農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Company Report

PICC P&C - Buy
Property & Casualty Insurance
Initiation (2013E TP: HK$13.48)

Key sector data

Share price (HK$)	12.10
Target price (HK$)	13.48
Upside potential (%)	11.40
52Wk H/L(HK$)	12.28/ 7.81
Issued shares:	12,256
Market cap (HK$mn)	148,297
30-day avg vol (HK$mn)	183.7
Major shareholder (%):	
PICC Group	69.98
AIG	9.90

Source: Company & Bloomberg

Premium composition in 2011 (%)

Motor	73.6
Non-motor	26.4

** data as of 2011*
Source: Company data

Sector performance (%)

	Absolute	Relative*
1-mth	18.4	12.7
3-mth	17.2	4.0
6-mth	40.9	14.5

** Relative to MSCI Hong Kong Index*
Source: Bloomberg

1 year price performance

Source: Bloomberg

Analyst
Report Date: 16 January 2013

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Most profitable P&C operations in Asia

PICC P&C is the most profitable P&C operations in Asia, making US$1.3bn earnings in 2011. Also, the insurer continues to benefit from the bottoming combined ratios and stabilized 20% plus ROEs, as per our forecast. Lastly, the company will benefit from the Sannong policy going forward. Therefore, we initiate our research coverage on PICC P&C with a BUY recommendation. Our TP is HK$13.48 (2.45x 2013E PBV), representing 11.4% upside from now.

Most profits among regional peers. PICC P&C reported net profits of US$1.3bn (Rmb8.1bn) in 2011, up 51% YoY from 2010. Simultaneously, PICC recorded ROE of 26%, ranked the 2nd among 11 peers in Asia. Its ROE improved by 17.4ppt since 2009, topped its peers during 2009-11. This is driven by 8.2ppt improvement in its combined ratios since 2009.

Bottoming combined ratios. In 2009, the company's combined ratio was at 102.2%. In 2011, its underwriting profits increased to Rmb8.0bn, up 192% YoY, with a combined ratio of 94.0%. In 1H12, underwriting profits improved further to Rmb5.6bn, up 14% YoY and 82% HoH. Combined ratio was contained at 92.4%. Most importantly, this is a broad-based improvement, with all segments reporting underwriting profits. As such, we believe the improvement is a sustainable one.

Riding on 'Sannong' policy. PICC P&C was the market leader in agricultural insurance, with a 51.9% market share (Rmb7.1bn premiums) in 2011. Also, it controls an unparalleled distribution network, with 87,100 or 51.4% of its total P&C agents, in county areas.

Initiate coverage with a BUY recommendation; target price at HK$13.48. Factoring in the continuous strength in underwriting, and prospective upswing in investment income, we assume PICC P&C to achieve an average ROE of 23.7% going forward. Accordingly, we set our target price at HK$13.48, based on 2.45x 2013E PBV and 10.8x 2013E PER. Our TP is derived from our Gordon Growth Model, representing a 11.4% upside from the current share price. We initiate coverage of PICC P&C with a BUY recommendation.

Risk factors: worse-than-expected underwriting and investment performance, tighter-than-expected regulations

Results and valuation

FY ended Dec 31	2010	2011	2012E	2013E	2014E
Revenue (Rmb mn)	127,892	136,904	156,827	177,041	197,767
Chg (YoY)	*30.85*	*7.05*	*14.55*	*12.89*	*11.71*
Net profit (Rmb mn)	5,288	8,027	11,886	12,116	13,234
Chg (YoY)	*196.58*	*51.80*	*48.07*	*1.93*	*9.23*
EPS (HK$)	0.57	0.84	1.20	1.25	1.43
PER (x)	21.39	14.48	10.06	9.67	8.49
BPS (HK$)	2.87	3.49	4.51	5.51	6.82
P/B (x)	4.22	3.46	2.68	2.19	1.77
DPS (HK$)	0.00	0.27	0.26	0.27	0.27
Div. yield (%)	0.00	2.26	2.15	2.23	2.23
Combined Ratio (%)	97.8	94.0	94.3	96.3	96.3
Gross inv't yield (%)	3.94	2.33	4.12	4.65	4.60

** Prices as of 15January 2013*
Source: Company, ABCI Securities estimates

Contents

Executive Summary –Most profitable P&C operations in Asia

Most profitable P&C operations in Asia; BUY; TP of HK$13.48 on five positives

We are initiating coverage on PICC P&C with a BUY recommendation and a target price (TP) of HK$13.48. We are bullish on the insurer from now onwards, judging by: (i) most profitable P&C operations in Asia; (ii) bottoming combined ratios and stabilized margins; (iii) well reserved for claims; (iv) recovering motor sales leading to rebounding premiums; and (v) agricultural insurance aligning with national policies. However, we note that PICC P&C also has a few investment negatives, which include: (a) possible reversal of favorable underwriting cycle and (b) severe competition from Ping An and China Pacific. As a result, while we are positive on the stock's fundamentals, we are holding a slightly conservative stance towards PICC P&C. We derived our target price of HK$13.48/share, equivalent to 2.45x 2013E PBV and 10.8x 2013E PER. Our TP was set by our Gordon Growth Model, applying assumptions of a 11.6% discount rate and 23.7% mid-term ROE. Such TP represents 11.4% upside from the current trading price. As such, we initiate coverage of PICC P&C with a BUY recommendation.

Highest profits among regional peers

Not only the biggest, but the one improved the most in ROE since 2009

PICC P&C reported net profits of US$1.3bn (Rmb8.1bn) in 2011, up 51% YoY from 2010. This is the most profitable P&C operations in the year. PICC's profits was 178% of QBE's from Australia, 371% of Hyundai Insurance's from South Korea, 1,256% of Fubon Insurance's from Taiwan and 1,642% of Tokio Marine's from Japan. On the other hand, PICC P&C demonstrated great improvement in operating efficiency during 2009-11. PICC recorded ROE of 26%, ranked the 2nd among 11 peers in Asia. Its ROE improved by 17.4ppt since 2009, topped its peers during 2009-11. This is driven by 8.2ppt improvement in its combined ratios since 2009.

