



# Sector Report

## China Insurance - Overweight Life & Health Insurance Industry Initiation

### Key sector data

Average PER (x)	15.2
Average PBV (x)	1.6
Average PEV (x)	1.1
Average VNB (x)	0.6
Average Dividend Yield (%)	1.0

Sector Market cap (HK\$bn)	1,408
Average 30-day avg vol (HK\$mn)	1,851
Sector Weighting in MSCI China	~ 8%

\* valuations as of 2013E

Source: Company & Bloomberg

### Sector premiums composition (%)

Life	60.6
Health	4.8
Personal Accident	2.3
Property & Casualty	32.2

\* data as of 2011

Source: CIRC

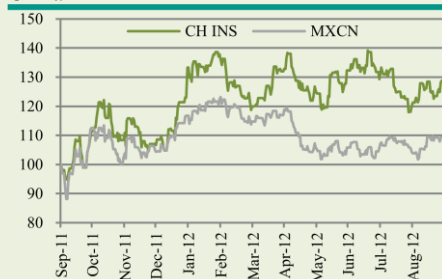
### Sector performance (%)

	Absolute	Relative*
1-mth	8.98	5.82
3-mth	(2.56)	(5.82)
6-mth	7.41	12.22

\* Relative to MSCI China Index

Source: Bloomberg

### China Insurance: relative performance to MSCI China



Source: Bloomberg

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### Presenting a sweet entry point

**We believe China Insurance to have reached a sweet entry point. In 1H12, Life industry reached an inflection point in operations. P&C industry remained solid in underwriting performance. Also the sector is blessed with multiple national policies. Lastly, China Insurance is situated at a cyclical sweet spot of investments. Therefore, we initiate our research coverage on the sector with an OVERWEIGHT rating.**

**Life reaching an inflection point.** We hold such a view due to the reviving VNB growth, resuming uptrend in EV, flourishing health premium sales and the new game changer of tax deferred pension products. We expect Life operations to fully recovery in 2013E.

**P&C remaining solid.** P&C will benefit from stabilized premium growth, emerging new sales channels, defensive underwriting margins and rising contribution by non-motor insurance. We forecast P&C insurers to maintain high ROEs in 2013E.

**Complementary national policies.** China Insurance will be blessed with the policies of Medicare reform, tax deferred pension products, 'Sannong' support and broadening investment channels by CIRC. These policies will bring about new growth engines for the sector.

**At a cyclical sweet spot of investments.** We expect investment return to recover in 2013E. We render A-share markets to be close to its cyclical bottom, after the resumption of PBOC rate cut cycle. Also, Chinese insurers will gain from improving return of corporate and finance bonds. Lastly, they may benefit from broadening investment channels by CIRC.

**Initiate coverage with an OVERWEIGHT rating; Top picks: China Life & China Pacific.** Based on our assumptions, we appraise the sector at a valuation of 1.20x 2013E PEV and 2.8x 2013E VNB. Our target prices imply an average 9.3% upside potential from the current share prices of insurers. As such, we initiate coverage of China Insurance with an Overweight rating. Our top picks are China Life and China Pacific. Our SELL is Ping An. Also, we have a HOLD rating on New China Life and a BUY rating on China Taiping.

**Risk factors:** worse-than-expected underwriting and investment performance, tighter-than-expected regulations for the sector

### Results and valuation

Companies	Code	Price (HK\$)	MCap (HK\$ bn)	ABCI Rec.	TP (HK\$)	PER 2013E	PBV 2013E	PEV 2013E	VNB 2013E	Yield 2013E
China Life	2628 hk	22.40	633	BUY	26.45	17.1	2.1	1.3	5.6	1.8%
Ping An	2318 hk	58.60	464	SELL	58.04	13.0	1.6	1.1	3.0	1.2%
China Pacific	2601 hk	23.45	213	BUY	27.93	18.7	1.6	1.1	(1.6)	1.9%
New China Life	1336 hk	24.85	78	HOLD	24.85	14.5	1.5	0.9	(1.5)	0.0%
China Taiping	0966 hk	12.18	21	BUY	13.42	12.6	1.2	0.9	(2.6)	0.0%
Sector Average						15.2	1.6	1.1	0.6	1.0%

\*We assume Rmb1 = HK\$1.23 Prices as of 28 September 2012

Source: Company, ABCI Securities estimates



## Contents

Contents	2
Executive Summary – Presenting a sweet entry point	3
Life reaching an inflection point	3
P&C remaining solid	3
Complimentary national policies	3
Ample solvency	4
At a cyclical sweet spot of investments	4
Valuation & Trading: reaching retry points	4
Recommendations: identifying the up-swingers	4
Life reaching an inflecting point	6
Bottoming premium sales & VNB	6
Embedded value resuming uptrend	8
Accident & Health products fueling growth	10
Tax deferred pension product the game changer	10
P&C remaining solid	13
Stabilizing premium sales	13
New sales channels emerging	14
Defensive underwriting margins	15
Non-motor rising in contribution	16
Pricing liberalization could be negative	17
Overhang with compulsory auto insurance	17
Complimentary national policies	19
Medicare reform driving health sales growth	19
Tax deferred pension products the game changer	20
Agriculture insurance the new driver for P&C	20
Broadening investment channels	21
Ample solvency	23
Subordinated debt issuance lifted solvency	23
Slower capital consumption	24
Less investment markdowns	24
At a cyclical sweet spot of investments	26
Rebounding equity performance at sight	26
Bond prices remaining solid	28
Broadening investment channels could lift returns	30
Valuation & Trading: reaching entry point	32
Valuation summary	32
Trading at historical trough valuation	33
Performance against benchmarks since 2011 lows	35
Long-short ideas	36
Sector volatility, liquidity & momentum	37
Recommendations: identifying the up-swingers	39
China Life (2628.hk) - Goliath returns	40
China Pacific (2601.hk) - The preferred composite play	47
Ping An (2318.hk) - Multiple decelerations	54
China Taiping (966.hk) - An undervalued small-cap	62
New China Life (1366.hk) - Cheap for good reasons	39
Appendix I – Industry data	76
Disclosures	78



## Executive Summary – Presenting a sweet entry point

*We initiate with an OVERWEIGHT rating on China Insurance, based on five fundamental developments*

In our view, China Insurance has reached a sweet entry point. There are five fundamental developments in the industry, which lead to our conclusion. Firstly, Life industry has reached an inflection point in operations, and will recover from now. Secondly, P&C industry remains solid in underwriting performance, as revealed in 1H12 results. Thirdly, China Insurance will be blessed with multiple national policies. Fourthly, the overhang on solvency has been largely removed for the sector. Most importantly, China Insurance is situated at a cyclical sweet spot of investments. As a result, we initiate our research coverage on the sector with an OVERWEIGHT rating. In terms of stock recommendations, we recommend BUY on China Life, China Pacific and China Taiping, SELL on Ping An and HOLD on New China Life. China Life and China Pacific are our top picks at present.

*Reviving VNB growth in 2H12, resuming uptrend in EV, A&H products fueling growth, the game changer of tax deferred pension products*

### Life reaching an inflection point

In our opinion, Life insurance has reached an inflection point, for both the share price performance and fundamentals. Firstly, as revealed in 1H12 results, sector premium sales and value of new business (VNB) have been bottoming out. We expect Life insurers to continue pursuing a strategy of ‘margin over volume’ and bring about a mild recovery of VNB in 2H12. Secondly, Life embedded values (EV) resumed a sharp uptrend in 1H12, following the sector-wide decline reported in 2011. Thirdly, accident & health (A&H) products begin to flourish and outgrow the mainstream life products. These products can fuel the sector premium growth going forward. Lastly, we view the recently advocated tax deferred pension products as the game changer to Life industry in China. We forecast the product to help expanding the Life market size by over 10% p.a.

*P&C premium growth stabilized, new sales channels emerging, defensive underwriting margins, rising contribution from non-motor*

### P&C remaining solid

As revealed in 1H12 results, P&C industry remains solid in operations. We expect P&C insurers to maintain its resilient performance going forward. Firstly, P&C premium growth stabilized in 1H12. Industry premium growth re-accelerated to 14.7% YoY, from 3.9% YoY in Jan 2012. Secondly, new sales channels have been emerging and these help offsetting the dropping premium sales from traditional agency and car dealership channels. Thirdly, to the surprise of market, underwriting margins remained resilient and defensive in 1H12. Thanks to the lack of major natural disasters and better expense control by P&C insurers. Fourthly, we are aware of the rising contribution from non-motor insurance lines during the half. P&C insurers can hence enjoy a better balance of growth going forward. However, we note that the industry is still haunted by the pricing liberalization of commercial auto insurance, and the loss-making compulsory auto insurance.

*Medicare reform fueling health sales, the game changer of tax deferred pension products, agricultural insurance blessed by ‘Sannong’ policy, Broadening investment channels by CIRC*

### Complimentary national policies

Currently, China Insurance is blessed with several complimentary national policies. Firstly, Medicare reform will help driving health premium sales going forward. In fact, health premium sales outgrew normal life product sales over the past 18 months. Secondly, as discussed, tax deferred pension products could be the game changer of Life industry. Per our analysis, Life insurers can enjoy an average increment of 11.1% in First Year Premiums (FYP) because of the new product. Thirdly, agricultural insurance is aligning with the policy of ‘Sannong’ advocated in the 12<sup>th</sup> five year plan. Lastly,



CIRC announced further deregulation on insurance fund investments since Jan 2012. In future, Chinese insurers may achieve higher and more stable investment returns, through more diversified investment channels.

### Ample solvency

*Sub-debt issuance lifting solvency, slower capital consumption, less investment markdowns*

We believe that the solvency concern on China Insurance is behind us. Firstly, Chinese insurers have resorted to the issuance of subordinated debts for lifting solvency since early 2012. Other than Taiping Life, all listed Chinese insurers have room for further sub-debt issuance. Secondly, we believe Chinese insurers will consume capital in a slower pace, in respect to a limited growth in premiums. Lastly, with the bottoming of A-share markets, we expect less investment markdowns for the sector. That said, actual solvency of Chinese insurers may not suffer from further mark-to-market declines.

### At a cyclical sweet spot of investments

*A-share markets close to its cyclical bottom, favorable bond prices, broadening investment channels by CIRC*

In our view, Chinese insurers are currently situated at a cyclical sweet spot in investments. Firstly, we believe A-share markets should be close to its cyclical bottom after the resumption of PBOC rate cut cycle. Secondly, the prices of corporate bonds and financial bonds continue to generate higher return year to date in 2012. Such trend will bring a positive impact to book values and EV of Chinese insurers in 2012. Thirdly, as mentioned, Chinese insurers will benefit from the new policies of broadening investment channels by CIRC. To sum, we expect Chinese insurers to report higher gross investment yields, due to minimal mark-to-market losses on both equity and bond investments, in 2012-14E.

### Valuation & Trading: reaching retry points

*Sector trading at a historical low valuation, considerable upside for Chinese insurers*

In our view, China Insurance has reached a sweet entry point. Chinese insurers are trading at historical low valuations. The average 2012E and 2013E PEV of sector are 1.21x and 1.07x respectively, compared with an all-time average of 2.20x. We estimate the average return on EV, or EVPS growth, of Chinese insurers will reach 21.5% YoY in 2012E and 14.1% YoY in 2013E. We consider these growth rates promising by the standard of developing insurance markets. Currently, the sector is trading at 3.1x 2012E and 0.6x 2013E VNB. In our opinion, this is reflecting a low market expectation towards the VNB growth of Chinese insurers going forward. We estimate the sector to grow VNB at 0.6% YoY in 2012E and 1.9% YoY in 2013E. Based on these assumptions, we value the sector with an average EVPS growth of 17.8% per annum. Applying a 15.1% discount rate, derived from a CAPM, we conclude a fair sector valuation of 1.20x 2013F PEV. As such, we believe that valuation upside from here is still considerable for Chinese insurers.

### Recommendations: identifying the up-swingers

In terms of stock picks, we identify based on the swing factors in the company fundamentals. Our top picks are China Life and China Pacific. Our top sell is Ping An. On the other hand, we recommend BUY on China Taiping and HOLD on New China Life. Our rationale is as follows:



CH INS: Stock Recommendations

**China Life (2628.hk), BUY, TP: HK\$26.45**

**Investment positives**

A winner in the margin game  
Volume downtrend reversing  
EV sensitive to investment upturn  
Ample solvency  
Anchor index stock

**'Goliath returns'**

**Investment concerns**

Losing market shares  
Not as high EV operating margins

**China Pacific (2601.hk), BUY, TP: HK\$27.93**

**Investment positives**

The earliest turnaround in Life  
Most balanced Composite play  
First beneficiary of tax deferred pension products  
Ample solvency

**'The preferred composite play'**

**Investment concerns**

EV insensitive to investment upturn  
Lowest EV operating margins  
Overhang from share placements

**Ping An (2318.hk), SELL, TP: 58.04**

**Investment concerns**

A loser in the margin game  
Volume weakness continues  
Owning a Joint Stock Bank  
Securities & Trust trending down  
Inadequate solvency

**'Multiple decelerations'**

**Investment positives**

Resilient performance of P&C  
Anchor index stocks

**China Taiping (966.hk), BUY, TP: HK\$13.42**

**Investment positives**

Reinsurance recovery at sight  
P&C returning to underwriting profits  
Attractive valuation  
EV sensitive to investment upturn

**'An undervalued small-cap'**

**Investment concerns**

Life under margin pressure  
Limped by small-cap status  
Inadequate solvency

**New China Life (1336.hk), HOLD, TP: HK\$24.85**

**Investment positives**

Trading at a low valuation  
Potential entry to MSCI China-H Index  
High EV operating margins

