX



Source: Bloomberg, PSR

KEY FINANCIALS

| USD BN | FY 13 | FY 14 | FY 15 | FY 16 |
|---------------|-------|-------|-------|-------|
| Revenue | 23.5 | 22.5 | 20.7 | 22.7 |
| EBITDA | 4.4 | 4.3 | 4.2 | 4.2 |
| NPAT (adj.) | 2.9 | 2.8 | 2.8 | 2.9 |
| EPS (adj.) | 6.18 | 6.26 | 5.76 | 6.99 |
| PER, x (adj.) | 10.81 | 9.76 | 10.4 | 10.0 |
| P/BV, x | 2.11 | 1.47 | 1.4 | 1.4 |
| DPS (USD) | 1.4 | 1.5 | 1.6 | 1.7 |
| Div Yield, % | 2.1% | 2.4% | 2.6% | 2.4% |
| ROE, % | 21% | 18% | 14% | 14% |

Source: Company Data, PSR est.

Ho Kang Wei (+65 62121855)

hokw@phillip.com.sg

Jeremy Ng (+65 62121857)

jeremyngch@phillip.com.sg

Key Points:

- Technical.** AFL has turned back into the long term uptrend since April 2016 confirmed by the 20 week moving average crossing above the 60 week moving average. The increase in bullish momentum succeeded in lifting price higher to break above the prior all-time high at 67.52 further validates the accelerating bullish momentum.
- Since then, price made a new all-time high at 74.50 in September 2016 before experiencing a period of correction. Nonetheless, the long term uptrend remains intact with the confluence of 67.52 resistance turned support area, 60 week moving average and 38.2% Fibonacci retracement level halted the correction. Moreover, the bullish momentum is reappearing again as buyers effectively broke price above the 70.80 range high and 20 week moving average on the week ended 17/02/17. Expect the long term uptrend to resume next to test the 74.50 resistance area followed by 77.00.

Resistance 1: 74.50
Resistance 2: 77.00

Support 1: 67.52
Support 2: 66.50

AFL weekly chart



Red line = 20 period moving average, blue line = 60 period moving average,
Green line = 200 period moving average

Source: Bloomberg, PSR

- Valuations.** AFL currently trades at a PER of 11.07. In comparison, American International Group (NYSE:AIG) trades at 117.49 PER and Manulife Financial Corporation (NYSE:MFC) at 17.55 PER. AFL's 5 year average PER is about 9.73. AFL's dividend history is also very strong, having not only paid out a dividend every year for 34 years, but also increasing that dividend every consecutive year. Its current dividend yield is about 2.42%, and its payout ratio is about 0.27, meaning it can very comfortably continue boosting its dividends. AFL has an Operating Margin of 18.03% and Net Profit Margin of 11.79%. Overall, we believe that AFL is currently **Under Valued**.
- Risk.** AFL derives a majority of its revenue from Japan, and as such is susceptible to fluctuations in currency. When yen weakens against the dollar, AFL's earnings will be negatively impacted as they report earnings in dollars. Additionally, the market is likely to be somewhat pricing in the effects of the expected rate hikes and in the event the hikes do not take place, AFL share price may be punished for that.

| Counter | Sector | Ticker | Currency | Last Price | Time Horizon | Entry | Stop Loss | Target | Bloomberg Consensus T/P |
|-----------|---------|--------|----------|------------|--------------|-------|-----------|--------|-------------------------|
| Aflac Inc | Finance | AFL | USD | 71.1 | 1-3 Month | 71.44 | 66.4 | 77 | 71.62 |

Contact Information (Singapore Research Team)
Research Operations OfficerMohamed Amiruddin - amiruddin@phillip.com.sg**Consumer | Healthcare**Soh Lin Sin - sohls@phillip.com.sg**Transport | REITs (Industrial)**Richard Leow, CFTe, FRM -
richardleowwt@phillip.com.sg**Banking and Finance**Jeremy Teong - jeremyteongfh@phillip.com.sg**Property | Infrastructure**Peter Ng - peterngmc@phillip.com.sg**REITs (Commercial, Retail, Healthcare) | Property**Dehong Tan - tandh@phillip.com.sg**US Equity**Ho Kang Wei - hokw@phillip.com.sg**Macro**Pei Sai Teng - peist@phillip.com.sg**Technical Analysis**Jeremy Ng - jeremyngch@phillip.com.sg**Oil & Gas | Energy**Chen Guangzhi - chengz@phillip.com.sg