Bottoming combined ratios and stabilized margins

Broad-based improvement in underwriting in 1H12, implying sustainability

PICC P&C demonstrated great improvement in combined ratios and hence underwriting profits of different segments from 2009 to 2011. In 2009, the company's combined ratio was at 102.2%. In 2011, its underwriting profits increased to Rmb8.0bn, up 192% YoY, with a combined ratio of 94.0%. In 1H12, underwriting performance improved further, with profits at Rmb5.6bn, up 14% YoY and 82% HoH. Combined ratio was contained at 92.4%. Most importantly, this is a broad-based improvement, with all segments reporting underwriting profits. We believe such an improvement is a sustainable one, in view of multiple profit sources for PICC P&C in the future.

Well-reserved for claims

Claim provision greatly enhanced to 49.8% NEP in1H12

PICC P&C was complained about the adequacy of claim provision in earlier years. However, things have improved fast since 2009. In 2005, PICC reported net outstanding claim reserve of Rmb15.4bn, representing only 31.0% of net earned premiums (NEP). In 2011, net outstanding claims reserve reached Rmb62.6bn, representing 47% of NEP. In 1H12, the reserve was further raised to 49.8% of NEP. Based on such an improvement, we believe its profits will not be adversely affected by under-provided claims in the future.

Recovering motor sales leading to rebounding premiums

The company's premium sales growth rebounded from the low in Jan 2012, *Premium growth intact because of reviving car sales*

along with the improving car sales. Year to Nov 2012, PICC P&C reported premium income of Rmb175.6bn, up 11.5% YoY. This was compared to a decline of 0.5% YoY in Jan 2012. With a continuous increase in car ownership (105.8mn in 2011, +16.7% YoY) in China, we forecast passenger car sales to maintain a double digit growth rate in 2012-14E. Based on this assumption, we forecast premium growth of 11.4% YoY in 2012E, 12.7% YoY in 2013E and 12.8% YoY in 2014E, for PICC P&C.

Agricultural insurance aligning with national policies

Riding on 'Sannong' policy

PICC P&C is in the best position to ride on the 'Sannong' policy. PICC P&C was the market leader in the agricultural insurance, with a 51.9% market share (Rmb7.1bn of agriculture premiums) in 2011. In 2010, Agriculture insurance premiums grew 18.6x from Rmb730mn to Rmb13.6bn in China. In 2011, its premiums grew by 28% YoY to Rmb17.4bn. PICC P&C controls an unparalleled distribution network in county areas. In 1H12, 87,100, or 51.4% of its total P&C agents, were located in these areas. Also, PICC P&C launched a successful pilot program on agricultural insurance, called 'Changde Model' and enjoyed a great success. Therefore, we expect PICC P&C to continue benefiting from such policies in the future.

Valuation & Recommendation- Initiate coverage with a BUY rating and a TP of HK$13.48/share

Initiate coverage with a BUY rating; our TP implied 11.4% upside potential

Factoring in the continuous strength in underwriting, and prospective upswing in investment income, we assume PICC P&C to achieve an average ROE of 23.7% going forward. Accordingly, we derive our target price from our Gordon Growth Model, with assumptions of a 11.6% discount rate and mid-term ROE of 23.7%. As such, we set our target price at HK$13.48, based on 2.45x 2013E PBV and 10.8x 2013E PER. Our TP represents a 11.4% upside from the current share price. We initiate coverage of PICC P&C with a BUY recommendation.

PICC P&C: investment positives & concerns

PICC P&C (2328.hk), BUY, TP: HK$13.48 **Investment positives**	'Most profitable P&C operations in Asia' **Investment concerns**
Most profitable P&C operations in Asia	Possible reversal of favorable underwriting cycle
Bottoming combined ratios and stabilized margins	Severe competition from Ping An and China Pacific
Well reserved for claims	
Recovering motor sales leading to rebounding premiums	
Agricultural insurance aligning with national policies	

Source: Company data, ABCI Securities

PICC P&C Gordon Growth Model

Implied ROE		22.7%	23.2%	23.7%	24.2%	24.7%
Long term dividend payout ratio (k)	64.0%					
Market risk free rate (Rf)	3.6%					
Market risk premium (Rm)	11.6%					
Stock beta (B)	0.96					
Cost of Equity (CoE= Rf + Rm * B)	14.7%					
Long term sustainable growth (g)	8.5%					
Discount rate (CoE - g)	6.2%					
Target Price to Book Value (ROE * k) / (CoE - g)		2.34	2.39	2.45	2.50	2.55
2013E BVPS (HK$)	5.51					
Est. "Fair" Price YE2013		12.92	13.20	13.48	13.77	14.05
Target Price YE2013 based on DDM				**13.48**		

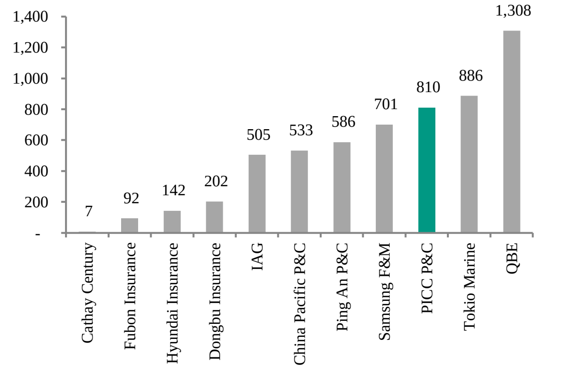
Source: Company data, ABCI Securities estimates

Highest profits among regional peers

The most profitable P&C operations in Asia

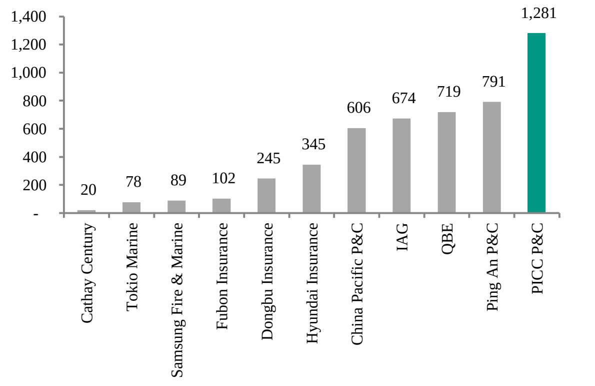
PICC P&C reported net profits of US$1.3bn (Rmb8.1bn) in 2011, up 51% YoY from 2010. This is the most profitable P&C operations in the year. PICC's profits was 178% of QBE's from Australia, 371% of Hyundai Insurance's from South Korea, 1,256% of Fubon Insurance's from Taiwan and 1,642% of Tokio Marine's from Japan. While Ping An P&C and China Pacific P&C delivered considerable profits in the same year, they are parts of the other two integrated insurance groups. Therefore, we regard PICC P&C as the single largest P&C exposure in either China or Asia.

