



Company Report

China Pacific (2601 HK) – Buy Life & Health Insurance Industry

Key data

H-share price (HK\$)	24.30
Target price (HK\$)	27.93
Upside potential (%)	19.08
52Wk H/L(HK\$)	31.0 / 19.8
Issued shares:	
H-shares (mn)	2,775
A-shares (mn)	6,287
H-share mkt cap (HK\$m)	220,207
30-day avg vol (HK\$m)	298.8
Major shareholder (%):	
Fortune Investments (Baosteel)	17.4
Shenergy Group	16.6

Source: Company & Bloomberg

Premium breakdown in 2011 (%)

Life individual channel	27.6
Life bancassurance channel	28.7
Life direct sales	9.2
P&C motor	30.6
P&C non-motor	3.8

*Based on 2011 results

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	2.6	(1.6)
3-mth	(2.4)	(8.8)
6-mth	(5.1)	(1.7)

*Relative to MSCI China

Source: Bloomberg

1 year price performance



Source: Bloomberg

Analyst

Report Date: 29 October 2012

Name: Francis Chan
Tel: (852) 2147 8311
Email: francischan@abci.com.hk

Remaining profitable (3Q12 results review)

China Pacific's 3Q12 numbers look weak, with net profit down 58.7% YoY to Rmb497mn. However, the company remained profitable in P&L, despite a heavy impairment of Rmb1.6bn. The company's comprehensive loss narrowed 93.2% YoY to Rmb358mn for 3Q12. Shareholders' funds remained flatish QoQ (Rmb82.7bn) from 1H12, despite a 6.3% decline in A-share market. As a result, we remain positive on China Pacific.

Heavy impairment for 3Q12. China Pacific recorded a heavy impairment of Rmb1.6bn in 3Q12. This is mainly due to a 6.3% decline in A-share market and about 1.5% drop in bond prices. Nevertheless, such trend could be reversing, with stabilizing A-share market and bond yields since end Sep 2012. We render further impairment loss unlikely in 4Q12.

Improving Life & P&C underwriting. Individual Life FYP rose by 11.2% YoY to Rmb9.6bn in 9M12. 93.7% of these premiums are higher margin regular policies. P&C premiums were reported at Rmb52.1bn, up 11.2% YoY. More importantly, cost-effective premiums from telemarketing and cross selling increased significantly. In 9M12, they contributed 17.3% (11.9% in 2011) of total P&C premiums.

AFS reserves lifted. The company reported a comprehensive income of Rmb7.7bn in 9M12, implying improving AFS reserves during the same period. As such, we estimate China Pacific's EV to reach Rmb136.3bn, up 20.1% YoY, in 2012E.

Lower IFRS profit forecast. While we are not concerned with the weaker profitability of China Pacific in 3Q12, we adjusted down our IFRS profit forecast to Rmb6.0bn (Rmb8.4bn previously) in 2012E. Meanwhile, we maintain our profit forecast at Rmb8.7bn in 2013E.

Maintain BUY and TP of HK\$27.93. We maintain an appraisal value of Rmb194.0bn for 2013E, and adopt it as TP, or HK\$27.93/ share. The implied valuation of our TP is 1.33x 2013E PEV and 7.0x 2013E VNB. This represents 14.9% upside potential from the current share price. We maintain our BUY recommendation on China Pacific.

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)	141,327	155,517	167,916	183,395	193,978
Chg (% YoY)	35.6	10.0	8.0	9.2	5.8
Net profit (Rmb mn)	8,557	8,313	6,028	8,708	10,945
Chg (% YoY)	16.3	(2.8)	(27.5)	44.5	25.7
EPS (HK\$)	0.55	0.61	1.19	1.18	0.84
PER (x)	20.5	20.6	28.9	20.2	15.2
BPS (HK\$)	11.3	11.1	13.3	14.3	16.2
P/B (x)	2.2	2.2	1.8	1.7	1.5
EVPS (HK\$)	15.3	16.1	19.0	21.1	24.7
PEV (x)	1.6	1.5	1.3	1.2	1.0
VNB (HK\$)	0.8	0.9	0.9	1.0	1.1
VNB (x)	8.5	5.2	1.8	(0.7)	(4.6)