**'Cheap for good reasons'**

**Investment concerns**

With the lowest NBM  
Volume weakening  
EV insensitive to investment upturn

Source: Bloomberg, Company data, ABCI Securities

CH INS: Sector valuation summary

Name	China Life			Ping An			China Pacific			New China Life			China Taiping		
	2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E
Stock code	2628.hk			2318.hk			2601.hk			1336.hk			966.hk		
Share Price (HK\$)	22.40			58.60			23.45			24.85			12.18		
ABCI Rec.	BUY			SELL			BUY			HOLD			BUY		
Target Price (HK\$)	26.45			58.04			27.93			24.85			13.42		
Upside / Downside (%)	18.08			(0.96)			19.08			(0.02)			10.20		
EVPS (HK\$)	12.61	15.17	17.24	36.24	44.59	51.14	16.08	18.99	21.07	19.14	23.87	27.62	9.96	12.09	13.97
YoY Growth (%)	0.37	20.23	13.64	15.65	23.04	14.68	5.39	18.11	10.98	(31.39)	24.71	15.72	7.78	21.38	15.52
VNB (HK\$)	0.87	0.89	0.92	2.67	2.45	2.47	0.93	0.93	0.98	1.70	1.83	1.83	0.69	0.70	0.69
YoY Growth (%)	4.02	2.02	3.90	10.33	(8.09)	0.94	12.45	(0.57)	5.97	(63.83)	7.17	0.30	28.22	2.26	(1.40)
NBM (APE basis - %)	33.86	38.00	37.00	40.67	37.00	35.00	34.19	37.00	37.00	22.37	25.00	23.50	27.87	30.00	29.00
Gross Inv't Yield (%)	3.52	3.57	4.31	3.59	3.36	4.04	3.43	4.26	4.52	3.83	3.81	3.90	3.42	3.51	4.09
APE Growth (%)	(9.58)	(10.00)	5.00	(2.88)	0.00	5.00	(6.29)	(5.00)	7.00	(22.97)	(5.00)	5.00	(19.00)	(5.00)	2.00
PEV (x)	1.78	1.48	1.30	1.62	1.31	1.15	1.46	1.23	1.11	1.30	1.04	0.90	1.22	1.01	0.87
VNB (x)	11.25	8.15	5.60	8.38	5.71	3.02	4.26	0.92	(1.60)	3.35	0.54	(1.51)	3.22	0.13	(2.57)
PER (x)	28.37	21.60	17.07	19.56	14.74	12.98	19.93	20.06	18.74	16.43	18.34	14.54	42.03	15.38	12.60
PBV (x)	2.21	1.88	1.71	2.22	1.87	1.64	2.58	2.11	2.00	2.03	1.69	1.48	1.83	1.41	1.20

Source: Bloomberg, Company data, ABCI Securities estimates



## Life reaching an inflecting point

*Sector reversed its underperformance against benchmarks since 1H12 results*

In our view, Life industry has reached an inflection point, for both the share price performance and fundamentals. Following a massive underperformance of Life insurers against relevant benchmarks in 2011, we have witnessed stabilization in their share prices since 1H12 results. In 2011, Life insurers traded down 38.0% in average, compared to 20.4% down of MSCI China and 20.0% down of HSI. Year to date in 2012, the sector slightly underperformed the overall markets (up 2.5% against 4.6% of MSCI China and 13.1% of HSI). However, we note that the weak trend has been reversing since the announcement of 1H12 results in late Aug. The sector traded up 4.1% in average, outperforming 1.4% up of MSCI China and 3.7% up of HSI.

*Sector fundamentals reached an inflection point, with bottoming VNB, rising EV, flourishing A&H sales and the game changing tax deferred pensions products*

We believe the reversal of sector performance was led by the bottoming-out of sector fundamentals. Firstly, as revealed in 1H12 results, sector premium sales and value of new business (VNB) have reached a trough. Life insurers will continue pursuing a strategy of 'margin over volume' and bring about a mild recovery of VNB in 2H12. Secondly, Life embedded values (EV) resumed a sharp uptrend in 1H12, following the sector-wide decline reported in 2011. Thirdly, accident & health (A&H) products begin to flourish and outgrow the mainstream life products. These products could fuel the sector premium growth going forward. Lastly, we view the recently advocated tax deferred pension products as a game changer to Life industry in China. We forecast the product to help expanding the market size by over 10% p.a.

## Bottoming premium sales & VNB

*Sector Life premiums resuming a mild growth*

According to CIRC, total Life premiums bottomed in 1H12. Life & Health premium sales totaled Rmb569.7bn in 1H12, up 2.4% YoY, and Rmb632.9bn year to Jul 2012, up 2.2% YoY. This contrasted the sharp downtrend in 2011. In 2011, Life & Health premium sales reported Rmb972.1bn, down 8.6% YoY. Such a weak trend was attributed to the more-stringent bancassurance regulations imposed by CIRC and tightened market liquidity during the same year. Nevertheless, the negative impact has been fading since early 2012. Worth to note, A&H premium sales continue to outgrow traditional life premiums, at 22.8% YoY in 1H12 and 22.1% YoY year to Jul in 2012. We expect this product line to fuel the future growth of Life premium sales.

*Standardized premiums may reverse its weak trend in 2Q12*

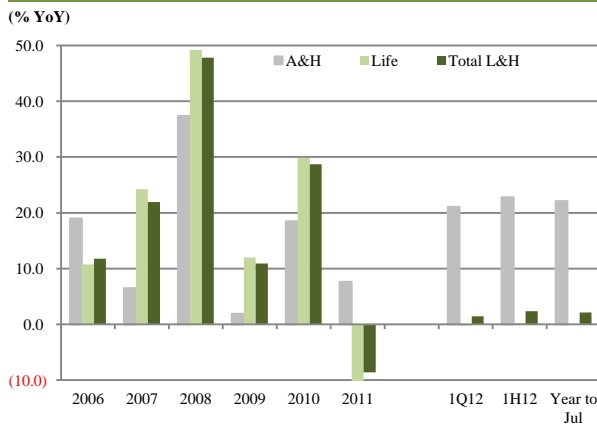
On the other hand, standardized premium growth hit its trough in 1Q12. Standardized premium is FYP adjusted by payment durations, which is released in a quarterly basis by CIRC. The industry growth reached a low at 0.9% YoY in 1Q12, compared to 5.1% YoY in 2011. This is mainly due to the fast-shrinking bancassurance sales in 1Q12. According to the management of Life insurers, bancassurance sales have been declining at a slower rate since 2Q12. They expect standardized premiums to resume a mild growth from 1H12 onwards. Also, dropping bancassurance sales may not have a material impact to insurers' VNB. Most insurers have migrated to the sales of high-margin critical illness / health products with long payment durations, and avoid the low-margin, volume-based single bancassurance products.

*'Margin over Volume'*

To conclude, we believe the sector premium sales have reached an inflection point. While the sales will remain stagnant, we believe the sector will no longer suffer from top-line decline in 2H12 and 2013. On one hand, this relieves the volume pressure on Life insurers. On the other hand, this helps to nurture the strategy of 'margin over volume'.



**CH INS: Total Life Premiums Growth (2006 – Jul 2012)**



Source: CIRC, ABCI Securities

**CH INS: Standardized Premiums Growth (1H11 - 1Q12)**

(% YoY)	1H11	2011	1Q12
China Life	3.8	(2.0)	(7.5)
Ping An Life	20.8	13.7	0.7
China Pacific Life	7.8	4.0	(1.0)
Taikang Life	(1.4)	3.3	16.1
New China Life	(5.5)	(4.8)	(10.4)
Taiping Life	(6.3)	(3.2)	10.6
Industry	10.9	5.1	0.9

Source: CIRC, Company data, ABCI Securities

**More regular FYP and higher NBM for Life insurers in 1H12**

‘Margin over volume’ becomes the prevailing strategy of Life insurers. In 1H12, all listed Life insurers reported improvement in New Business Margins (NBM) in FYP basis. Except for Ping An, all other listed Life insurers recorded higher NBM in APE basis. In our opinion, this is partly attributed to higher portion of regular FYP sales. Per company data, China Life, Ping An Life and China Pacific Life reported sequentially higher portions of regular FYP in 1H12. Regular FYP represents new premium sales embedding multiple premium payments, against single FYP with only one premium payment. The former carries higher NBM than the latter.

**China Life did the best in lengthening regular payment durations**

Currently, most Life insurers apply the tactics of lengthening payment durations of FYP, in order to improve NBM. China Life raised the portion of regular FYP with 5 years payments or above to 68% in 1H12, compared to 45% in 1H11. New China Life increased such portion to 89% in 1H12, compared to 80% in 1H11. China Pacific Life grew the portion of regular FYP with 10 years payment or above to 47.7% in 1H12, compared to 41.8% in 2011.

**China Life and China Pacific with good CI products**

Lastly, insurers launched new critical illness (CI) and health protection products throughout 1H12. These products are implanted with high protection element and NBM, as compared to mainstream participating products. China Life debuted Kang Ning critical illness in Apr 2012. Per our channel check, this product was a blockbuster, and contributed close to 10% of FYP in 1H12. New China Life introduced Xiang Rui Life, a bundled product with whole life and critical illness element, in Jun 2012. This was well received too, contributing 6-7% of FYP in the same month. Lastly, China Pacific Life sold its Hong Fa annuity product well in 1H12. This product was attached with a rider of critical illness and constituted close to 20% of FYP in 1H12. Ping An Life and Taiping Life were behind in the competition, without any successful CI products during the half.

**Expecting China Life and China Pacific to win in the new game**

To sum, Life insurers adapt well in the low volume environment. Most of them resorted to a margin strategy, focusing on raising portion of regular FYP, lengthening regular payment durations and increasing protection elements of products. Per our finding, China Life and China Pacific Life are leading in the new margin game. Both companies have product capability, yet room for further improvement in regular FYP mix. Meanwhile, Ping An could be the loser in this game, with a focus on universal product historically, and limited room for further improvement in FYP mix. In our view, Taiping Life is in a



similar situation. Lastly, we are cautious on New China Life. The insurer failed to deliver a substantial improvement in NBM, despite having applied right tactics, in 1H12. We are concerned with its product capability in future.

**CH INS: Regular FYP % of APE & FYP (2009 – 1H12)**

<u>Regular FYP/APE</u>	2009	2010	2011	1H12	VS 2011
China Life	77.3	79.1	80.6	83.4	UP
Ping An Life	88.1	91.9	92.6	95.5	UP
China Pacific Life	83.4	81.9	84.1	86.0	UP
New China Life	86.8	86.5	86.7	86.2	FLAT
Taiping Life	87.3	81.5	87.2	85.7	DN

<u>Regular FYP/FYP</u>	2009	2010	2011	1H12	VS 2011
China Life	25.4	27.4	29.4	33.5	UP
Ping An Life	42.6	53.0	55.7	68.2	UP
China Pacific Life	33.4	31.1	34.6	38.0	UP
New China Life	39.6	39.1	39.4	38.4	DN
Taiping Life	40.8	30.6	40.6	37.5	DN

Source: CIRC, Company data, ABCI Securities

**CH INS: New Business Margins [NBM] (2009 - 1H12)**

<u>NBM (APE Basis)</u>	2009	2010	2011	1H12	VS 2011
China Life	34.5	30.1	33.9	38.0	UP
Ping An Life	35.3	35.3	39.5	35.2	DN
China Pacific Life	32.7	29.6	34.8	36.9	UP
New China Life		18.7	22.4	23.3	UP
Taiping Life	19.5	19.7	26.5	31.9	UP

<u>NBM (FYP Basis)</u>	2009	2010	2011	1H12	VS 2011
China Life	11.3	10.4	12.4	15.3	UP
Ping An Life	18.2	20.4	23.7	27.3	UP
China Pacific Life	13.1	11.3	14.3	16.3	UP
New China Life		8.5	10.2	10.4	UP
Taiping Life	9.1	7.4	12.3	13.3	UP

Source: CIRC, Company data, ABCI Securities

**Bottoming sector VNB, due to slower decline in new sales and continuous margin improvement**

As discussed, we applaud for the VNB growth reported by China Life and China Pacific, regardless of sharp FYP declines in 1H12. In the meantime, Taiping Life recorded VNB growth also but only because of the change of actuarial assumptions. Ping An Life reported a YoY decline of 8.6% in VNB, the worst among peers. New China Life recorded a YoY decline of 1.4% in VNB, due to weaker-than-peers improvement in NBM. After all, we render the sector FYP has been bottoming out, for a sector-wide decline in FYP during 1H12. With a slower fall in bancassurance sales, FYP decline could tame in 2H12. In our opinion, by applying ‘margin over volume’ strategy, the sector could resume VNB growth in 2H12 and 2013. At present, we feel more positive on China Life and China Pacific Life.

**CH INS: First Year Premiums [FYP] (2009 – 1H12)**

<u>FYP (Rmb mn)</u>	2009	2010	2011	1H12
China Life	156,156	190,252	163,523	81,824
Ping An Life	64,984	76,050	70,917	33,502
China Pacific Life	38,147	54,186	46,936	24,942
New China Life	44,769	55,966	42,863	22,523
Taiping Life (HK\$ mn)	14,879	24,752	18,202	9,679

<u>(% YoY)</u>	2009	2010	2011	1H12
China Life	(5.6)	21.8	(14.0)	(26.4)
Ping An Life	43.1	17.0	(6.7)	(28.1)
China Pacific Life	32.8	42.0	(13.4)	(17.8)
New China Life	27.8	25.0	(23.4)	(6.6)
Taiping Life	(0.7)	66.4	(26.5)	(8.7)

Source: CIRC, Company data, ABCI Securities

**CH INS: Value of New Business [VNB] (2009 – 1H12)**

<u>VNB (Rmb mn)</u>	2009	2010	2011	1H12
China Life	17,713	19,839	20,199	12,494
Ping An Life	11,805	15,507	17,343	9,160
China Pacific Life	4,915	5,996	6,599	4,061
New China Life		4,741	4,360	2,338
Taiping Life (HK\$ mn)	1,353	1,827	2,244	1,283

<u>(% YoY)</u>	2009	2010	2011	1H12
China Life	27.2	12.0	1.8	2.5
Ping An Life	38.2	31.4	11.8	(8.6)
China Pacific Life	36.9	22.0	10.1	6.0
New China Life			(8.0)	(1.4)
Taiping Life	56.4	35.0	22.8	2.4

Source: CIRC, Company data, ABCI Securities

**Embedded value resuming uptrend**

**Reviving investment markets together with EV operating profits**

The resumption of Embedded Value (EV) uptrend is another sign of turnaround for Life insurers. In 1H12, Life insurers’ EV went up by 7.3% - 15.8% HoH, following a weak sequential growth of EV in 2011. In our opinion, such growth was to a large extent driven by the stabilized A-share markets and rising bond prices in 1H12. Also, Life insurers are running at lucrative EV operating margins, subject to the current actuarial assumptions.