PICC P&C: net profits vs regional peers in 2010



Source: Company data, ABCI

PICC P&C: net profits vs regional peers in 2011



Source: Company data, ABCI

Most improved P&C operations in Asia since 2009

Other than the absolute amount of net profits, PICC P&C demonstrated great improvement in operating efficiency during 2009-11. PICC recorded ROE of 26%, ranked the 2nd among 11 peers in Asia. Its ROE improved by 17.4ppt since 2009, topped its peers during 2009-11. In the meantime, PICC P&C reported combined ratios of 94.0%, representing an underwriting margin excluding investment yield of 6.0%, in 2011. Its combined ratio was the 4th lowest among peers. The marginal improvement in its combined ratio was 8.2ppt since 2009, only second to Fubon Insurance (9.3ppt). Therefore, we regard PICC P&C the most improved P&C unit in Asia from 2009 to 2011.

PICC P&C: ROE against regional peers (2009-11)

(%)	**2009**	**2010**	**2011**	**Chg since 09**
Hyundai Insurance	19.4	14.4	27.6	8.15
PICC P&C	8.6	21.5	26.0	17.36
Ping An P&C	8.6	29.2	25.1	16.57
Dongbu Insurance	22.5	22.3	22.5	0.03
China Pacific P&C	14.0	26.3	19.9	5.95
Cathay Century	21.2	7.8	16.5	(4.70)
Fubon Insurance	6.9	11.9	13.4	6.52
Samsung F&M	23.6	24.6	11.5	(12.18)
QBE	18.4	13.1	6.8	(11.62)
IAG	4.1	1.9	5.6	1.47
Tokio Marine	6.8	3.5	0.3	(6.44)
Average	**14.0**	**16.0**	**15.9**	**1.92**
High	**23.6**	**29.2**	**27.6**	**3.91**
Low	**4.1**	**1.9**	**0.3**	**(3.76)**
PICC Ranking	**7**	**5**	**2**	**Up 5**

Source: Company data, Bloomberg

PICC P&C: Combined ratios against regional peers (2009-11)

(%)	**2009**	**2010**	**2011**	**Chg since 09**
China Pacific P&C	97.5	93.7	93.1	(4.40)
Ping An P&C	98.9	93.2	93.5	(5.40)
Fubon Insurance	84.7	89.1	94.0	9.30
PICC P&C	102.2	97.6	94.0	(8.20)
Tokio Marine	102.8	90.9	94.1	(8.72)
QBE	89.6	89.7	96.8	7.17
Samsung F&M	103.2	103.1	97.1	(6.17)
IAG	103.7	100.9	97.6	(6.03)
Cathay Century	89.4	103.3	97.7	8.30
Dongbu Insurance	101.8	101.5	99.2	(2.62)
Hyundai Insurance	102.5	103.4	99.4	(3.12)
Average	**97.8**	**97.0**	**96.0**	**(1.81)**
High	**103.7**	**103.4**	**99.4**	**(4.31)**
Low	**84.7**	**89.1**	**93.1**	**8.40**
PICC Ranking	**6**	**5**	**4**	**Up 2**

Source: Company data, Bloomberg

Bottoming combined ratios & stabilized margins

Making underwriting losses before 2009

PICC P&C demonstrated great improvement in combined ratios and hence underwriting profits of different segments from 2009 to 2011. In 2009, the company ran at an underwriting loss (excluding investment yield) of Rmb2.1bn. Only Cargo and 'Other' reported small underwriting profits in the same year. The company's combined ratio was at 102.2%.

Underwriting picking up speed since the industry turnaround in 2010

However, in light of the industry turnaround in 2010, PICC P&C reported underwriting profits of Rmb2.8bn, with a combined ratio of 97.8%. 90.7% of its underwriting profits were contributed from motor insurance in that year. The only loss-making segment was commercial property, with a segmental underwriting loss of Rmb292mn and combined ratio of 104.3%. Eventually, its underwriting performance improved drastically in 2011. Underwriting profits increased to Rmb8.0bn, up 192% YoY, with a combined ratio of 94.0%.

More balanced improvement in 1H12, viewed as a sustainable one

In 1H12, underwriting performance improved further, with profits at Rmb5.6bn, up 14% YoY and 82% HoH. Combined ratio was contained at 92.4%, compared to 92.5% in 1H11. Most importantly, this is a broad-based improvement, with all segments reporting underwriting profits. We believe such an improvement is a balanced and sustainable one, in view of multiple profit sources for PICC P&C in the future.