Contact Information (Regional Member Companies)
SINGAPORE**Phillip Securities Pte Ltd**Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel +65 6533 6001
Fax +65 6535 6631
Website: www.poems.com.sg**JAPAN****Phillip Securities Japan, Ltd.**4-2 Nihonbashi Kabuto-cho Chuo-ku,
Tokyo 103-0026
Tel +81-3 3666 2101
Fax +81-3 3666 6090
Website: www.phillip.co.jp**THAILAND****Phillip Securities (Thailand) Public Co. Ltd**15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel +66-2 6351700 / 22680999
Fax +66-2 22680921
Website www.phillip.co.th**UNITED STATES****Phillip Capital Inc**141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1-312 356 9000
Fax +1-312 356 9005
Website: www.phillipusa.com**INDIA****PhillipCapital (India) Private Limited**No.1, 18th Floor, Urmi Estate
95, Ganpatrao Kadam Marg
Lower Parel West, Mumbai 400-013
Maharashtra, India
Tel: +91-22-2300 2999 / Fax: +91-22-2300 2969
Website: www.phillipcapiatal.in**CAMBODIA****Phillip Bank Plc**Ground Floor of B-Office Centre,#61-64,
Norodom Blvd Corner Street 306,Sangkat
Boeung Keng Kang 1, Khan Chamkamorn,
Phnom Penh, Cambodia
Tel: 855 (0) 7796 6151/855 (0) 1620 0769
Website: www.phillipbank.com.kh**MALAYSIA****Phillip Capital Management Sdn Bhd**B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel +603 2162 8841
Fax +603 2166 5099
Website: www.poems.com.my**INDONESIA****PT Phillip Securities Indonesia**ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel +62-21 5790 0800
Fax +62-21 5790 0809
Website: www.phillip.co.id**FRANCE****King & Shaxson Capital Limited**3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel +33-1 45633100
Fax +33-1 45636017
Website: www.kingandshaxson.com**AUSTRALIA****Phillip Capital Limited**Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel +61-03 9629 8288
Fax +61-03 9629 8882
Website: www.phillipcapiatal.com.au**TURKEY****PhillipCapital Menkul Degerler**Dr. Cemil Bengü Cad. Hak Is Merkezi
No. 2 Kat. 6A Caglayan
34403 Istanbul, Turkey
Tel: 0212 296 84 84
Fax: 0212 233 69 29
Website: www.phillipcapiatal.com.tr**HONG KONG****Phillip Securities (HK) Ltd**11/F United Centre 95 Queensway
Hong Kong
Tel +852 2277 6600
Fax +852 2868 5307
Websites: www.phillip.com.hk**CHINA****Phillip Financial Advisory (Shanghai) Co Ltd**No 550 Yan An East Road,
Ocean Tower Unit 2318,
Postal code 200001
Tel +86-21 5169 9200
Fax +86-21 6351 2940
Website: www.phillip.com.cn**UNITED KINGDOM****King & Shaxson Capital Limited**6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel +44-20 7426 5950
Fax +44-20 7626 1757
Website: www.kingandshaxson.com**SRI LANKA****Asha Phillip Securities Limited**2nd Floor, Lakshmans Building,
No. 321, Galle Road,
Colombo 03, Sri Lanka
Tel: (94) 11 2429 100
Fax: (94) 11 2429 199
Website: www.ashaphillip.net**DUBAI****Phillip Futures DMCC**Member of the Dubai Gold and
Commodities Exchange (DGCX)
Unit No 601, Plot No 58, White Crown Bldg,
Sheikh Zayed Road, P.O.Box 212291
Dubai-UAE
Tel: +971-4-3325052 / Fax: + 971-4-3328895

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