*Benefited from improving equity and bond prices in 1H12*

Shanghai Composite Index recovered mildly by 1.1% and CSI 300 rose by 4.9% in 1H12. Meanwhile, per our estimates, 5 year government bond price rose by 1.0% for a 25bps yield compression, and 2 year government bond price rose by 0.9% for a 49bps yield compression. Financial bonds' aggregate return increased by 2.0% and corporate bonds' jumped by 5.9% during the same half. Life insurers held 7.4% - 12.7% of investment portfolio in equities and 42.4% - 65.6% in bonds.

*All Life insurers reported lower AFS reserve deficits*

In average, Life insurers classified 80% - 90% of equities and 50% - 60% of bonds as available-for-sale (AFS) securities. Therefore, better investment returns led to smaller deficits in AFS reserves, and hence increments to the book values and EV of Life insurers. In 1H12, the fair value gains from AFS securities ranged from Rmb1.6bn to Rmb11.7bn for the big four Life insurers. Their book values increased by 6.4% - 12.1% HoH. This resulted in a sharp rise in EV for Life insurers during the same half.

**CH INS: Available-for-sale reserves (2010 - 1H12)**

<u>AFS Reserves (Rmb mn)</u>	2010	2011	1H12	VS 2011
China Life	(16,203)	(24,205)	(12,503)	Lower deficit
Ping An Life	(175)	(14,412)	(8,367)	Lower deficit
China Pacific Life	(2,098)	(10,883)	(5,561)	Lower deficit
New China Life	845	(2,848)	(1,871)	Lower deficit
China Taiping (HK\$ mn)	489	(1,275)	(456)	Lower deficit
<u>Fair value gain / loss on AFS (Rmb mn)</u>				
China Life	(13,666)	(45,576)	11,702	Fair value gain
Ping An Life	(6,218)	(18,638)	8,318	Fair value gain
China Pacific Life	(4,242)	(11,899)	7,202	Fair value gain
New China Life	1,332	(10,474)	1,618	Fair value gain
China Taiping (HK\$ mn)	1,169	(5,074)	632	Fair value gain

Source: Company data, ABCI Securities

**CH INS: Book Values (2010 - 1H12)**

<u>Book value (Rmb mn)</u>	2010	2011	1H12
China Life	208,710	191,530	213,473
Ping An	112,030	130,867	146,762
China Pacific	80,297	76,796	81,748
New China Life	6,567	31,306	34,934
China Taiping (HK\$ mn)	12,712	11,435	12,966
<u>(% YoY)</u>			
China Life	(1.1)	(8.2)	11.5
Ping An	31.8	16.8	12.1
China Pacific	7.6	(4.4)	6.4
New China Life	55.0	376.7	11.6
China Taiping	23.5	(10.1)	13.4

Source: Company data, ABCI Securities

*Estimating Life EV growth at 18.1% - 24.7% YoY in 2012E*

Currently, Life insurers run at lucrative EV operating margins. Such margins represent the percentage of profits on EV yielded from expected investment return and VNB, as per actuarial assumptions. In 2011, Ping An Life, New China Life and Taiping Life reported the margins at over 20%. China Life and China Pacific recorded lower, yet attractive, margins of 15.9% and 11.7% respectively. Coupled with rising book values, they reported EV growth of 7.3% - 15.8% HoH in 1H12. Assuming minimal investment markdowns, we forecast Life insurers to report EV growth of 18.1% - 24.7% YoY in 2012E.

**CH INS: Embedded Values [EV] (2009 - 1H12)**

<u>Group EV (Rmb mn)</u>	2009	1H10	2010	1H11	2011	1H12
China Life	285,229	278,441	298,099	296,493	292,854	334,326
Ping An	155,258	184,338	200,986	233,966	235,627	259,005
China Pacific	98,371	104,723	110,089	110,008	113,564	121,833
New China Life			28,085	42,322	48,991	56,150
China Taiping (HK\$ mn)	11,834	12,522	15,731	17,500	17,074	19,780
<u>(% HoH)</u>						
China Life		(2.4)	7.1	(0.5)	(1.2)	14.2
Ping An		18.7	9.0	16.4	0.7	9.9
China Pacific		6.5	5.1	(0.1)	3.2	7.3
New China Life				50.7	15.8	14.6
China Taiping		5.8	25.6	11.2	(2.4)	15.8

Source: Company data, ABCI Securities

**CH INS: EV Operating Margins (2011)**

<u>(Rmb mn)</u>	China Life	Ping An Life	China Pacific	New China Life	Taiping Life
Beginning EV	298,099	121,086	110,089	28,383	17,511
Expected return	27,781	12,248	7,254	3,858	2,244
New business contribution	20,199	17,343	6,714	4,681	1,548
Economic assumption Chg	(584)	(1,050)	(1,080)	285	1,400
Others	(52,641)	(5,227)	(9,413)	12,083	(1,129)
Ending EV	292,854	144,400	113,564	49,290	21,574
EV operating profits	47,396	28,541	12,888	8,824	5,192
% of end EV	16.2	19.8	11.3	17.9	24.1
<b>% of beg EV (Op. Margins)</b>	<b>15.9</b>	<b>23.6</b>	<b>11.7</b>	<b>31.1</b>	<b>29.7</b>

Source: Company data, ABCI Securities



### Accident & Health products fueling growth

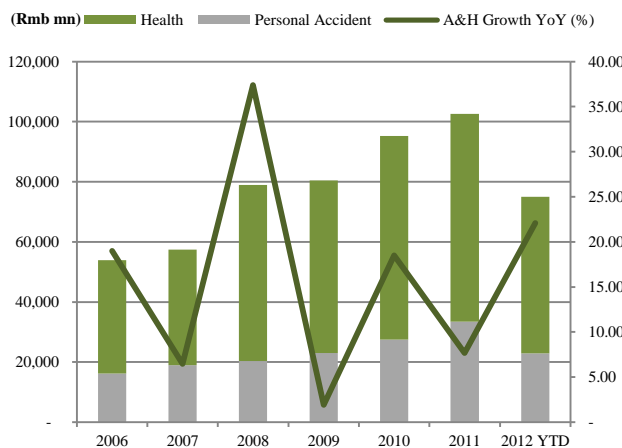
*A&H products continued to outgrow normal life products*

While the mainstream participating products suffered from stagnant sales over the past 18 months, we believe accident & health (A&H) products can help fueling the future growth of Life industry. As of 2011, A&H premiums constituted 11.8% of total life premiums. More importantly, A&H premiums continuously outgrow normal life premiums. Year to Jul in 2012, A&H premiums reached Rmb61.4bn, up 22.1% YoY. This is compared to flattish YoY for normal life premiums. In a very difficult year of 2011, A&H premiums managed to rise by 7.7% YoY, compared to a 8.6% YoY drop of normal life premiums. With mounting public concern towards health and critical illness coverage, we believe such products can further flourish.

*Most Life insurers delivered double digit growth YoY in A&H products for 1H12*

Other than critical illness products discussed above, Life insurers are pushing hard on short term A&H products in the market. In 1H12, Ping An Life, China Pacific Life and New China Life delivered double digits YoY growth in A&H premiums. China Life recorded a slower growth of 3.5% YoY. Meanwhile, A&H products contributed 10% - 12% FYP to Life insurers. On the other hand, all Life insurers reported YoY declines in normal life FYP during the same half. Therefore, we regard these products one of the future growth drivers for Life insurers.

CH INS: Accident & Health [A&H] (2006 – 2012 YTD)



Source: CIRC, Company data, ABCI Securities

CH INS: A&H sales by insurers (2009 – 1H12)

(Rmb mn)	2008	2009	2010	2011	1H12
China Life	12,725	13,194	14,975	15,802	8,623
Ping An Life	5,421	5,938	6,203	7,126	4,555
China Pacific Life	2,838	3,336	4,106	4,613	2,714
New China Life	3,224	4,191	5,022	6,121	3,670

(% YoY)	2009	2010	2011	1H12
China Life	3.7	13.5	5.5	3.5
Ping An Life	9.5	4.5	14.9	13.8
China Pacific Life	17.5	23.1	12.3	10.3
New China Life	30.0	19.8	21.9	22.2

Source: Company data, ABCI Securities

### Tax deferred pension product the game changer

*Tax deferred pension product to pilot in Shanghai in late 2012*

As declared by Chen Wenfei, the Vice-chairman of CIRC in Jul 2012, CIRC is planning a pilot program of individual deferred tax pension products in Shanghai. Per China Security Journal on 6 Jul 2012, the program may debut towards end-2012. Accordingly, Life insurers will be permitted to issue new participating and universal life products embedded with deferred-tax features. At the initial stage, the tax-deferred limit will be set at Rmb1,000 per month, with Rmb700 cap on personal tax and Rmb300 cap on corporate tax.

*Huge pension deficit to fill in China*

Such products are designed to fill the huge national pension deficit in China. In 2011, there are 185mn persons, or 13.7% of population, exceeding the age of 65 in the country. The asset balance of NSSF was Rmb867bn (US\$138bn), or Rmb4,686 per each aged citizen. This is compared to US\$7 tn of pension assets in USA. This product may become a game changer to Life industry.



*Fast growth of assets and contributions of 401K historically*

401K is one of the major taxed-deferred retirement plans of USA. The plans were designed to be offered through corporates. The program came into effect in Jan 1980. By 1984, half of the large US corporates were either offering or considering offering 401k plans to their employees. We extract the data of 401K from 1985 to 1996 for our analysis. Based on our findings, the planned assets and contributions grew at CAGRs of 19.9% and 14.3% respectively during the period. More importantly, with its deferred tax nature, 401K plans became more and more important over time. The portion of contributions to 401K plans constituted 74% of those to all private retirement plans in 1996, compared to 46% in 1985. Therefore, referring to the history of 401K, we conclude that tax deferred pension or retirement products could meet with high market demand in China.

**United States: 401K assets and pension contribution (1986-1996)**

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	CAGR (%)
Number of 401K plans	29,869	37,420	45,054	68,121	83,301	97,614	111,314	139,704	154,527	174,945	200,813	230,808	20.4
Active participants ('000)	10,339	11,559	13,131	15,203	17,337	19,548	19,126	22,404	23,138	26,206	28,061	30,843	10.4
Assets (US\$ bn)	144	183	215	277	357	385	440	553	616	675	864	1062	19.9
Contributions (US\$ bn)	24	29	33	39	46	49	52	64	69	76	87	104	14.3
Benefits (US\$ bn)	16	22	22	25	31	32	33	43	44	51	62	78	15.5
<b>% of total private plans</b>													<b>Ppt increment</b>
Assets	34	37	41	47	52	54	53	58	58	62	65	64	31
Contributions	46	50	53	61	63	65	64	69	68	72	74	74	28
Benefits	35	35	40	43	47	51	51	58	57	62	64	64	29

Source: US bureau of labor, company data, ABCI Securities

*Maximum 51.9% of market expansion in Shanghai*

In accordance to our sensitivity analysis, the pilot program of tax deferred products could add a maximum of Rmb27bn life premiums in Shanghai. In 2011, there is a population of 23 mn and working population of 13 mn in the city. Annual salary per employee reached RMB51,984. If we assume 20% of working population to contribute 20% of annual salary to tax deferred products, the additional premiums could reach Rmb27bn, or 51.9% of total L&H premiums. By applying conservative assumptions of only 5% of working population to contribute 5% of annual salary to tax deferred products, the additional premiums were Rmb1.7bn, or 3.2% of total L&H premiums. While we forecast the level participation and contribution to be mild in the beginning, subsequent growth could be exponential.

**CH INS: Est. new premiums from tax deferred products in Shanghai**

Population (mn)	23.0	(including 9mn migrant workers)
Working population (mn)	13.0	(Shanghai Statistics Yearbook)
Annual salary / employee (Rmb)	51,984	(Shanghai Statistics Yearbook)
L&H insurance market (Rmb bn)	52.0	(CIRC - Life: Rmb45.4bn, A&H: Rmb6.6bn)

**5% salary equivalent annual contribution**

% of participation by working population	5.0	10.0	15.0	20.0
Add'l deferred-taxed premiums (Rmb bn)	1.7	3.4	5.1	6.7
% of 2011 L&H insurance market	3.2	6.5	9.7	13.0

**10% salary equivalent annual contribution**

% of participation by working population	5.0	10.0	15.0	20.0
Add'l deferred-taxed premiums (Rmb bn)	3.4	6.7	10.1	13.5
% of 2011 L&H insurance market	6.5	13.0	19.5	25.9

**15% salary equivalent annual contribution**

% of participation by working population	5.0	10.0	15.0	20.0
Add'l deferred-taxed premiums (Rmb bn)	5.1	10.1	15.2	20.2
% of 2011 L&H insurance market	9.7	19.5	29.2	38.9

**20% salary equivalent annual contribution**

% of participation by working population	5.0	10.0	15.0	20.0
Add'l deferred-taxed premiums (Rmb bn)	6.7	13.5	20.2	27.0
% of 2011 L&H insurance market	13.0	25.9	38.9	51.9

Source: Shanghai Statistics Yearbook, CIRC, ABCI Securities estimates



*FYP could increase by 11.1% in average because of the new pension products*

Assuming a nationwide roll-out of tax deferred pension products, we forecast Life insurers to expand FYP by 9.4% - 12.3% p.a. In 2011, there is a population of 1.3bn and working population of 764mn in China. Annual salary per employee reached RMB27,909. By applying conservative assumptions of the participation by 5% working population contributing 5% of annual salary, the additional premiums could reach Rmb53.3bn, or 5.6% of L&H market. If the additional premiums are obtained by top players in reference to market shares, FYP can grow by 11.1% in average for Life insurers.