PICC P&C: underwriting profits & combined ratios (2009-1H12)

(Rmb mn)	**2009**	**1H10**	**2H10**	**2010**	**1H11**	**2H11**	**2011**	**1H12**	**HoH (%)**	**YoY (%)**
Motor	(1,042)	1,089	1,415	2,492	3,678	997	4,675	3,475	249	(6)
Commercial Property	(1,533)	474	(764)	(292)	145	168	313	663	295	357
Cargo	287	143	199	342	359	389	748	332	(15)	(8)
Liability	(73)	33	34	66	59	262	321	214	(18)	263
Accident	(224)	1	41	42	21	94	115	239	154	1,038
Other	525	178	(76)	98	674	1,170	1,844	688	(41)	2
PICC	(2,060)	1,918	849	2,748	4,936	3,080	8,016	5,611	82	14
Combined Ratio (%)	**2009**	**1H10**	**2H10**	**2010**	**1H11**	**2H11**	**2011**	**1H12**	**HoH ppt**	**YoY ppt**
Motor	101.5	97.7	97.3	97.5	93.0	98.1	95.5	94.1	(4.0)	1.0
Commercial Property	125.5	85.7	121.6	104.3	96.4	95.1	95.8	82.9	(12.2)	(13.5)
Cargo	85.8	89.4	84.4	87.0	76.5	69.7	73.4	76.2	6.6	(0.3)
Liability	102.3	98.4	98.4	98.4	97.4	89.0	93.1	91.8	2.7	(5.6)
Accident	108.4	99.9	97.3	98.5	98.8	95.3	96.9	88.2	(7.0)	(10.6)
Other	93.9	95.0	101.5	98.9	82.1	80.0	80.8	86.8	6.8	4.7
PICC	102.2	96.7	98.7	97.8	92.5	95.4	94.0	92.4	(3.0)	(0.1)
Underwriting profit increment for 1 ppt improvement in combined ratio	933	582	670	1,239	659	672	1,331	735	9	12
1 ppt for U/W profits as % of pretax profits	43	17	21	19	10	19	13	9	(55)	(10)
PICC Pretax Profit	2,167	3,400	3,196	6,596	6,797	3,489	10,286	8,413	141	24
PICC Underwriting Profit	(2,060)	1,918	849	2,748	4,936	3,080	8,016	5,611	82	14
PICC Combined Ratio	102.2	96.7	98.7	97.8	92.5	95.4	94.0	92.4	(3.0)	(0.1)

Source: Company data, ABCI

Continuous improvement in loss ratios since 2007

We believe the improvement in combined ratio and underwriting profits to be sustainable for PICC P&C. In fact, PICC P&C has well contained its loss and expense ratios, as compared to its P&C peers in China, since 2007. In 2008, PICC P&C reported peaking loss ratios, due to Sichuan Earthquake and

South China flooding. From 2009 to 2011, the unit improved its loss ratio by 10.1ppt to 65.8%, under the circumstance of relative milder natural disasters and better claim management. In 1H12, PICC P&C demonstrated an even better performance in claims, with its loss ratios declined further to 61.5%. So far in 2H12, there has been no major natural disaster assembling the magnitude of those in 2008. Hence we believe PICC P&C can maintain its loss ratio at around 65% in 2012-14E.

PICC P&C: loss & expense ratios vs major peers in China (2007 – 1H12)

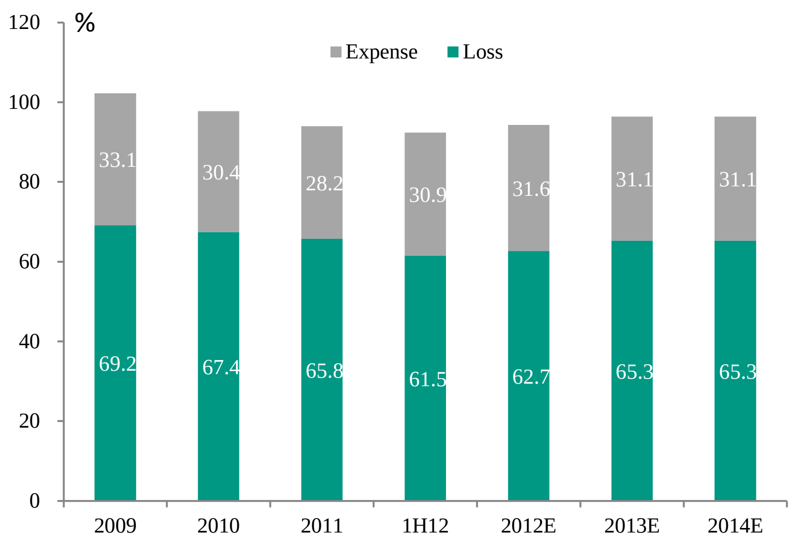
(%)	2007	2008	2009	2010	2011	1H12	Improvement fm Peak (%)
PICC P&C							
Loss	68.3	75.9	69.2	67.4	65.8	61.5	(14.4)
Expense	33.8	27.4	33.1	30.4	28.2	30.9	(2.9)
Ping An P&C							
Loss	66.0	68.1	57.0	55.4	57.8	58.5	(9.6)
Expense	32.6	36.3	41.8	37.9	35.7	34.6	(7.2)
China Pacific P&C							
Loss	60.9	64.9	61.0	57.4	58.5	59.6	(5.3)
Expense	37.8	37.9	37.3	36.6	34.8	34.6	(3.3)

Source: PICC P&C, PICCG, annual reports of Ping An and China Pacific

Expense ratios still weaker than Ping An & China Pacific

On the other hand, PICC P&C boosted efficiency by the implementation of centralized IT and claim system throughout 2009 and 2010. As a result, PICC P&C recorded 4.9ppt lower expense ratio since 2009 and 5.6ppt since the peak in 2007. In 2011, PICC P&C reported an improved expense ratio of 28.2%, resulted from the economies of scale as the market leader. In 1H12, its expense ratio edged tiny bit to 30.9%. Nevertheless, it was still lower than that of Ping An P&C (34.7%) and China Pacific P&C (34.7%). Projecting forward, PICC P&C will contain its expense ratio at 32% or below in 2012-14E.

PICC P&C: loss & expense ratios (2009 – 14E)



Source: Company data, ABCI Securities estimates

Well reserved for claims

Inadequate claim provision before 2009

PICC P&C was complained about the adequacy of claim provision in earlier years. However, as time goes by, the company has largely resolved the problem through making higher claim provisions and improving loss ratios. In 2005, PICC reported net outstanding claim reserve of Rmb15.4bn, representing only 31.0% of net earned premiums (NEP). The claims paid-to-incurred ratio recorded 95.8%, reflecting minimal excess provisions for future claim payables. The contemporary loss ratio was 73.0%. The company's management was aware of the problem and strengthened the underwriting discipline from 2009.