Source: Company data, ABCI Securities estimates



China Pacific: 3Q12/ 9M12 profit & loss

(RMB mn)	3Q12	3Q11	% YoY	9M12	9M11	% YoY
	CAS	CAS	Chg	CAS	CAS	Chg
GWP	36,536	34,503	5.9%	127,047	121,378	4.7%
Premiums to Reinsurers	(2,563)	(3,034)	-15.5%	(9,188)	(10,340)	-11.1%
NWP	33,973	31,469	8.0%	117,859	111,038	6.1%
Chg. In Unearned Premium Reserves	(311)	(117)	165.8%	(3,294)	(4,564)	-27.8%
NEP	33,662	31,352	7.4%	114,565	106,474	7.6%
Investment Income	5,825	3,578	62.8%	16,678	15,224	9.6%
Other Income	280	206	35.9%	819	676	21.2%
Total Income	39,767	35,136	13.2%	132,062	122,374	7.9%
Surrenders	(3,126)	(3,162)	-1.1%	(9,307)	(7,060)	31.8%
Claims Incurred	(11,010)	(8,152)	35.1%	(30,857)	(25,116)	22.9%
Chg in LT Life Insurance Contract Liabilities	(12,256)	(13,110)	-6.5%	(49,593)	(51,161)	-3.1%
Policyholders Dividends	(1,072)	(1,053)	1.8%	(2,855)	(2,796)	2.1%
Finance Costs	(561)	(260)	115.8%	(1,633)	(571)	186.0%
Handling charges & commissions	(3,359)	(3,137)	7.1%	(11,469)	(10,339)	10.9%
SG & A	(4,694)	(3,692)	27.1%	(13,329)	(10,636)	25.3%
Other opex (incl. Impairment loss)	(3,209)	(1,974)	62.6%	(9,078)	(6,578)	38.0%
Total Benefits, Claims & Expenses	(39,287)	(34,540)	13.7%	(128,121)	(114,257)	12.1%
Associate Profit & Loss	2	671	-99.7%	22	669	-96.7%
Profit Before Tax	482	1,267	-62.0%	3,963	8,786	-54.9%
Tax Expenses	14	(68)	-120.6%	(799)	(1,704)	-53.1%
Net Profit	496	1,199	-58.6%	3,164	7,082	-55.3%
Minority Interest	1	3	-66.7%	(29)	(64)	-54.7%
Net Profit to CPIC Shareholders	497	1,202	-58.7%	3,135	7,018	-55.3%
Other Comprehensive Income	(854)	(6,459)	-86.8%	4,561	(9,810)	-146.5%
Total Comprehensive Income	(358)	(5,260)	-93.2%	7,725	(2,728)	-383.2%
Operating Ratios						
NEP as % of Total Income	84.6%	89.2%	-4.6%	86.8%	87.0%	-0.3%
Total Inv't Income as % of Total Income	14.6%	10.2%	4.5%	12.6%	12.4%	0.2%
Insurance Benefits & Claims as % of NEP	-42.0%	-36.1%	-5.9%	-35.1%	-30.2%	-4.8%
Increase in Insurance Liabilities as % of NEP	-36.4%	-41.8%	5.4%	-43.3%	-48.1%	4.8%
Policyholders Dividends (Participating) as % of NEP	-3.2%	-3.4%	0.2%	-2.5%	-2.6%	0.1%
Commissions as % of NEP	-10.0%	-10.0%	0.0%	-10.0%	-9.7%	-0.3%
SG&A as % of NEP	-13.9%	-11.8%	-2.2%	-11.6%	-10.0%	-1.6%
Other Comp Inc / Loss as % of Net Profit	-171.8%	-537.4%	365.5%	145.5%	-139.8%	285.3%

Source: Company, ABCI Securities



China Pacific: 9M12 investment asset mix

(Rmb mn)	9M12	2011	% 9M Chg
Cash	15,047	14,903	1.0%
Trading Securities	1,737	2,907	-40.2%
Policy Loans	5,265	4,094	28.6%
Deposits	167,517	137,373	21.9%
AFS Securities	132,165	117,592	12.4%
HTM Securities	223,637	202,536	10.4%
Returned Loans & Inv'ts	33,035	32,929	0.3%
Restricted statutory deposits	3,580	3,580	0.0%
Investment property	6,394	6,573	-2.7%
Total investments	588,377	522,487	12.6%
Gross yields	3.00%	3.70%	-0.7%