**CH INS: Est. new premiums from tax deferred products to insurers**

Population (mn)	1,341				
Working population (mn)	764				
Annual salary / employee (Rmb)	27,909				
L&H insurance market (Rmb bn)	956				
% of participation by working population	5.0	10.0	15.0	20.0	
Add'l deferred-taxed premiums (Rmb bn)	53.3	106.6	159.9	213.2	
% of 2011 L&H insurance market	5.6	11.2	16.7	22.3	
<b>Impact on major Life insurers</b>					
	TWP (Rmb bn)	FYP (Rmb bn)	Market Share	Est. add'l Premiums	% of FYP
China Life	318	164	33.3	17.75	10.9
Ping An Life	119	71	12.4	6.63	9.4
China Pacific Life	93	47	9.7	5.20	11.1
New China Life	95	43	9.9	5.29	12.3
Taiping Life	31	15	3.3	1.75	11.9

Source: NBS, Company data, ABCI Securities estimates

*Ping An the market leader in corporate annuity payments*

At present, China Life, Ping An, China Pacific and China Taiping have their corresponding subsidiaries in the business of corporate annuity. In our view, corporate annuity products are complementary to the new tax-deferred pension products. In 1H12, Ping An Annuity has the largest market share in corporate annuity market, with Rmb17.0bn payments. The corporate annuity payments to Ping An were equivalent to 50.8% of FYP during the same half. This is followed by Rmb14.5bn of China Life, Rmb2.8bn of Taiping and Rmb1.7bn of China Pacific.

*China Pacific to benefit first from tax deferred pension products*

In terms of entrusted pension assets, China Life has the biggest market share of 38.2%. In 1H12, China Life was entrusted with Rmb65.8bn, followed by Rmb50.8bn of Ping An, Rmb29.4bn of China Pacific and Rmb21.2bn of Taiping. All listed Life insurers, except for New China Life, have corporate annuity arms and well set for the new tax deferred product markets. China Pacific will benefit the first, with Changjiang Pension as the market leader in Shanghai, where the pilot program of tax deferred products is implemented.

**CH INS: Corporate annuity payments (2009 – 1H12)**

(Rmb mn)	2009	2010	2011	1H12
China Life Annuity	9,408	17,362	20,686	14,528
Ping An Annuity	9,579	10,235	9,575	17,033
China Pacific Annuity	2,583	3,269	3,623	1,670
Taiping Annuity	3,579	3,821	5,507	2,783
Taikang Annuity	1,210	1,057	1,654	1,403
Total	26,360	35,744	41,047	37,418
<b>% of Life FYP</b>				
	2009	2010	2011	1H12
China Life Annuity	6.0	9.1	12.7	17.8
Ping An Annuity	14.7	13.5	13.5	50.8
China Pacific Annuity	6.8	6.0	7.7	6.7
Taiping Annuity	21.1	13.0	25.0	23.4

Source: Company data, ABCI Securities

**CH INS: Entrusted pension assets (2009 - 1H12)**

(Rmb mn)	2009	2010	2011	1H12
China Life Annuity	13,775	31,895	51,335	65,764
Ping An Annuity	20,372	29,807	37,400	50,794
China Pacific Annuity	24,688	26,038	27,258	29,438
Taiping Annuity	10,457	13,918	17,990	21,201
Taikang Annuity	1,507	2,257	3,835	5,071
Total	70,800	103,914	137,818	172,268
<b>(% YoY)</b>				
		2010	2011	1H12
China Life Annuity		131.5	60.9	55.0
Ping An Annuity		46.3	25.5	51.7
China Pacific Annuity		5.5	4.7	14.3
Taiping Annuity		33.1	29.3	29.2
Taikang Annuity		49.8	69.9	44.5
Total		46.8	32.6	41.7

Source: Company data, ABCI Securities



## P&C remaining solid

*P&C remained solid, against the earlier market expectation*

Property and casualty (P&C) industry was perceived to face both volume and margin pressure in early 2012. The market expected P&C to peak off in 2011. The industry could suffer from slower premium sales, indirectly resulted from weaker car sales, and higher combined ratios in 2012. Nevertheless, as revealed in 1H12 results, P&C industry remained solid in China. We expect P&C insurers to continue its resilient performance going forward.

*Further resilience by P&C, due to stabilizing premium sales, newly emerging sales channels, defensive underwriting margins and increasing contribution from non-motor*

Firstly, albeit growing at a slower rate YoY, P&C premiums stabilized in 1H12. Industry premium growth re-accelerated to 14.7% YoY, from 3.9% YoY in Jan 2012. Most listed P&C insurers maintained a double digit YoY growth in premiums for 1H12. Secondly, new sales channels have been emerging and these help offsetting the lost premium sales from traditional agency and car dealership channels. Thirdly, to the surprise of market, underwriting margins remained defensive in 1H12. Thanks to the lack of major natural disasters and better expense control by P&C insurers. Fourthly, we are aware of the rising contribution from non-motor business. As such, P&C insurers can hence enjoy a better balance of growth. However, we note that the industry is still haunted by the pricing liberalization of commercial auto insurance, and the loss-making compulsory auto insurance.

## Stabilizing premium sales

*Sharp decline in car sales for Jan 2012*

In Jan 2012, P&C industry experienced a slow growth in premiums (3.9% YoY), along with a sharp decline in passenger car sales (-24% YoY) in China. Such a slowdown was extended from 2H11. In 2011, passenger car sales grew by merely a 2.6% YoY. In the same year, motor insurance contributed 73.5% - 78.0% of P&C insurers' premiums. Therefore the market viewed this as a worrying sign to the industry as a whole.

*Car sales re-accelerated since 2Q12*

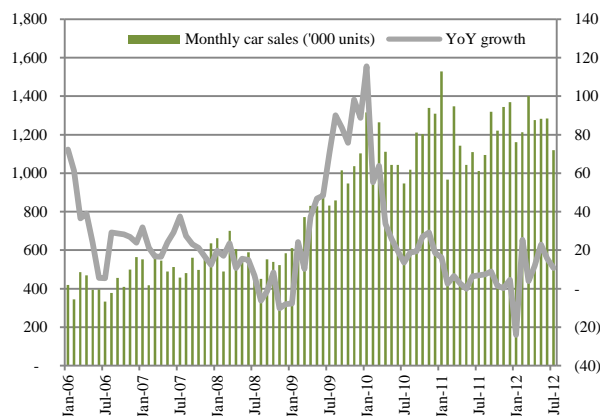
Nevertheless, passenger car sales recovered rapidly from Mar 2012 onwards. The monthly passenger car sales rose 15.8% YoY in Jun 2012. Such growth far exceeded a 2.6% YoY growth in 2011. More importantly, passenger car sales may climb further in light of the new policy 'Motors to Rural Area'. Accordingly, rural residents could receive financial subsidy up to a maximum of Rmb5,000, or 10% of car purchase price, for buying any passenger cars built-in with an engine of 1.3cc or below. In our view, this will serve as a major driver of motor premiums towards end 2012.

*Most P&C insurers maintained a double digit premium growth in 1H12*

As revealed in 1H12 results, most P&C insurers maintained a double digit YoY growth in P&C premiums. Ping An P&C grew P&C premiums by 19.5% YoY, followed by 10.7% of market leader and 9.2% of China Pacific P&C. Taiping Insurance grew premiums by 26.1% YoY. But this is not an indicative read-across to the industry, due to its small market share of only 1.3%. While the big three reported a slower YoY growth than that in 2011, they managed to maintain a double digit growth. In our opinion, this is attributable to the recovery of passenger car sales and emerging of new sales channels. We forecast P&C insurers to grow premiums at a rate of 10% - 15% in 2012E and 2013E.



CH INS: passenger car monthly sales (2006 – 2012 YTD)



Source: Bloomberg, Company data, ABCI Securities

CH INS: P&C gross premiums by insurers (2008 - 1H12)

(Rmb bn)	2008	2009	2010	2011	1H12
Market leader	101,878	119,771	154,307	173,962	101,192
Ping An P&C	27,014	38,774	62,507	83,708	48,914
China Pacific P&C	27,924	34,344	51,682	61,755	35,246
Taiping Insurance	4,261	4,500	5,349	5,801	3,661

(% YoY)	2009	2010	2011	1H12	
Market leader		17.6	28.8	12.7	10.7
Ping An P&C		43.5	61.2	33.9	19.5
China Pacific P&C		23.0	50.5	19.5	9.2
Taiping Insurance		5.6	18.9	8.4	26.1

Source: Company data, ABCI Securities

### New sales channels emerging

#### Alternate sales channel for auto insurance products

We partly attribute the resilient P&C premium sales to the emerging new sales channels. New sales channels include telemarketing, internet marketing and mobile marketing. These channels were set up primarily for supplementing traditional sales channels of auto insurance, such as sales agents and car dealerships. With better use of technology, these channels are more cost effective. Needless to say, they are rising in importance as key distribution channels for P&C insurers.

#### Rising sales contribution from the new channels

As of 1H12, Ping An P&C achieved premium sales of Rmb15.3bn through the new sales channels, up 31.7% YoY. China Pacific P&C obtained premium sales of Rmb5.8bn through these channels, up 94.5% YoY. These channels are growing in sales contribution rapidly. 31.4% of Ping An P&C premiums were derived from these channels, versus 16.3% of China Pacific P&C. At the same time, market leader reported premium sales of Rmb12.5bn through these channels in 2011. This represented a growth of 245% YoY. The sales contribution was still small, at 7.2%. With an increasing focus towards young customers, we anticipate these channels to continue rising in sales contributions going forward.

CH INS: New sales channels by insurers (2009 – 1H12)

(Rmb bn)	2009	2010	2011	1H12
Market leader	401	3,610	12,450	NA
Ping An P&C	12,297	12,608	22,190	15,361
China Pacific P&C	NA	2,252	7,366	5,756

(% YoY)	2010	2011	1H12
Market leader	800.0	244.9	
Ping An P&C	2.5	76.0	31.7
China Pacific P&C		227.1	94.5

(% of ttl. P&C)	2009	2010	2011	1H12
Market leader	0.3	2.3	7.2	NA
Ping An P&C	31.7	20.2	26.5	31.4
China Pacific P&C	NA	4.4	11.9	16.3

Source: Company data, ABCI Securities



## Defensive underwriting margins

*Improving sector combined ratios in 1H12*

To the surprise of market, P&C insurers continued to deliver good underwriting performance. Thanks to the lack of major natural disasters and better expense control by insurers year to date in 2012. Except for China Pacific P&C, all listed P&C insurers recorded an improvement in combined ratios and underwriting margins in 1H12.

*Big three P&C insurers maintained underwriting margins at 5.6% - 7.6% in 1H12*

Market leader reported combined ratios of 92.4%, with an improvement of 1.4ppt HoH. This is followed by 93.1% of Ping An P&C and 94.4% of China Pacific P&C. In 1H12, market leader enjoyed the widest underwriting margins of 7.6%, followed by 6.9% of Ping An P&C and 5.6% China Pacific P&C. Market leader enjoyed a big improvement in claim ratios, due to an improved IT and risk based pricing platform. While Ping An P&C and China Pacific P&C remained resilient in claim ratios, they achieved improvements primarily from better expense control. Thanks for a rising sales contribution from the cost-effective new sales channels.

*Big three P&C insurers achieved an average ROE of 23.3% in 1H12*

In terms of underwriting, market leader achieved a record-breaking profit of Rmb5.6bn, compared to Rmb4.9bn in 1H11. In 1H12, market leader achieved an underwriting profits equivalent to 70.0% of that in 2011. Ping An P&C recorded underwriting profit of Rmb2.6bn, or 63.4% of that in 2011. China Pacific underperformed major peers, with only Rmb1.5bn in underwriting profit, representing 48.4% of that in 2011. After all, this is still promising with an attractive margin of 5.6%. Per our estimates, the big three P&C insurers obtained an annualized ROE of 23.3% in 1H12. We consider this lucrative. Accordingly, we expect the average ROE of P&C insurers to stay beyond 20% in 2012E and 2013E.

### CH INS: Combined ratios by insurers (2008 – 1H12)

Combined	2008	2009	2010	2011	1H12
Market leader	103.3	102.2	97.8	94.0	92.4
Ping An P&C	104.4	98.7	93.4	93.6	93.1
China Pacific P&C	102.9	98.3	94.1	93.3	94.4
Taiping Insurance	102.0	104.8	102.1	99.9	98.0
Claim	2008	2009	2010	2011	1H12
Market leader	75.9	69.2	67.4	65.8	61.5
Ping An P&C	68.1	57.0	55.4	57.8	58.5
China Pacific P&C	64.9	61.0	57.4	58.5	59.7
Taiping Insurance	57.3	63.5	56.4	53.4	48.9
Expense	2008	2009	2010	2011	1H12
Market leader	27.4	33.1	30.4	28.2	30.9
Ping An P&C	36.3	41.8	37.9	35.7	34.7
China Pacific P&C	37.9	37.3	36.6	34.8	34.7
Taiping Insurance	44.7	41.3	45.7	46.5	49.1

Source: Company data, ABCI Securities

### CH INS: Underwriting profits & margins (2008 - 1H12)

(Rmb bn)	2008	2009	2010	2011	1H12
Market leader	(2,605)	(2,060)	2,727	8,016	5,611
Ping An P&C	(931)	360	3,028	4,088	2,590
China Pacific P&C	(587)	424	2,076	3,122	1,510
Taiping Insurance	(347)	(292)	(87)	5	53
Margins excl. Inv	2008	2009	2010	2011	1H12
Market leader	(3.3)	(2.2)	2.2	6.0	7.6
Ping An P&C	(4.4)	1.3	6.6	6.4	6.9
China Pacific P&C	(2.9)	1.7	5.9	6.7	5.6
Taiping Insurance	(2.0)	(4.8)	(2.1)	0.1	2.0

Source: Company data, ABCI Securities

*P&C earnings & ROE highly sensitive to underwriting margins. This is a big swing factor!*

While we are optimistic on P&C underwriting, we are concerned with the high sensitivity of insurers' earnings to underwriting margins. We believe this may represent a big swing factor to P&C insurers. Per our analysis, 1ppt change in underwriting margins could lead to 8.7% change in market leader's pretax profits in 1H12. The same will induce a 9.8% and 12.3% change in pretax earnings for Ping An P&C and China Pacific P&C respectively. Market leader's ROE will swing from 33.1% to, 36.0% for 1ppt higher underwriting margins, or 30.2% for 1ppt lower margins. Ping An P&C's ROE will swing from 23.9% to 26.3% for 1ppt higher underwriting margins, or 21.6% for 1ppt lower margins. China Pacific P&C's ROE will swing from 12.9% to, 14.5% for 1ppt higher underwriting margins, or 11.4% for 1ppt lower margins.