Pay-to-incurred ratio largely improved since 2010

Since then, substantial progress has been made on the adequacy of claim provision. In 2011, net outstanding claims reserve reached Rmb62.6bn, representing 47% of NEP. The claims paid-to-incurred ratio edged lowered to 87.9%, reflecting higher excess provision for future claim payables. In 1H12, the reserve was further raised to 49.8% of NEP, and the claims paid-to-incurred ratio was lowered to 76.6%. Based on such an improvement, we are turning more positive on the sustainability of PICC P&C's profits. We believe its profits will not be adversely affected by under-provided claims in the future.

PICC P&C: net outstanding claims reserve (2005-1H12)

(Rmb mn)	2005	2006	2007	2008	2009	2010	2011	1H12
Net earned premiums (NEP)	49,802	55,616	68,728	80,019	93,296	122,990	133,134	73,539
- YoY Chg (%)		11.7	23.6	16.4	16.6	31.8	8.2	11.5
Net outstanding claims reserve (NOC)	15,446	16,621	22,425	26,460	40,643	52,067	62,627	73,203
- YoY Chg (%)		7.6	34.9	18.0	53.6	28.1	20.3	16.9
NOC / NEP (%)	31.0	29.9	32.6	33.1	43.6	42.3	47.0	49.8
Claims paid to incurred (%)	95.8	97.0	87.6	93.4	78.0	86.2	87.9	76.6
Loss ratio (%)	73.0	69.4	68.3	75.9	69.2	67.4	65.8	61.5

Source: Company data, ABCI

Recovering motor sales leading to rebounding premiums

Worrying sign for P&C industry in early 2012

In Jan 2012, PICC P&C experienced slow growth in premiums (-0.5% YoY), along with a sharp decline in passenger car sales (-24% YoY) in China. The slowdown was extended from 2H11. In 2011, passenger car sales grew by merely 2.6% YoY. In the same year, motor insurance contributed premiums of Rmb105bn, or 78.8% of the company's total NEP. Therefore this is viewed as a worrying sign to PICC P&C and to the industry as a whole.

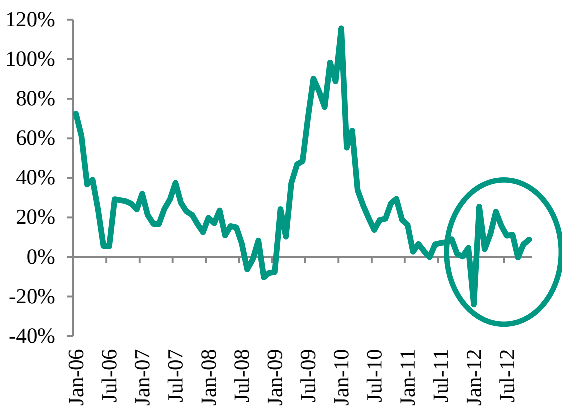
Car sales recovering slowly from the earlier weakness

Nevertheless, passenger car sales recovered rapidly from Feb-Mar 2012 onwards. The monthly passenger car sales rose 8.8% YoY in Nov 2012. Such growth far exceeded the 2.6% YoY growth in 2011. More importantly, passenger car sales may climb further on the back of new policy of 'Motors to County area'. Accordingly, rural residents could receive financial subsidy of up to a maximum of Rmb5,000, or 10% of car purchase price, for buying any passenger cars implanted with an engine of 1.3cc or below. This will serve as a major driver of rebounding motor premiums for the company towards end 2012 and entering 2013.

PICC reporting sharp rebound in premium growth rate towards end-2012

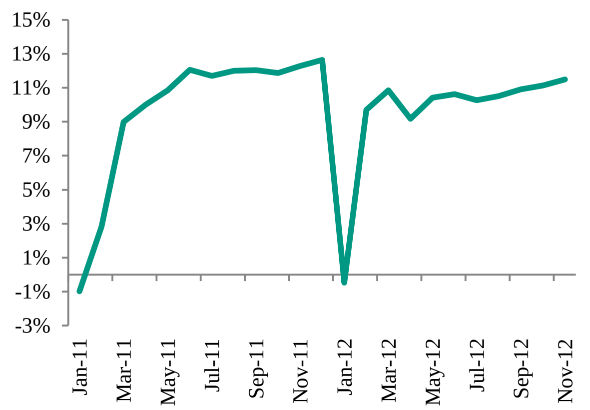
In fact, the company's premium sale growth rebounded from the low in Jan 2012. Year to Nov 2012, PICC P&C reported premium income of Rmb175.6bn, up 11.5% YoY. This was compared to a decline of 0.5% YoY in Jan 2012. With a continuous increase in car ownership (105.8mn in 2011, +16.7% YoY) in China, we forecast passenger car sales to maintain a double digit growth rate in 2012-14E. Based on this assumption, we forecast premium growth of 11.4% YoY in 2012E, 12.7% YoY in 2013E and 12.8% YoY in 2014E, for PICC P&C.

China: YoY growth of passenger car monthly sales (Jan 2006 – Nov 2012)



Source: Bloomberg, ABCI

PICC P&C: cumulative premium growth YoY (Jan 2011 – Nov 2012)



Source: CIRC, ABCI

PICC P&C: premium growth & market share (2005 - Nov 2012)

(Rmb mn)	2006	2007	2008	2009	2010	2011	Nov 2012	CAGR (%)
PICC P&C	71,299	88,592	101,656	119,464	153,930	173,372	175,609	17.9
- YoY Chg (%)		24.3	14.7	17.5	28.9	12.6	11.5	
Industry	158,035	208,648	244,625	299,290	402,689	477,906	499,165	22.9
- YoY Chg (%)		32.0	17.2	22.3	34.5	18.7	15.5	
Market Share (%)	45.1	42.5	41.6	39.9	38.2	36.3	35.8	

Source: CIRC, ABCI

Agricultural insurance aligning with national policies

PICC set to benefit from the 'Sannong' policy

In our opinion, PICC P&C is in the best position to ride on the national policy of 'Sannong', the acronym in Chinese for "agricultural, county areas and farmers", advocated in the 12th Five Year Plan in 2011. In 2010, Agriculture insurance premiums grew 18.6x from Rmb730mn to Rmb13.6bn in China. In 2011, its premiums grew by 28% YoY to Rmb17.4bn. Such growth rate exceeded the P&C industry premium growth of 18.7% YoY in the same year. At present, Agriculture premiums contributed to merely 3.6% of total P&C premiums. PICC P&C was the market leader in the product, with a 51.9% market share (Rmb7.1bn of agriculture premiums) in the same year. Agriculture premiums constituted 5.4% and 8.1% of the company's premiums in 2011 and 1H12 respectively. PICC's agriculture insurance premiums recorded Rmb9,430 mn in 2011 and RMB8,159 mn in 1H12. This product increased at a CAGR of 16.1% since 2009.