Source: Company, ABCI Securities

China Pacific: 9M12 balance sheet snapshot

(RMB mn)	9M12	2011	% 9M Chg
Total Assets	646,169	570,612	13.2%
Total Liabilities	563,471	492,557	14.4%
Shareholders' Equity	82,698	78,055	5.9%

Source: Company, ABCI Securities



China Pacific: Embedded Value

(Rmb mn)	2009	2010	2011	2012E	2013E	1H12
Embedded value						
Adjusted net worth	72,368	75,905	72,664	84,964	91,321	76,824
Value of in-force	33,971	43,991	52,671	62,880	73,420	56,604
Cost of solvency margin	(7,516)	(9,212)	(11,059)	(11,503)	(11,966)	(11,595)
Embedded value	98,371	110,089	113,564	136,341	152,775	121,833
Vnb (long term)	4,915	5,996	6,599	6,669	7,136	4,061
Multiplier	10	7	6	6	6	
New business value (long term)	48,870	42,713	42,129	41,824	41,210	
Appraisal value	147,241	152,803	155,693	178,166	193,985	
EV movement analysis						
Opening embedded value	69,669	98,371	110,089	113,564	136,341	
Expected return						
- SHF's	2,698	3,763	3,947	3,779	4,418	
- In-force	2,772	2,578	3,307	6,057	7,231	
Value of new business (VNB)	4,915	5,996	6,599	6,669	7,136	
Inv't r var + mkt val adj	(226)	(2,556)	(9,080)	1,000	820	
Capital raising & dividends	18,080	(2,580)	(3,010)	5,272	(3,172)	
OpEx var, model chg & others	463	4,518	1,712	-	-	
Closing embedded value	98,371	110,089	113,564	136,341	152,775	
EVPS (HK\$)	12.98	15.26	16.08	18.99	21.07	
AVPS (HK\$)	20.06	24.73	28.30	28.47	27.93	
PEV implied	1.55	1.62	1.76	1.50	1.33	
VNB (HK\$)	0.65	0.83	0.93	0.93	0.98	
VNB implied (x)	8.39	9.02	9.45	6.34	2.97	
EV contributions 1 (%)						
Expected return on beg EV	8%	6%	7%	9%	9%	
IRV + MVA contribution to beg EV	0%	-3%	-8%	1%	1%	
VNB contribution to beg EV	7%	6%	6%	6%	5%	
VNB contribution to beg VIF	20%	18%	15%	13%	11%	
EVPS (HK\$) growth	26%	18%	5%	18%	11%	
EV contributions 2 (%)						
Beginning EV	71%	89%	97%	83%	89%	
Expected return						
- SHF's	3%	3%	3%	3%	3%	
- In-force	3%	2%	3%	4%	5%	
Inv't r var + mkt val adj	0%	-2%	-8%	1%	1%	
Value of new business (VNB)	5%	5%	6%	5%	5%	
Capital raising & dividends	18%	-2%	-3%	4%	-2%	
OpEx var, model chg & others	0%	4%	2%	0%	0%	
Ending EV	100%	100%	100%	100%	100%	