**CH INS: ROE & pre-tax profit sensitivity to underwriting margins**

<u>Pretax profits</u> (Rmb mn)			<u>Reported ROE</u> (%)		
	2011	1H12		2011	1H12
Market leader	10,286	8,413	Market leader	25.9	33.1
Ping An P&C	6,760	3,852	Ping An P&C	25.1	23.9
China Pacific P&C	5,113	2,197	China Pacific P&C	19.9	12.9
Taiping Insurance	129	139			
<u>Chg in profits for 1ppt chg in U/W margins</u> (Rmb mn)			<u>ROE for 1ppt higher U/W margins</u> (%)		
	2011	1H12		2011	1H12
Market leader	1,331	735	Market leader	29.3	36.0
Ping An P&C	635	377	Ping An P&C	27.5	26.3
China Pacific P&C	467	269	China Pacific P&C	21.7	14.5
Taiping Insurance	48	27			
<u>Chg in profits as % of pretax profits</u> (%)			<u>ROE for 1ppt lower U/W margins</u> (%)		
	2011	1H12		2011	1H12
Market leader	12.9	8.7	Market leader	22.6	30.2
Ping An P&C	9.4	9.8	Ping An P&C	22.8	21.6
China Pacific P&C	9.1	12.3	China Pacific P&C	18.1	11.4
Taiping Insurance	37.2	19.2			

Source: Company data, ABCI Securities

**Non-motor rising in contribution**

*Big three with rising premium contribution from non-motor in 1H12*

We observed rising premium contribution from non-motor segments in 1H12. Non-motor constituted 30.9% of market leader's premiums, compared to 26.4% in 2011. During the same half, non-motor contributed 25.1% and 25.6% of Ping An P&C's and China Pacific P&C premiums respectively. The portions rose sequentially from 2011.

*Liability, accident and agricultural insurance are the key growth areas*

Per our channel check, such growth is primarily attributable to liability, accident and agricultural insurance. Market leader is strong at agricultural insurance, while Ping An P&C and China Pacific P&C are more dominant in liability and accident. In our view, the development of non-motor lines will bring a better balance of growth for P&C insurers, which relied heavily on motor historically. More importantly, all the three non-motor product lines are adhering to the current national policies. Agricultural insurance has been aligning with the policy of 'Sannong' advocated in the 12<sup>th</sup> five year plan. Liability and accident will supplement the policy of nationwide medical reform. In 2010, these three product lines contributed to only 8.4% of total P&C premiums. Under the circumstance of favorable national policies, we expect these products to outgrow motor insurance going forward.

**CH INS: Non-motor P&C premiums rising in contribution**

<u>Market Leader</u>									
(Rmb bn)	2009	1H10	2010	1H11	2011	1H12	HoH %	YoY %	
Motor	85.5	58.8	115.8	64.3	128.0	70.0	9.8	8.7	
Non-Motor	34.2	22.8	38.5	27.1	45.9	31.2	66.0	15.2	
Non-Motor % of ttl.	28.6	27.9	25.0	29.7	26.4	30.9	Higher	Higher	
<u>Ping An P&amp;C</u>									
(Rmb bn)	2009	1H10	2010	1H11	2011	1H12	HoH %	YoY %	
Motor	29.6	23.0	49.4	30.8	65.3	36.7	6.3	19.1	
Non-Motor	9.2	7.2	13.1	10.1	18.4	12.3	47.9	21.0	
Non-Motor % of ttl.	23.8	23.9	20.9	24.8	22.0	25.1	Higher	Higher	
<u>China Pacific P&amp;C</u>									
(Rmb bn)	2009	1H10	2010	1H11	2011	1H12	HoH %	YoY %	
Motor	25.4	20.2	39.6	23.8	47.4	26.2	11.1	10.1	
Non-Motor	8.8	6.8	12.0	8.5	14.3	9.0	54.9	6.7	
Non-Motor % of ttl.	25.8	25.2	23.2	26.2	23.1	25.6	Higher	Lower	

Source: Company data, ABCI Securities





### Pricing liberalization could be negative

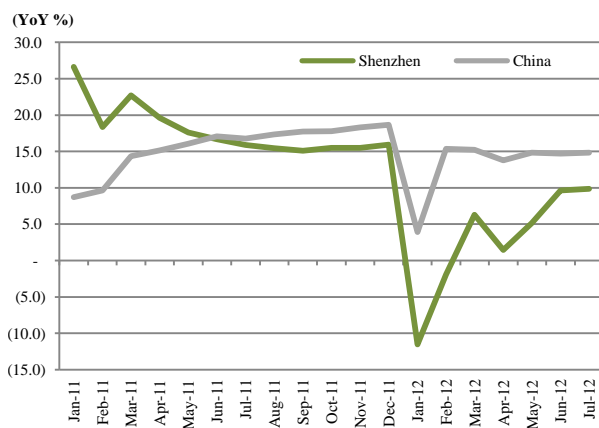
*Ping An P&C and China Pacific P&C may set their own pricing on commercial auto products*

In our opinion, the imminent pricing liberalization on commercial auto insurance could be an overhang for P&C insurers. In Sep 2011, CIRC issued a consultation notice on pricing liberalization for commercial auto insurance. In the notice, CIRC proposed to permit P&C insurers to decide their own product pricing. The eligible insurers are subject to the conditions of three years of operational history in commercial auto, solvency ratios above 150%, combined ratios lower than 100% over the previous two financial years, and underwriting auto insurance for more than 300,000 vehicles in the last financial year. Currently, Ping An P&C and China Pacific P&C are eligible for setting their own product pricing, subject to the implementation of pricing liberalization.

*Intensified pricing competition observed in Shenzhen*

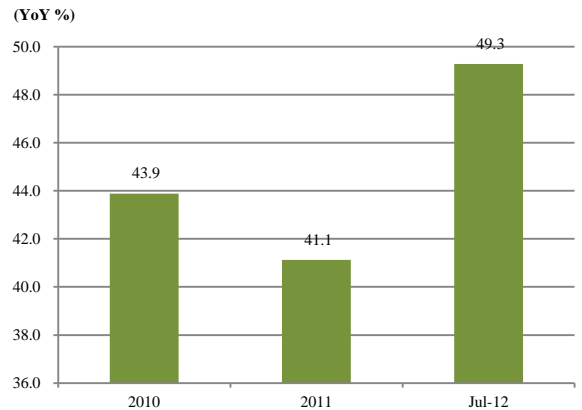
The sector may face severe pricing competition, should pricing liberalization be implemented. Pilots of commercial auto pricing liberalization were carried out in Shenzhen and Beijing from Mar 2011 onwards. According to CIRC Shenzhen, P&C premiums under-grew national average since then. Year to date in 2012, P&C premiums grew 9.9% YoY, slower than 14.8% YoY of national average. We believe pricing competition led to bigger discount on commercial auto policies. Meanwhile, P&C claim ratio increased from 43.9% in 2010 to 49.3% year to Jul in 2012. Such decline in per policy premiums resulted in higher claim ratios, as indicated in the data from CIRC Shenzhen. With the prospect of a national roll-out, industry practitioners are worried about another round of cut-throat pricing competition, just as in 2003-2008.

**CH INS: P&C premium growth in Shenzhen (2011 – Jul 2012)**



Source: CIRC, ABCI Securities

**CH INS: Claims / Gross P&C premiums in Shenzhen (2010 – Jul 2012)**



Source: CIRC, ABCI Securities

### Overhang with compulsory auto insurance

*Underwriting losses totaled Rmb7bn for big four P&C insurers on compulsory auto insurance*

We see big underwriting losses on compulsory auto insurance as another overhang for the sector. As of 2011, all major P&C insurers suffered from heavy underwriting losses on this product line. While CIRC stated that insurers are obliged to take this product as a national service, the underwriting loss is unbearable in our opinion. For instance, market leader made an underwriting loss of Rmb4.5bn, equivalent to 12.9% of shareholders' equity in 2011. Ping An P&C recorded a loss of Rmb1.5bn, equivalent to 6.5% of shareholders' equity in 2011. These heavy losses on compulsory auto insurance could adversely affect the solvency of P&C insurers, if the industry underwriting cycle worsens in the future.

***CH INS: Underwriting loss on compulsory auto insurance :  
insurers (2010-2011)***

<u>Underwriting losses</u>			<u>Underwriting loss margins on NEP</u>		
(Rmb mn)	2010	2011	(%)	2010	2011
Market leader	(3,960)	(4,540)	Market leader	(14.3)	(13.8)
Ping An P&C	(349)	(1,458)	Ping An P&C	(3.4)	(10.6)
China Pacific P&C	(676)	(512)	China Pacific P&C	(8.3)	(4.9)
China United	(952)	(544)	China United	(22.6)	(11.4)

*Source: CIRC, Company data, ABCI Securities****CH INS: Underwriting losses as % of shareholders' equity  
on compulsory auto insurance by insurers (2010-2011)***

<u>Shareholders' equity</u>			<u>U/W losses as % of equity</u>		
(Rmb mn)	2010	2011	(Rmb mn)	2010	2011
Market leader	26,808	35,160	Market leader	(14.8)	(12.9)
Ping An P&C	17,327	22,274	Ping An P&C	(2.0)	(6.5)
China Pacific P&C	14,297	23,984	China Pacific P&C	(4.7)	(2.1)

*Source: CIRC, Company data, ABCI Securities*



### Complimentary national policies

*Sector blessed with national policies, such as Medicare reform, tax deferred pension products, ‘Sannong’ policy and broadening investment channels by CIRC*

At present, China Insurance is blessed with several complimentary national policies. This is one of the reasons for our call on a sweet entry point. Firstly, Medicare reform will help driving health premium sales in future. In fact, health premium sales outgrew normal life products over the past 18 months. Secondly, as explained in earlier sessions, tax deferred pension products could be a game changer to Life industry. Life insurers can enjoy an average increment of 11.1% in FYP because of the new product. Thirdly, agricultural insurance is aligning with the policy of ‘Sannong’ advocated in the 12<sup>th</sup> five year plan. Lastly, CIRC announced further deregulation on insurance fund investments since Jan 2012. Insurers may yield higher and more stable investment returns, through more diversified investment channels.

### Medicare reform driving health sales growth

*National target of 800mn people under Medicare coverage by 2016*

In the coming years, health and critical illness premiums will be fueled by the Medicare reform advocated in in the 12th Five Year Plan. In accordance to National Bureau of Statistics of China (NBSC), the urban population with medical insurance coverage was 473mn, compared to total urban population of 691mn, in 2011. In the same year, the rural population with medical insurance coverage was 46mn, relative to total rural population of 657mn. In the 12th Five Year Plan, National Development and Reform Commission (NDRC) set a target of 800mn people with medical insurance coverage (519mn in 2011) by 2016.

*Limited government subsidies and underfunded Medicare program*

Another issue is the limited government subsidies to Medicare program. In 2011, government subsidy was Rmb200 per person, compared to Rmb80 per person in 2008. Despite a sharp increase, it is still far from enough. A subsidy of Rmb200 is equivalent to only 0.9% of disposal income per capita in 2011. Due to the underfunded nature of Medicare program, the newly launched critical illness products by China Life, China Pacific Life and New China Life have been well received since the debut in 1H12.

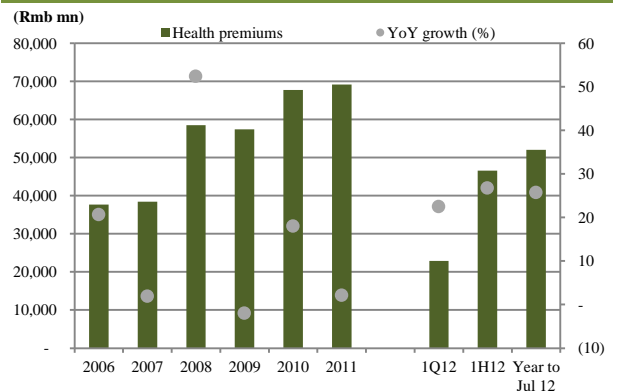
*Expecting health premiums to continue outgrow normal life premiums*

Meanwhile, health premiums outgrew normal life premiums so far in 2012. As of 2011, health premiums constituted 7.1% of total life premiums respectively. Year to Jul in 2012, Health premiums reached Rmb41.4bn, up 25.7% YoY. This is compared to flattish YoY for normal life premiums. With growing public concern towards health and critical illness coverage, we believe health premium sales can further flourish in future.

CH INS: Medicare coverage in urban areas (2008 vs 2011)

	Urban Population with Medicare (mn)	Total Urban Population (mn)	% covered
2008	317	607	52.3
2011	473	691	68.5
	Gov't subsidy per head (Rmb)	Disposable income per head (Rmb)	Subsidy as % of Disposable income
2008	80	15,781	0.5
2011	200	21,810	0.9

CH INS: Health insurance sales (2006 – 2012 YTD)



Source: Xinhua, NBS, company data, ABCI Securities

Source: CIRC, company data, ABCI Securities



### Tax deferred pension products the game changer

#### *Pilot of tax deferred pension product in Shanghai towards late 2012*

As declared by Chen Wenfei, the Vice Chairman of CIRC, in Jul 2012, CIRC is planning a pilot program of individual deferred tax pension products in Shanghai. Per China Security Journal on 6 Jul 2012, the program may debut in late 2012. Accordingly, Life insurers will be permitted to issue new participating and universal life products embedded with deferred-tax features. At the initial stage, tax-deferred limit will be set at Rmb1,000 per month, with Rmb700 cap on personal tax and Rmb300 cap on corporate tax.