Unparalleled distribution network in county areas

In the future, we believe this product will continue to fuel growth of PICC P&C, owing to the following reasons. Firstly, the company is the pioneer of insurance distribution in county areas, defined as areas designated as counties or county-level cities under China's administrative division system. County Areas include county centers, towns and the rural areas within their jurisdictions. In 1H12, 87,100, or 51.4% of its total P&C agents, were located in these areas. Consequently, PICC P&C has a high premium contribution, with Rmb43.8bn or 43.4% of PICC P&C's Original Premiums, generated from county areas. The company was the single largest distributor of agriculture insurance in the country at present.

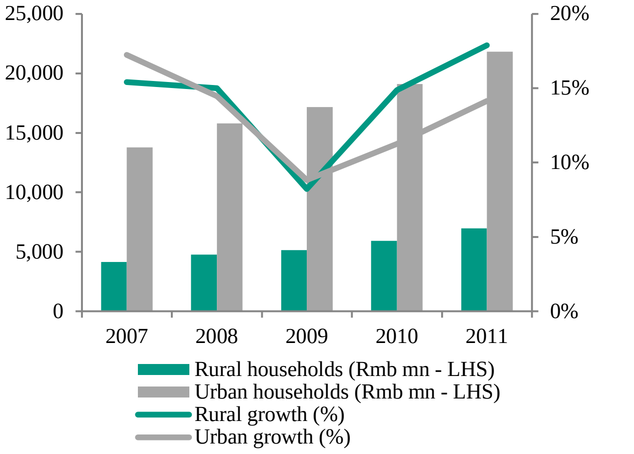
Success of Changde model set the future direction of agricultural insurance

Secondly, PICC P&C developed the "Changde model" in 2007. Such model empowered different branches to gain integrated access to customer information in the scattered county areas. The model was proven to be a success. In 2011 and 1H12, through this model, the company achieved 118.2mn and 70.4mn customer sales on agriculture insurance products, and 62.6mn and 58.1mn households in the number of insured for rural housing insurance.

Strong edge against Ping An and China Pacific in agricultural insurance

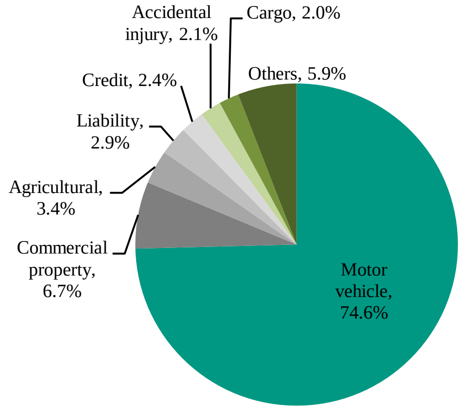
To sum, PICC P&C has a unique angle in the fast growing agriculture insurance. Major P&C competitors, such as Ping An P&C and China Pacific P&C, do not have parallel distribution capability and established infrastructure in this product line. In 2011, the company has only 118mn customers for the product, compared to the total rural population of 657mn. Therefore, we see an enormous potential for this product in the future.

China: Disposable income per capital and YoY, 2007-11



Source: NBSC, ABCI

China: agricultural premiums vs other P&C premiums (2010)



Source: Annual Report of China Insurance Market 2010-11, ABCI

Valuation & Recommendation

Sharp profit growth and high ROEs achieved in 2011 & 1H12

PICC P&C reported its net profits of Rmb8.0bn in 2011 and Rmb6.5bn in 1H12. This represented net profit growth of 51.8% YoY and 24.2% YoY respectively. The sharp growth in profitability was achieved primarily due to the sharp improvement of combined ratios in 2011 and 1H12. In 2011, PICC P&C reported combined ratios of 94.0%, relative to 97.8% in 2010. In 1H12, the ratios improved further from 92.5% in 1H11 to 92.4% in 1H12. Simultaneously, PICC P&C was not performing in investments. This is partly due to the sluggish A-share markets in 2011 and 1H12. PICC P&C reported gross investment yields of 2.2% in 2011 and 3.6% in 1H12. This is compared to 3.9% in 2010. Notwithstanding, PICC P&C accomplished a fast earning growth, reporting an ROE of 25.9% in 2011 and 33.1% in 1H12.

Assuming higher combined ratios in 2H12 and 2013

Projecting forward, we forecast PICC P&C to report weaker combined ratios in 2H12 and 2013, because of the severe competition in the market and possibly higher claims on natural disasters. For 2H12, we expect combined ratios to edge up to 96.2%, from 92.4% in 1H12. This is partly due to the seasonal factor of higher compensation expenses in 2Hs. In 2013, Ping An and China Pacific would start to adopt market pricing for commercial auto insurance. This may lead to more severe competition with PICC P&C. In turn, it may drive up the expense ratios of PICC P&C. As such, we estimate combined ratios to reach 96.3% in 2013, compared to 94.3% in 2012. We forecast an underwriting profit of Rmb6.1bn in 2013, compared to Rmb8.5bn in 2012 (Rmb6.5bn in 1H12).