Source: Company data, ABCI Securities estimates



China Pacific: Financial Statements

Profit & loss (Rmb mn)						Operating ratios (%)					
	2010	2011	2012E	2013E	2014E		2010	2011	2012E	2013E	2014E
GWP & policy fees	134,963	154,958	164,630	173,754	182,839	Gross written premium growth	40.1%	11.0%	6.2%	5.5%	5.2%
(-) Premiums to reinsurers	(13,148)	(13,384)	(12,736)	(14,147)	(15,219)	Net earned premium growth	39.3%	14.6%	6.5%	3.2%	4.9%
NWP & policy fees	121,815	141,574	151,893	159,607	167,619	Claims/benefits - of NEP	30.2%	36.1%	34.8%	36.8%	37.4%
Chg. in unearned premium res.	(4,656)	(4,336)	(5,793)	(8,763)	(9,444)	Div to PH & net inc. in PH res. of NEP	50.7%	40.9%	43.7%	44.7%	43.6%
NEP & policy fees	117,159	137,238	146,100	150,845	158,175	Ttl. claim/PH benefits to NEP	80.9%	76.9%	78.5%	81.5%	81.0%
Investment income	18,403	16,392	19,709	30,120	32,989	Claims/benefits - of total revenue	25.9%	31.8%	30.2%	30.3%	30.5%
Other income	812	1,887	2,107	2,430	2,814	Net inc. in PH res. - of total revenue	43.6%	36.0%	38.1%	36.7%	35.6%
Total revenue	136,374	155,517	167,916	183,395	193,978	Ttl. claim/PH benefits to total revenue	69.5%	67.9%	68.3%	67.0%	66.1%
Claims, surrenders, annuities/maturities	(35,354)	(49,518)	(50,791)	(55,572)	(59,193)	Commission cost ratio	0.0%	0.0%	0.0%	0.0%	0.0%
Div. & int. to PH & net inc. in PH res.	(59,405)	(56,063)	(63,898)	(67,365)	(69,004)	General & admin. cost ratio	21.0%	21.3%	22.2%	21.0%	21.1%
Ttl. claims/PH benefits	(99,225)	(111,645)	(120,630)	(131,476)	(136,944)	Other exp. & stat. levy ratio					
Commission expenses	-	-	-	-	-	Total expense ratio	94.1%	93.6%	95.3%	93.9%	92.8%
General & administrative expense	(28,637)	(33,120)	(37,301)	(38,583)	(40,876)	Gross investment yield	4.5%	3.4%	3.9%	4.5%	4.5%
Finance expense	(410)	(848)	(2,144)	(2,144)	(2,144)	CPIC Life	259.3%	187.3%	168.7%	164.4%	167.3%
Other expense	0	0	0	0	0	CPIC P&C	206.1%	233.1%	221.7%	226.6%	229.8%
Total operating expense	(29,047)	(33,968)	(39,445)	(40,727)	(43,020)						
Total expenses	(128,272)	(145,613)	(160,075)	(172,203)	(179,964)	Balance sheet (Rmb mn)					
Net profit before tax	8,102	9,904	7,841	11,192	14,014		2010	2011	2012E	2013E	2014E
Associate/JV - Profits/losses	100	495	21	18	15	Financial assets	433,385	522,530	626,764	729,722	837,705
Tax expense	(1,615)	(2,006)	(1,743)	(2,372)	(2,921)	Reinsurance assets	12,347	14,118	14,959	16,493	18,183
Net profit after tax	6,587	8,393	6,119	8,838	11,108	Insurance receivables	5,409	6,252	10,202	11,247	12,400
Minority interest	(38)	(80)	(90)	(130)	(163)	PP&E	6,831	7,833	7,987	7,827	7,671
NP to CPIC shareholders	6,550	8,313	6,028	8,708	10,945	Others	17,739	19,879	29,268	29,918	31,079
						Assets	475,711	570,612	689,180	795,208	907,038
Financial summary						Insurance contract liabilities	302,640	374,931	439,606	518,135	598,737
	2010	2011	2012E	2013E	2014E	Investment contract liabilities	52,690	47,182	46,261	49,079	52,068
EPS (RMB)	0.76	1.18	0.84	1.20	1.59	Financial liabilities	19,836	58,847	91,405	105,610	122,679
<i>EPS growth (%)</i>	-20.0%	-0.7%	-28.7%	43.1%	32.7%	Deferred revenue	-	-	-	-	-
PER (x)	35.1	20.6	28.9	20.2	15.2	Others	27,476	11,597	13,764	18,694	22,090
PBV (x)	2.95	2.20	1.82	1.70	1.50	Liabilities	402,642	492,557	591,036	691,517	795,575
PEV (x)	2.18	1.51	1.28	1.15	0.98	Net assets	76,605	76,796	96,790	102,206	109,816
VNB multiple (x)	26.71	5.17	1.85	-0.72	-4.63	Minority interests	1,202	1,259	1,355	1,485	1,648
Dividend per share (RMB)	0.40	0.35	0.35	0.35	0.35	Net equity to shareholders	77,854	78,055	98,154	103,691	111,464
Yield (%)	1.5%	1.8%	1.8%	1.8%	1.9%						
Payout ratio (%)	52.5%	29.7%	41.7%	29.1%	22.0%						
Return on equity (%)	8.5%	10.4%	6.8%	8.6%	10.2%						
Return on assets (%)	1.5%	1.6%	1.0%	1.2%	1.3%						
Tax rate (%)	19.9%	20.3%	22.2%	21.2%	20.8%						

Source: Company data, ABCI Securities estimates



Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ 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	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 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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**Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.
Tel: (852) 2868 2183**