#### *Huge pension deficit to fill in China*

Such products are designed to fill the huge national pension deficit in China. In 2011, there are 185mn persons, or 13.7% of population, exceeding the age of 65 in the country. The asset balance of NSSF was Rmb867bn (US\$138bn), or Rmb4,686 per each aged citizen. This is compared to US\$7 tn of pension assets, or US\$22,258 per person, in USA. We expect this product to become a game changer to Life industry.

#### *FYP rising by 11.1% in average due to the new pension products*

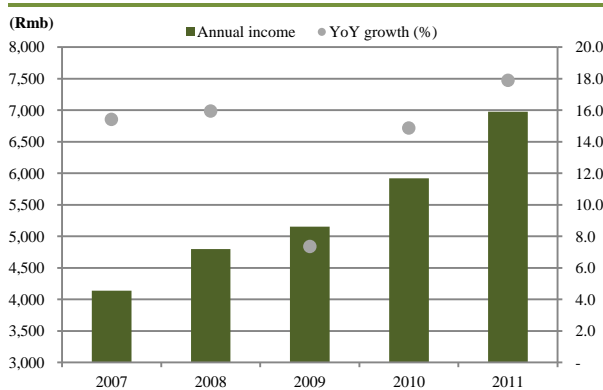
Assuming a nationwide roll-out of tax deferred pension products, we forecast Life insurers to expand FYP by 9.4% - 12.3% p.a. In 2011, there is a population of 1.3bn and working population of 764mn in China. Annual salary per employee reached RMB27,909. By applying conservative assumptions of the participation by 5% working population contributing 5% of annual salary, the additional premiums could reach Rmb53.3bn, or 5.6% of L&H market. If the additional premiums are obtained by top players in reference to market shares, FYP can increase by 11.1% in average for Life insurers.

### Agriculture insurance the new driver for P&C

#### *Agricultural insurance premiums grew 18.8x from 2005 to 2010*

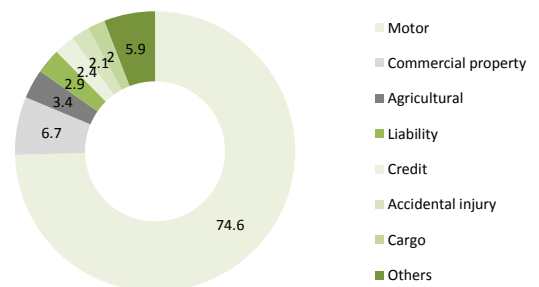
Agriculture insurance is situated at the best position to ride on the national policy of ‘Sannong’, the acronym in Chinese for ‘agricultural, rural areas and farmers’, advocated in the 12<sup>th</sup> Five Year Plan in 2011. Agriculture insurance premiums grew 18.8x from Rmb730mn in 2005 to Rmb13.7bn in 2010. This product line contributed 3.4% of total P&C premiums of Rmb403bn. P&C market leader was the market leader in this product, with a 51.9% market share (Rmb7.1bn of agriculture premiums) in the same year. Currently P&C insurers are subsidized by local and central government on this product line. With rising income per capita in rural areas, we believe P&C insurers will benefit from the fast growing agricultural insurance in future.

CH INS: Rural area - income per capita (2007 - 2011)



Source: NBS, ABCI Securities

CH INS: Agricultural premiums versus other P&C premiums (2010)



Source: Annual report of Chinese insurance market 2011



## Broadening investment channels

### *13 consultation notices on deregulation of insurance investments*

In Jun 2012, CIRC announced 13 consultation notices related to further deregulation on investment of insurance funds. CIRC aimed at the liberalization of investment channels for Chinese insurers, which would in turn facilitate a better use of insurance funding in China. The key areas of relaxation include investment limits on non-guaranteed corporate and infrastructure bonds, private equity projects, property projects and overseas investments. Most importantly, the consultation notices proposed the permission of stock lending and equity hedging with derivatives by Chinese insurers. The market expects most of the proposed relaxations to be implemented from 2013 onwards.

### *New proposals enhancing recurring investment yield and promoting stability on return*

In our opinion, there are several ramifications of these proposals. Firstly, these changes may enhance recurring investment return, or net investment yields, of Chinese insurers. Insurers may raise investment allocation to higher return instruments such as non-guaranteed corporate bonds, infrastructure bonds and property projects. Secondly, better duration matching of investment assets and insurance liabilities may be achieved, when investment limits on infrastructure bonds and private equity projects are relaxed. Lastly, the permission of stock lending and equity hedging with derivatives will help smoothing total investment return, or gross investment yields, of Chinese insurers. This could reduce the volatility of insurers' investment books, and promote the stability of industry solvency.

### *CH INS: Key investment channels and limits of insurance industry*

Items	Classes of Assets	Limits	Newly proposed changes
1	Deposits, Government Bonds, Central Bank Bills, Policy Bills, Money Market Funds	Min 5%	
2	Non-guaranteed Corporate Bonds, Bonds from Non-financials	Max 20%	Relaxing limits on non-guaranteed corporate and infrastructure bonds
3	Direct Equity, Mutual Funds	Max 20%	
4	Unlisted Equity	Max 5%	Relaxing limits on private equity projects
5	Financing Instruments issued by Unlisted Corporate	Max 4%	
6	4 + 5	Max 5%	
7	Physical Property Investment	Max 10%	Relaxing limits on property projects
8	Financing Instruments issued for Physical Property Projects	Max 3%	
9	7 + 8	Max 10%	
10	Infrastructure Projects	Max 10%	Relaxing limits on infrastructure bonds
11	Overseas Investments	Max 15%	Relaxing limits on overseas investments
12	Equity margin financing	Not allowed	Relaxing limits on stock lending
13	Equity derivative hedging	Not allowed	Relaxing limits on equity hedging with options / futures

Source: CIRC, ABCI Securities

### *Other countries or regions adopted more relaxed investment rules on insurance funding than China*

Different countries or regions have their respective investment channels and limits established for insurance industry. In our view, many countries imposed more relaxed regulations on insurance investments, as compared with China. The following table demonstrates the specific channels and limits for insurance investments in USA, Japan, South Korea and China Taiwan.

### *Key investment channels and limits of insurance industry in different countries*

Countries	Investments Instruments	Specific Limits on Asset Allocation
United States	Bond, Equity, Policy Loan, Real Estate, Overseas Investment	Equity & Corporate bond <20%, Real Estate <10%, Overseas Investment <10%
Japan	Publicly traded securities, Real Estate, Gold certificate, Bank deposit, Loan, Trust, Future / Option, Interest rate swap, Forex forward / future	Domestic equity <30%, Real Estate <20%, Forex nominated assets <30%, Loans on bond holding <10%, others <3%
South Korea	Publicly traded securities, Equity, Real Estate, Loan / Bill, Discounted Bill, Bank deposit, Trust	Equity <40%, Real Estate <15%, Single company exposure <5%, Single individual exposure <3%, Overseas Investment 10%
China Taiwan	Bank deposit, Equity, Real Estate, Loan, Overseas Investment, Project finance, Public investment	Publicly traded securities <35%, Real Estate <39%, Loan <35%, Overseas Investment <5%, Single project <10%, Single institution exposure <10%

Source: Regulators, ABCI Securities



*US & Korean insurers with more stable and higher investment return than Chinese insurers*

With less limitation on insurance investments, US and Korean insurers yielded more stable and higher investment return than Chinese insurers from 2008 to 2010. More importantly, insurers in US and Korea reported more consistent and stable investment returns. While Chinese insurers achieved high investment returns in 2006 and 2007, such returns were not sustainable in the following years. Chinese insurers suffered from high volatility in investments. As a result, we believe the latest proposal on broadening investment channels and limitations on investments can help restoring the stability of investment return for China Insurance.

***Insurance investment return in different countries***

(%)	US	Korea	Japan	China*	Comments
2006	5.85	5.21	2.45	7.11	China the highest
2007	5.92	5.67	1.90	12.33	China the highest
2008	5.57	5.76	0.39	5.21	China behind US & Korea
2009	5.27	4.71	1.86	4.67	China behind US & Korea
2010	5.37	5.29	1.79	3.41	China behind US & Korea

Source: Company data, Bloomberg, ABCI Securities \* proxy from average gross yields of listed insurers



## Ample solvency

*Inadequate solvency was one major market concern in early 2012*

Inadequate solvency was one of the major market concerns towards Chinese insurers in early 2012. Except for China Pacific, Chinese insurers reported an average solvency of 167.8% in 2011. This is only 17.8ppt higher than the recommended level of 150% solvency by CIRC. Except for New China Life, which raised funding from IPO in Dec 2011, all Chinese insurers reported HoH decline in solvency ratios. This is mainly due to a 21.7% YoY decline of A-share markets in 2011.

*Solvency issue is behind us due to more sub-debt issuance, slower capital consumption and less investment markdowns*

However, we believe the solvency concern on China Insurance is behind us. Firstly, Chinese insurers have resorted to the issuance of subordinated debts for lifting solvency since early 2012. Other than Taiping Life, all listed Chinese insurers have room for further issuance of sub-debt. Secondly, we believe Chinese insurers will consume capital at a slower pace, in respect to limited growth in premiums. Lastly, with the bottoming A-share markets, we expect less investment markdowns for the sector. That said, actual solvency of Chinese insurers may not suffer from further mark-to-market declines.

## Subordinated debt issuance lifted solvency

*Rebound in sector solvency for 1H12*

As mentioned, Chinese insurers resorted to the issuance of subordinated debts for boosting solvency since early 2012. In 1H12, average solvency of Chinese insurers reached 201.2%, higher than 191.0% in 2011. Other than a mild recovery of investment markets, sub-debt issuance is the major driver for the improving sector solvency. More importantly, except for Taiping Life, all listed Chinese insurers have room for further sub-debt issuance.

*Ample capacity for more sub-debt issuance by most insurers*

Based on the CIRC regulations, insurers are permitted to issue sub-debt for solvency purpose, up to a limit of 50% Net Asset Value (NAV) reported in the previous financial period. That said, China Life has a capacity to issue an additional Rmb79.7bn sub-debt, compared to current balance of Rmb28.0bn. Ping An Group has a capacity to issue an additional Rmb43.7bn sub-debt, compared to current balance of Rmb29.7bn. China Pacific has a capacity to issue an additional Rmb33.6bn sub-debt, compared to current balance of Rmb8.0bn. New China Life has a capacity to issue an additional Rmb7.5bn sub-debt, compared to current balance of Rmb10.0bn. Only Taiping Life was precluded from the option of further sub-debt issuance. But China Taiping, the parent of Taiping Life, sits with a cash balance of HK\$2.2bn in the holding level. Such resources can be injected to Taiping Life if necessary.

*Three listed insurers with over 200% solvency margins at present*

In 1H12, China Life and China Pacific reported solvency of 230.6% and 271.0% respectively. These far exceeded the recommended level of 150% solvency by CIRC. For New China Life, its 1H12 solvency did not include the Rmb10bn sub-debt issued in Jul 2012. Post sub-debt issuance, its solvency surpassed 200%, according to management. Only Ping An Group reported a relatively low solvency during the same half. But as explained earlier, Ping An has a capacity to issue more sub-debts from now onwards. To conclude, we believe the sector has been free from the solvency concern as of now.



**CH INS: Subordinated debt balance, capacity and solvency margins by insurers (1H12)**

(Rmb bn)	China Life	New China Life	Taiping Life	Ping An Life	Ping An P&C	SDB	Ping An Group	China Pacific Life	China Pacific P&C	China Pacific
Forex sub-debt approved	8.0									
Domestic sub-debt approved	38.0						26.0	7.5		
Domestic sub-debt balance	28.0	10.0	7.1	9.0	4.6	16.1	29.7	8.0		8.0
Capacity for further issuance	79.7	7.5	(2.3)	9.5	7.9		43.7	7.0		33.6
Sub-debt limit (50% NAV)	107.7	17.5	4.8	18.5	12.5	NA	73.4	15.0	12.3	41.6
1H12 NAV	215.4	34.9	9.6	37.0	25.0	NA	146.8	30.0	24.6	83.1
1H12 Solvency (%)	230.6	158.8	169.0	167.3	164.5	NA	176.7	183.4	174.9	271.0

Source: Company data, ABCI Securities

**Slower capital consumption**

**Slower life and P&C premium growth in 2011 and 1H12**

We observed that Chinese insurers consumed capital at a slower pace than before in 2011 and 1H12. Per our findings, this is primarily due to a slower premium growth in China. In 2011, total life premiums declined by 8.6% YoY in China. In 1H12, they rose by merely 2.4% YoY. This is compared to a YoY growth of 28.9% in 2010. Total P&C premiums also decelerated in growth. They increased 8.7% YoY in 2011 and 14.7% YoY in 1H12. This is considerably slower than 34.5% up YoY in 2010. For FYP, all listed Life insurers reported YoY declines in 2011 and 1H12. This is relative to 25.8% YoY growth in 2010. With less and less premiums underwritten, capital consumption became slower for Chinese insurers.

**Chinese insurers reported less solvency cost as a % of VIF in 1H12 than before**

We measured total solvency cost as a percentage of Value in Force (VIF) for Chinese insurers. Total solvency cost represents the capital required for covering the insurance liabilities. Per our findings, all listed Chinese insurers reported solvency cost as a lower percentage of VIF in 1H12, as compared with that in 2010 and 2011. Evidently, Chinese insurers have decelerated in capital consumption, in the environment of slow premium growth. Consequently, we conclude that Chinese insurers may face little pressure on solvency cost at present.