Gross yield assumptions in-line with our sector assumptions

With the recent rebound of A-share markets, and favorable outlook on China economy in 2013, we adopt gross yield assumptions of 4.1% in 2012 and 4.6% in 2013 for our earnings forecast of PICC P&C. Our yield assumption is in-line with our industry assumption of 4.5% in 2013. We estimate gross investment income to increase to Rmb10.3bn in 2013, compared to Rmb8.0bn in 2012 (Rmb3.6 bn in 1H12)

Higher than consensus earnings forecast in 2012 & 2013

Accordingly, we forecast PICC P&C to report net earnings of Rmb11.9bn in 2012 (Rmb6.5bn in 1H12) and Rmb12.1bn in 2013. The equivalent EPS is HK$1.20 in 2012 and HK$1.25 in 2013. Our forecast is 15.9% and 10.2% higher than the Bloomberg consensus in 2012 and 2013 respectively. Our earnings forecast implies a ROE of 24.7% in 2012 and 22.7% in 2013.

Initiate coverage with a BUY rating; our TP implied 11.4% upside potential

Factoring in the continuous strength in underwriting, and prospective upswing in investment income, we assume PICC P&C to achieve an average ROE of 23.7% going forward. Accordingly, we derive our target price from our Gordon Growth Model, with assumptions of a 11.6% discount rate and mid-term ROE of 23.7%. As such, we set our target price at HK$13.48, based on 2.45x 2013E PBV and 10.8x 2013E PER. Our TP represents a 11.4% upside from the current share price. We initiate coverage of PICC P&C with a BUY recommendation.

PICC P&C Gordon Growth Model

Implied ROE		22.7%	23.2%	23.7%	24.2%	24.7%
Long term dividend payout ratio (k)	64.0%					
Market risk free rate (Rf)	3.6%					
Market risk premium (Rm)	11.6%					
Stock beta (B)	0.96					
Cost of Equity (CoE= Rf + Rm * B)	14.7%					
Long term sustainable growth (g)	8.5%					
Discount rate (CoE - g)	6.2%					
Target Price to Book Value (ROE * k) / (CoE - g)		2.34	2.39	2.45	2.50	2.55
2013E BVPS (HK$)	5.51					
Est. "Fair" Price YE2013		12.92	13.20	13.48	13.77	14.05
Target Price YE2013 based on DDM				**13.48**		

Source: Company data, ABCI Securities estimates

PICC P&C: valuation against peers

	Share Price (HK$)	2011 PER (x)	2012E PER (x)	2013E PER (x)	2011 PBV (x)	2012E PBV (x)	2013E PBV (x)
PICC	12.10	14.48	10.06	9.67	3.46	2.68	2.19
China Life	26.95	34.1	46.79	18.67	2.6	2.32	2.07
Ping An	69.35	23.2	16.71	12.40	2.6	2.17	1.86
China Pacific	31.35	26.6	31.72	26.29	3.5	2.87	2.72
New China Life	31.80	21.0	22.05	17.11	2.6	2.13	1.84
China Taiping	16.54	57.1	20.24	15.73	2.5	1.58	1.37
Average		29.42	24.59	16.65	2.87	2.29	2.01
PICC < or > average		Lower	Lower	Lower	Higher	Higher	Higher

Source: Bloomberg, ABCI Securities estimates

PICC P&C: share price performance against peers & benchmarks

Company	Stock code	Current (HK$)	4-Sep	24-Jul	5-Jun	29-Feb	25-Nov	4-Oct
China Life	**2628.hk**	26.95	20.85	20.85	17.08	24.20	19.34	17.24
Ping An	**2318.hk**	69.35	55.10	59.25	53.90	67.85	52.00	38.65
China Pacific	**2601.hk**	31.35	22.85	24.90	21.65	27.95	21.70	20.15
New China Life	**1336.hk**	31.80	21.70	23.95	29.40	34.20	25.65	-
PICC	**2328.hk**	12.10	8.83	8.31	8.01	10.94	10.02	7.82
China Taiping	**966.hk**	16.54	10.56	11.40	11.70	18.12	14.50	13.90
Hang Seng Index	**HSI**	23,382	19,145	18,877	18,185	21,680	17,682	16,250
MSCI China	**MXCN**	65.22	54.90	52.04	51.67	62.48	50.89	44.74

Company	Versus MXCN	Versus HSI	From Sep 5 Low	From Jul 12 Low	From Jun 12 Low	From Feb 12 High	From Nov 11 Low	From Oct 11 Low
China Life	Outperform	Outperform	29.3%	29.3%	57.8%	11.4%	39.3%	56.3%
Ping An	Outperform	Outperform	25.9%	17.0%	28.7%	2.2%	33.4%	79.4%
China Pacific	Outperform	Outperform	37.2%	25.9%	44.8%	12.2%	44.5%	55.6%
New China Life	Outperform	Outperform	46.5%	32.8%	8.2%	-7.0%	24.0%	
PICC	Outperform	Outperform	37.0%	45.6%	51.1%	10.6%	20.8%	54.7%
China Taiping	Outperform	Outperform	56.6%	45.1%	41.4%	-8.7%	14.1%	19.0%
Sector simple av.	Outperform	Outperform	38.8%	32.6%	38.6%	3.4%	29.3%	53.0%
Big three av.	Outperform	Outperform	30.8%	24.1%	43.8%	8.6%	39.1%	63.8%
Hang Seng Index			22.1%	23.9%	28.6%	7.9%	32.2%	43.9%
MSCI China			18.8%	25.3%	26.2%	4.4%	28.2%	45.8%

Source: Bloomberg, ABCI Securities estimates

PICC P&C: Financial Statements

Profit & loss (Rmb mn)