**CH INS: Total solvency cost on value in force (VIF) by insurers**

(%)	2010	2011	1H11	1H12	1H12 vs 1H11	1H12 vs 2011	1H12 vs 2010
China Life	16.2	15.3	15.7	14.9	(0.8)	(0.4)	(1.3)
Ping An Life	18.5	18.2	24.8	18.2	(6.6)	(0.0)	(0.3)
China Pacific Life	20.9	21.3	20.8	20.5	(0.3)	(0.8)	(0.5)
New China Life	27.4	26.6	27.1	26.0	(1.1)	(0.6)	(1.4)
Taiping Life	18.7	14.3	18.5	12.8	(5.7)	(1.5)	(6.0)

Source: Company data, ABCI Securities

**Less investment markdowns**

**Minimal investment markdowns in 2H12E and 2013E, with the stabilized A-share markets and bond**

Chinese insurers suffered from heavy investment markdowns in 2011 and 1H12. This is primarily due to the weak A-share markets in 2011. Investment markdowns booked in P&L amounted to Rmb22.1bn in 2011 and Rmb26.7bn in 1H12 for all listed Chinese insurers. These represent 0.61% and 1.30% of average investment assets during the respective periods. In 2011, Shanghai Composite Index dropped by 21.7% and CSI 300 fell 25.0%. The weak A-share markets led to heavy investment losses by Chinese insurers. This in turn hammered their solvency. With stabilized A-share markets and bond prices, we anticipate minimal investment markdowns for Chinese insurers in 2H12E and 2013E. This will help upholding the sector solvency, in our opinion.





**CH INS: Mark-to-market gain / loss in P&L (2008- 1H12)**

<u>(Rmb mn)</u>	2008	2009	2010	2011	1H12
China Life	(13,158)	22,693	16,121	(10,871)	(12,937)
Ping An Group	(26,045)	12,947	5,111	(5,020)	(6,153)
China Pacific	(9,645)	6,582	3,623	(4,807)	(4,594)
New China Life	(8,487)	1,407	1,245	(905)	(1,869)
Taiping Life	391	906	901	(482)	(1,134)
<u>(% of av. inv't assets)</u>	2008	2009	2010	2011	1H12
China Life	(1.47)	2.15	1.29	(0.77)	(1.64)
Ping An Group	(5.75)	2.46	0.76	(0.62)	(1.33)
China Pacific	(3.36)	2.01	0.91	(1.01)	(1.66)
New China Life	(5.44)	0.80	0.51	(0.27)	(0.45)
Taiping Life	0.76	1.31	0.92	(0.36)	(1.41)

Source: Company data, ABCI Securities

**CH INS: Equity / bond market performance (2008- 1H12)**

<u>(Period end closing)</u>	2008	2009	2010	2011	1H12
Shanghai Composite Index	1,821	3,277	2,808	2,199	2,225
CSI 300 Index	1,818	3,576	3,128	2,346	2,462
5 yr Gov't Bond Yield	1.79	2.99	3.58	3.08	2.83
2 yr Gov't Bond Yield	1.27	1.65	3.40	2.86	2.37
<u>(% YoY)</u>	2008	2009	2010	2011	1H12
Shanghai Composite Index	(65.39)	79.98	(14.31)	(21.68)	1.18
CSI 300 Index	(65.95)	96.71	(12.51)	(25.01)	4.94
5 yr Gov't Bond Price	10.27	(5.03)	(2.47)	2.10	1.05
2 yr Gov't Bond Price	11.35	(1.59)	(7.33)	2.26	2.05

Source: Bloomberg, ABCI Securities



## At a cyclical sweet spot of investments

*A-share markets and China GDP could be turning, referring to the timing of PBOC rate cuts*

In our view, Chinese insurers are currently situated at a cyclical sweet spot in investments. Firstly, based on the experience during Global Financial Crisis (2008-09), A-share market should be close to its cyclical bottom after the resumption of PBOC rate cut cycle. The same logic could be applied to the China economy, as reflected by the real GDP growth. Therefore we anticipate equity return to recover for Chinese insurers.

*Solid bond prices bringing good impacts to book values and EV*

Secondly, bond prices have been stable, reflecting the loosening liquidity environment, since 4Q11 in China. According to Bloomberg, the prices of China government bonds, corporate bonds and financial bonds have remained solid since early 2012. Such trend will bring a positive impact to book values and EV of Chinese insurers in 2012.

*New policies on investment of insurance funds may enhance return*

Thirdly, Chinese insurers will benefit from new policies of broadening investment channels by CIRC, as mentioned in earlier sections. Investment restriction on non-guaranteed corporate bonds and infrastructure bonds will be relaxed. We expect this to lift net investment yields. New policies on stock lending for margin financing and derivative hedging on equity investments will smooth equity return of Chinese insurers over time.

*Forecasting higher gross yields for Chinese insurers*

To sum, we estimate Chinese insurers to report higher gross investment yields, due to minimal mark-to-market losses on both equity and bond investments, in 2012-14E. However, owing to the low interest rate environment, we forecast net investment yields to decline slightly in the coming two years.

## Rebounding equity performance at sight

*Expecting A-share market to bottom out soon, following more rate cuts by PBOC*

Comparing A-share market performances in the previous and current rate cut cycle, we believe that A-share market could reach its trough very soon. Also, with more aggressive rate cuts by PBOC, we expect China economy to bottom out in the coming one or two quarters. Consequently, we believe that rebounding equity return is at sight for Chinese insurers. In 2011, gross investment yields of insurers averaged 3.68% (4.82% in 2010), primarily due to equity markdowns of Rmb22.1bn. Subsequently, the weakness extended into 1H12, with gross investment yields averaged 3.53%. With stabilized A-share markets, we forecast gross investment yields to recover to an average of 3.66% in 2012E and 4.15% in 2013E.

*Previous rate cycle started amid the stock market peak in 4Q07*

During the previous rate cut cycle, PBOC lowered rates for the first time in Dec 2007, in response to toppish GDP growth and stock market in 4Q07. On 21 Dec 2007, the date of first rate cut, Shanghai Composite Index (SHCOMP) traded at 5,102pts, or 41.2x forward PER and 6.6x forward PBV. CSI 300 Index closed at 5,102pts, or 38.4x forward PER and 6.1x forward PBV. Since then, both indices fell off the cliff, along with the deepening Global Financial Crisis throughout 2008.

*PBOC cut rates 4x amid the Lehman Brother crisis*

In 4Q08 alone, PBOC cut rates for four times. On the date of last rate cut on 23 Dec 2008, SHCOMP closed at 1,897pts, or 13.1x forward PER and 2.1x forward PBV. CSI 300 traded at 1,919 pts, or 12.3x forward PER and 2.0x forward PBV. At end-1Q09, three months after the last rate cut by PBOC, SHCOMP rebounded by 25.1% and CSI 300 recovered 30.7%.

On 6 Jul 2012, PBOC announced its second rate cut in this cycle, following the first on 8 Jun 2012. On 28 Sep 2012, SHCOMP traded at 2,086pts, or



*Towards the end of this rate cycle, A-share market could bottom-out*

11.4x forward PER and 1.6x forward PBV. CSI closed at 2,293pts, or 11.5x forward PER and 1.7x forward PBV. These valuation levels are close to the bottom in the last rate cut cycle. Therefore, based on the past experience, we believe A-share market will be bottoming out in the coming quarter or two, and rebounding equity market is at sight.

**China: A-share market performance during the current and previous rate cut cycles by PBOC**

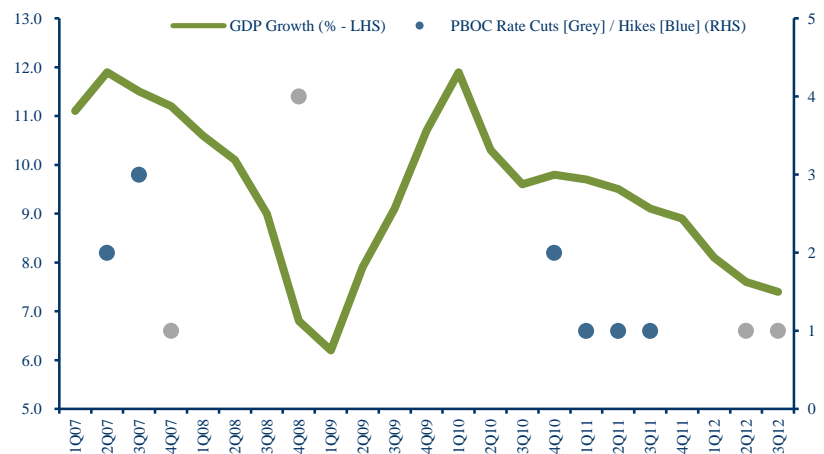
Last Cycle	Date	SH-C	Chg (%)	PER (x)	PBV (x)	Last Cycle	Date	CSI 300	Chg (%)	PER (x)	PBV (x)
1st PBOC rate cut	21-Dec-07	5,102		41.2	6.6	1st PBOC rate cut	21-Dec-07	5,102		38.4	6.1
2nd PBOC rate cut	9-Oct-08	2,075	(59)	14.4	2.3	2nd PBOC rate cut	9-Oct-08	1,995	(61)	12.8	2.1
3rd PBOC rate cut	30-Oct-08	1,764	(15)	12.2	2.0	3rd PBOC rate cut	30-Oct-08	1,698	(15)	10.9	1.8
4th PBOC rate cut	27-Nov-08	1,918	9	13.5	2.2	4th PBOC rate cut	27-Nov-08	1,870	10	12.0	2.0
5th PBOC rate cut	23-Dec-08	1,897	(1)	13.1	2.1	5th PBOC rate cut	23-Dec-08	1,919	3	12.3	2.0
3 mo after 5th rate cut	31-Mar-09	2,373	25	20.9	2.5	3 mo after 5th rate cut	31-Mar-09	2,508	31	22.4	2.7
This cycle	Date	SH-C	Chg (%)	PER (x)	PBV (x)	This cycle	Date	CSI 300	Chg (%)	PER (x)	PBV (x)
1st PBOC rate cut	8-Jun-12	2,281		12.2	1.7	1st PBOC rate cut	8-Jun-12	2,524		12.5	1.9
2nd PBOC rate cut	6-Jul-12	2,224	(3)	12.2	1.7	2nd PBOC rate cut	6-Jul-12	2,473	(2)	12.4	1.8
Present	28-Sep-12	2,086	(6)	11.4	1.6	Present	28-Sep-12	2,293	(7)	11.5	1.7

Source: Bloomberg, PBOC, ABCI Securities

*China economy may recover as early as 1Q13*

Meanwhile, China economy is close to its trough too, in our opinion. During the last rate cut cycle, PBOC applied four rate cuts in the single quarter of 4Q08, in response to the domestic recession led by Lehman Brothers' bankruptcy and global economic slowdown. China's real GDP growth touched base at 6.2% YoY in 1Q09. In this rate cut cycle, PBOC have cut rate twice since early Jun 2012. According to Bloomberg consensus, PBOC may cut rates for two other times towards end-2012. Therefore, based on the past experience, China economy could be bottoming out in 1Q13 the latest. And A-share market will start reflecting the bottoming economy one quarter earlier in 4Q12, in our opinion.

**China: Real GDP growth YoY versus timing of PBOC rate changes (1Q07 - 2Q12)**



Source: NBSC, PBOC, ABCI Securities

*China Life and China Taiping most sensitive to equity return*

We measured the sensitivity of Chinese insurers' EV to equity values, according to company risk disclosure. In view of an imminent rebound of A-share market towards end-2012, we render China Life and China Taiping the foremost beneficiaries. 10% change in equity values will lead to a 5.4% change in EV of China Life, and 5.5% change in EV of China Taiping. On the other hand, equity value-at-risk (VaR) at a 10 days interval is equivalent



to 2.8% of EV for Ping An. These names are relatively more sensitive to the equity values. Therefore, we regard them as more prominent investment targets, in respect to rebounding equity returns.

**CH INS: EV sensitivity on equity investments by insurers (1H12)**

(Rmb mn)	Ping An	China Pacific	(Rmb mn)	China Life	New China Life	China Taiping
Equity VaR (10 days)	7,150	1,622	AFS reserve chg on 10% chg in equity values	17,942	962	1,427
Equity investments	125,228	62,354	Equity investments	164,507	33,396	13,426
- Equity VaR as %	5.7	2.6	- AFS Res. Chg. as %	10.9	2.9	10.6
Investment assets	986,047	586,610	Investment assets	1,661,690	452,910	173,016
- Equity VaR as %	0.7	0.3	- AFS Res. Chg. as %	1.1	0.2	0.8
1H12 Embedded Value	259,005	121,833	1H12 Embedded Value	334,326	56,150	25,815
- Equity VaR as %	2.8	1.3	- AFS Res. Chg. as %	5.4	1.7	5.5

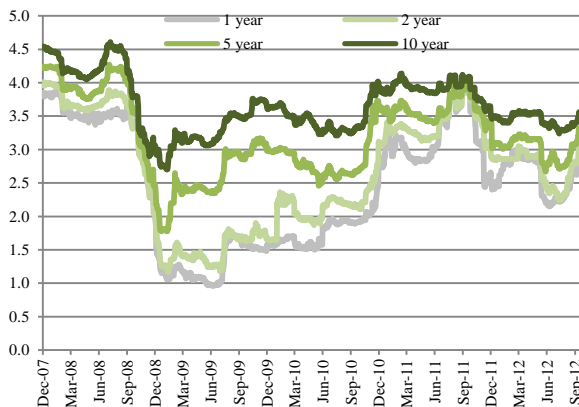
Source: Company data, ABCI Securities

**Bond prices remaining solid**

*Bond prices remained solid over the past four quarters*

Bond prices were rising, reflecting the weakening economy and loosening liquidity in 4Q11 and 1H12. The prices retreated in 3Q12 only because of the recent rise in government bond yields. After all, bond prices remained solid in China over the past four quarters. We believe this trend will benefit book values and EV of Chinese insurers in 2012E and 2013E.