	2010	2011	2012E	2013E	2014E
GWP & policy fees	**154,307**	**173,962**	**193,822**	**218,506**	**246,409**
(-) Premiums to reinsurers	(13,699)	(3,485)	(23,939)	(6,555)	(7,392)
NWP & policy fees	**140,608**	**170,477**	**169,883**	**211,951**	**239,017**
Chg. in unearned premium res.	(17,618)	(37,343)	(21,040)	(45,236)	(52,276)
NEP & policy fees	**122,990**	**133,134**	**148,843**	**166,715**	**186,741**
Net claims	**(82,908)**	**(87,546)**	**(93,332)**	**(108,789)**	**(121,854)**
Acquisition costs	(23,412)	(20,290)	(30,539)	(33,505)	(37,528)
Insurance provision	0	0	0	0	0
General & administrative expense	(13,890)	(17,282)	(16,493)	(18,335)	(20,541)
Total non-claims expense	**(37,302)**	**(37,572)**	**(47,032)**	**(51,840)**	**(58,070)**
Underwriting profits	**2,780**	**8,016**	**8,478**	**6,086**	**6,818**
Investment income on reserves	1,386	2,725	3,867	4,547	4,395
Interest on PH deposits	(25)	(17)	(15)	(20)	(22)
Sundry income/expense	16	53	42	46	50
Insurance trading income	**4,157**	**10,777**	**12,371**	**10,659**	**11,240**
Investment income on SHF	3,516	1,045	4,118	5,779	6,631
Financing expenses	(788)	(1,316)	(1,307)	(965)	(965)
Exchange gains/loss	(370)	(328)	(129)	(280)	(280)
Associate/JV - Profits/losses	81	108	222	340	340
Net profit before tax	**6,596**	**10,286**	**15,274**	**15,533**	**16,966**
Tax expense	(1,308)	(2,259)	(3,389)	(3,417)	(3,733)
Net profit after tax	**5,288**	**8,027**	**11,886**	**12,116**	**13,234**

Financial summary

	2010	2011	2012E	2013E	2014E
EPS (HK$)	**0.566**	**0.835**	**1.203**	**1.252**	**1.425**
EPS growth (%)	211.4%	47.7%	44.0%	4.1%	13.9%
PER	**20.3**	**13.7**	**10.1**	**9.7**	**8.5**
BVPS (HK$)	**2.87**	**3.49**	**4.51**	**5.51**	**6.82**
BVPS growth (%)		21.8%	29.1%	22.3%	23.7%
PBV	**4.0**	**3.3**	**2.7**	**2.2**	**1.8**
Dividend per share (HK$)	**0.000**	**0.274**	**0.260**	**0.270**	**0.270**
Yield (%)	**0.0%**	**2.4%**	**2.2%**	**2.2%**	**2.2%**
Payout ratio (%)	0.0%	32.8%	21.7%	21.6%	18.9%

Underwriting performance (%)

	2010	2011	2012E	2013E	2014E
GWP growth	**28.8%**	**12.7%**	**11.4%**	**12.7%**	**12.8%**
UEP/reins. exp. to GWP	12.5%	21.9%	12.4%	21.3%	21.9%
NEP growth	**31.8%**	**8.2%**	**11.8%**	**12.0%**	**12.0%**
Loss ratio	**67.4%**	**65.8%**	**62.7%**	**65.3%**	**65.3%**
Acquisition expense ratio	19.0%	15.2%	20.5%	20.1%	20.1%
Insurance provision ratio	0.0%	0.0%	0.0%	0.0%	0.0%
G&A expense ratio	11.3%	13.0%	11.1%	11.0%	11.0%
Total expense ratio	**30.4%**	**28.2%**	**31.6%**	**31.1%**	**31.1%**
Combined ratio	**97.8%**	**94.0%**	**94.3%**	**96.3%**	**96.3%**
Underwriting margins	**3.3%**	**8.1%**	**8.3%**	**6.4%**	**6.0%**

Financial & operating ratios (%)

	2010	2011	2012E	2013E	2014E
Return on equity	**21.8%**	**25.9%**	**29.8%**	**24.7%**	**22.7%**
Return on assets	2.9%	3.4%	4.1%	3.5%	3.4%
Inv yield on reserves	1.9%	2.9%	3.9%	4.4%	4.5%
Inv yield on SHF	7.1%	1.5%	4.4%	4.9%	4.7%
Int rate to PH deposits	0.6%	0.7%	0.7%	0.9%	0.9%
Tax rate	19.8%	22.0%	22.2%	22.0%	22.0%
Gross yield	3.9%	2.3%	4.1%	4.7%	4.6%
Book value (RMB/share)	**2.41**	**2.87**	**3.64**	**4.36**	**5.17**
Price to book value (x)	**4.00**	**3.29**	**2.65**	**2.17**	**1.75**
Reported solvency ratio	114.6%	184.0%	198.8%	198.9%	201.8%
Solvency - premiums	21.8%	26.4%	29.9%	32.0%	33.9%
Solvency - claims	51.5%	56.1%	57.1%	60.0%	62.6%
Holding period (NWP)	0.67	0.70	0.60	0.59	0.48

Balance sheet (Rmb mn)

	2010	2011	2012E	2013E	2014E
Cash	32,209	58,638	74,658	79,713	63,074
Investments	111,574	120,625	133,899	155,779	181,236
Reinsurance recoveries	9,270	12,078	10,400	10,449	10,504
Other receivables	16,609	34,290	46,528	52,644	59,583
Prepayments	12,346	15,347	30,948	44,565	64,174
Deferred acquisition costs (DAC)	0	0	0	0	0
Fixed assets	19,065	20,623	21,179	22,251	23,377
Other	2,686	4,043	3,564	3,564	3,564
Total assets	**203,759**	**265,644**	**321,175**	**368,965**	**405,512**
Unearned premium	60,214	69,617	87,626	94,181	96,028
Provision for outstanding claims	62,732	76,100	89,812	100,740	112,981
Policyholders' deposits	2,517	2,328	2,135	2,353	2,595
Other payables	11,264	26,272	26,066	37,536	54,051
Borrowings	14,157	19,299	19,299	19,299	19,299
Other	26,067	36,868	51,663	61,475	57,252
Total liabilities	**176,951**	**230,484**	**276,600**	**315,584**	**342,206**
Net equity to shareholders	**26,808**	**35,160**	**44,575**	**53,381**	**63,306**

Source: Company data, ABCI Securities estimates

Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ Stock return < Market return rate
Sell	Stock return < Market return – 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Market return: 5-year average market return rate from 2007-2011
Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.
Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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