**China: Government bond yields for various maturities (Jan 2008 - present)**



Source: Bloomberg, chinabonds.com.cn, ABCI Securities

**China: Financial & corporate bond return indices (Oct 2008 - present)**



Source: Bloomberg, chinabonds.com.cn, ABCI Securities

*Government bond yields are flattish 2012 YTD*

China government bond yields of various maturities (1, 2, 5 & 10 years) dropped by 49-98bps in 4Q11. After a short rebound in 1Q12, bond yields resumed its downward trend in 2Q12 and Jul 2012. Bond yields started to rise again from Aug onwards. Year to date, bond yields of various maturities remained flattish, up by 10bps in average across different maturities. In accordance, we estimate China government bond prices to remain solid in 2012E. We applied the modified durations of these bonds obtained from Bloomberg for estimating the changes in bond prices. As of 1H12, Chinese insurers allocated 42.4% - 65.6% of investment assets to bonds.

*Better return from corporate and finance bonds*

Meanwhile, China corporate and financial bonds delivered higher returns. According to Bloomberg, China corporate bond total return index ascended



1.5% from 139.6 at end-2011 to 141.7 at present. China financial bond total return index rose 5.9% from 116.5 at end-2011 to 123.4 at present. In 1H12, Chinese insurers allocated 50% - 72% of their bond portfolio to corporate and finance bonds. Therefore, improving return of these bonds would lift book values and EV of Chinese insurers.

**China: Estimated price changes of government bonds (2008 – present)**

(%)	1 year	2 year	5 year	10 year
2008	2.37	4.93	10.27	13.91
2009	(0.40)	(0.69)	(5.03)	(7.20)
2010	(1.49)	(3.19)	(2.47)	(2.21)
2011	0.56	0.98	2.10	3.84
2012 YTD	(0.15)	(0.11)	(0.54)	(0.25)

Source: Bloomberg, chinabonds.com.cn, ABCI Securities

**China: Estimated price changes of government bonds (3Q11 – present)**

(%)	1 year	2 year	5 year	10 year
3Q11	(0.12)	(0.38)	(1.22)	(0.33)
4Q11	0.88	1.57	3.02	4.01
1Q12	(0.20)	(0.04)	(0.25)	(0.65)
2Q12	0.50	0.93	1.30	1.47
3Q12 QTD	(0.45)	(1.00)	(1.59)	(1.06)

Source: Bloomberg, chinabonds.com.cn, ABCI Securities

**Estimating minimal investment markdowns in 2H12E and 2013E**

Chinese insurers suffered from heavy investment markdowns in 2011 and 1H12. This is primarily due to the weak A-share markets in 2011. Investment markdowns booked in P&L amounted to Rmb22.1bn in 2011 and Rmb26.7bn in 1H12 for all listed Chinese insurers. These represent 0.61% and 1.30% of average investment assets during the respective periods. In 2011, Shanghai Composite Index dropped by 21.7% and CSI 300 fell 25.0%. The weak A-share markets led to heavy investment losses to Chinese insurers and hence hammered their solvency. With stabilized A-share markets and bond prices, we anticipate minimal investment markdowns for Chinese insurers in 2H12E and 2013E. As such, book values and EV of Chinese insurers will continue to trend up in 2H12, following a strong rebound in 1H12.

**CH INS: Mark-to-market gain / loss in P&L (2008- 1H12)**

(Rmb mn)	2008	2009	2010	2011	1H12
China Life	(13,158)	22,693	16,121	(10,871)	(12,937)
Ping An Group	(26,045)	12,947	5,111	(5,020)	(6,153)
China Pacific	(9,645)	6,582	3,623	(4,807)	(4,594)
New China Life	(8,487)	1,407	1,245	(905)	(1,869)
Taiping Life	391	906	901	(482)	(1,134)

(% of av. inv't assets)	2008	2009	2010	2011	1H12
China Life	(1.47)	2.15	1.29	(0.77)	(1.64)
Ping An Group	(5.75)	2.46	0.76	(0.62)	(1.33)
China Pacific	(3.36)	2.01	0.91	(1.01)	(1.66)
New China Life	(5.44)	0.80	0.51	(0.27)	(0.45)
Taiping Life	0.76	1.31	0.92	(0.36)	(1.41)

Source: Company data, ABCI Securities

**CH INS: Equity / bond market performance (2008- 1H12)**

(Period end closing)	2008	2009	2010	2011	1H12
Shanghai Composite Index	1,821	3,277	2,808	2,199	2,225
CSI 300 Index	1,818	3,576	3,128	2,346	2,462
5 yr Gov't Bond Yield	1.79	2.99	3.58	3.08	2.83
2 yr Gov't Bond Yield	1.27	1.65	3.40	2.86	2.37

(% YoY)	2008	2009	2010	2011	1H12
Shanghai Composite Index	(65.39)	79.98	(14.31)	(21.68)	1.18
CSI 300 Index	(65.95)	96.71	(12.51)	(25.01)	4.94
5 yr Gov't Bond Price	10.27	(5.03)	(2.47)	2.10	1.05
2 yr Gov't Bond Price	11.35	(1.59)	(7.33)	2.26	2.05

Source: Bloomberg, ABCI Securities

**Forecasting higher gross yields but slightly lower net yields going forward**

Based on our views towards the investment markets, we forecast gross investment yields of Chinese insurers to bottom out in 1H12 and recover from 2H12 onwards. We estimate average gross yields to reach 3.66% in 2012E and 4.15% in 2013E. This is compared to 3.68% in 2011 and 3.53% in 1H12. In our forecast, we factored in minimal mark-to-market losses in 2012E and 2013E. However, we expect Chinese insurers to report slightly lower net investment yields going forward. In 1H12, net investment yields rose to 4.45% from 4.27% in 2011. Chinese insurers increased the investment allocation to negotiated deposits with joint stock banks, which needed liquidity during the half. Nevertheless, following the start of PBOC rate cut cycle in Jun 2012, we expect net investment yields to be adversely impacted in the low interest environment. We estimate average net yields to record 4.31% in 2012E and 4.24% in 2013E, lower than 4.45% reported in 1H12.



**CH INS: Net investment yields**

(%)	2009	2010	2011	1H12	2012E	2013E
China Life	3.69	3.90	4.28	4.48	4.47	4.31
Ping An Group	3.90	4.20	4.50	4.50	4.27	4.26
China Pacific	4.10	4.26	4.70	4.90	4.53	4.44
New China Life		3.80	4.10	4.40	4.26	4.16
Taiping Life	3.74	3.64	3.76	3.95	4.03	4.01
Average	3.86	3.96	4.27	4.45	4.31	4.24

Source: Company data, ABCI Securities

**CH INS: Gross investment yields**

(%)	2009	2010	2011	1H12	2012E	2013E
China Life	5.84	5.18	3.51	2.83	3.57	4.31
Ping An Group	6.40	4.90	4.00	3.70	3.36	4.04
China Pacific	5.00	5.17	3.70	3.90	4.26	4.52
New China Life		4.30	3.80	3.60	3.81	3.90
Taiping Life	5.05	4.56	3.40	3.60	3.31	4.00
Average	5.57	4.82	3.68	3.53	3.66	4.15

Source: Company data, ABCI Securities

**Broadening investment channels could lift returns**

*13 consultation notices on deregulation of insurance investments*

In Jun 2012, CIRC announced 13 consultation notices related to further deregulation on investment of insurance funds. CIRC aimed at the liberalization of investment channels for Chinese insurers, which would in turn facilitate a better use of insurance funding in China. The key areas of relaxation include investment limits on non-guaranteed corporate and infrastructure bonds, private equity projects, property projects and overseas investments. Most importantly, the consultation notices proposed the permission of stock lending and equity hedging with derivatives by Chinese insurers. The market expects most of the proposed relaxations to be implemented from 2013 onwards.

*New proposals enhancing recurring investment yield and promoting stability on return*

In our opinion, there are several ramifications of these proposals. Firstly, these changes may enhance recurring investment return, or net investment yields, of Chinese insurers. Insurers may raise investment allocation to higher return instruments such as non-guaranteed corporate bonds, infrastructure bonds and property projects. Secondly, better duration matching of investment assets and insurance liabilities may be achieved, when investment limits on infrastructure bonds and private equity projects are relaxed. Lastly, the permission of stock lending and equity hedging with derivatives will help smoothing total investment return, or gross investment yields, of Chinese insurers. This could reduce the volatility of insurers' investment books, and promote the stability of industry solvency.

**CH INS: Key investment channels and limits of insurance industry**

Items	Classes of Assets	Limits	Newly proposed changes
1	Deposits, Government Bonds, Central Bank Bills, Policy Bills, Money Market Funds	Min 5%	
2	Non-guaranteed Corporate Bonds, Bonds from Non-financials	Max 20%	Relaxing limits on non-guaranteed corporate and infrastructure bonds
3	Direct Equity, Mutual Funds	Max 20%	
4	Unlisted Equity	Max 5%	Relaxing limits on private equity projects
5	Financing Instruments issued by Unlisted Corporate	Max 4%	
6	4 + 5	Max 5%	
7	Physical Property Investment	Max 10%	Relaxing limits on property projects
8	Financing Instruments issued for Physical Property Projects	Max 3%	
9	7 + 8	Max 10%	
10	Infrastructure Projects	Max 10%	Relaxing limits on infrastructure bonds
11	Overseas Investments	Max 15%	Relaxing limits on overseas investments
12	Equity margin financing	Not allowed	Relaxing limits on stock lending
13	Equity derivative hedging	Not allowed	Relaxing limits on equity hedging with options / futures

Source: CIRC, ABCI Securities

*US & Korean insurers with more stable and higher investment return than Chinese insurers*

With less limitation on insurance investments, US and Korean insurers yielded more stable and higher investment return than Chinese insurers from 2008 to 2010. More importantly, insurers in US and Korea reported more consistent and stable investment returns. While Chinese insurers achieved high investment returns in 2006 and 2007, such returns were not sustainable in the following years. Chinese insurers suffered from high volatility in



investments. As a result, we believe the latest proposal on broadening investment channels and limitations on investments can help restoring the stability of investment return for China Insurance.

*Insurance investment return in different countries*

(%)	US	Korea	Japan	China*	Comments
2006	5.85	5.21	2.45	7.11	China the highest
2007	5.92	5.67	1.90	12.33	China the highest
2008	5.57	5.76	0.39	5.21	China behind US & Korea
2009	5.27	4.71	1.86	4.67	China behind US & Korea
2010	5.37	5.29	1.79	3.41	China behind US & Korea

Source: Company data, Bloomberg, ABCI Securities \* proxy from average gross yields of listed insurers



## Valuation & Trading: reaching entry point

*Presenting a sweet entry point based on five fundamental developments in China Insurance*

In our view, China Insurance has reached a sweet entry point. There are five fundamental developments in the industry, which lead to our conclusion. Firstly, Life industry has reached an inflection point, and will recover from now. Secondly, P&C industry remains solid in underwriting performance. Thirdly, the sector will be blessed with multiple national policies. Fourthly, the overhang on solvency has been largely removed for China Insurance. Most importantly, China Insurance is situated at a cyclical sweet spot of investments. As a result, we believe China Insurance is going to turn around in share price performance.

*Sector trading far below historical average valuation, against a normalized EVPS growth in 2012E and 2013E*

Currently, Chinese insurers are trading at historical low valuations. The average 2012E and 2013E PEV of sector are 1.21x and 1.07x respectively, compared with an all-time average of 2.20x. We estimate the average return on EV, or EVPS growth, of Chinese insurers will reach 21.5% YoY in 2012E and 14.1% YoY in 2013E. We consider these growth rates promising by the standards of developing insurance markets. However, we are still concerned with the VNB growth of Chinese insurers. Currently, the sector is trading at 3.1x 2012E and 0.6x 2013E VNB. In our opinion, this is reflecting a low market expectation towards the VNB growth of Chinese insurers going forward. We estimate the sector to grow VNB at 0.6% YoY in 2012E and 1.9% YoY in 2013E. Based on these assumptions, we value the sector with an average EVPS growth of 17.8% per annum. Applying a 15.1% discount rate, derived from a CAPM, we conclude a fair sector valuation of 1.20x 2013F PEV. As such, we believe that valuation upside from here is still considerable for Chinese insurers.

### CH INS: Sector Gordon Growth Model & Fair Valuation in PEV

Industry Average Return on EV / EVPS Growth	15.8%	16.8%	17.8%	18.8%	19.8%
Long term dividend payout ratio (k)	90.0%				
Market risk free rate (Rf)	3.5%				
Market risk premium (Rm)	11.3%				
Stock beta (B)	1.02				
Cost of Equity (CoE= Rf + Rm * B)	15.1%				
Long term sustainable growth (g)	1.8%				
Discount rate (CoEV - g)	13.3%				
<b>Fair PEV: (ROEV * k) / (CoEV - g)</b>	<b>1.07x</b>	<b>1.13x</b>	<b>1.20x</b>	<b>1.27x</b>	<b>1.34x</b>

Source: Bloomberg, Company data, ABCI Securities

## Valuation summary

*Our target prices imply over 15% absolute upside for China Life, China Pacific & China Taiping*

We initiated research coverage on the sector and set our target prices of Chinese insurers as per the following valuation summary. In our view, there is still over 15% absolute upside for China Life and China Pacific. China Life is trading at 1.30x 2013E PEV. We consider it fair, given its position as an anchor index stock and ample room for operation improvement. China Pacific is trading at 1.11x 2013E PEV, which we render attractive given its balanced business mix and reviving Life operations. China Taiping, which we also recommend BUY, is trading at 0.87x 2013E PEV. Despite its poor performance in Life operations, its reinsurance and P&C arms recorded significant improvement in 1H12. Its trading valuation is close to its all-time low. We expect a sharp turnaround of China Taiping in 2H12. Therefore, we consider the stock trading at an attractive valuation at present. We have BUY





recommendations on these three stocks. Our top picks are China Life and China Pacific.

*Ping An facing multiple slowdowns, New China Life not delivering in 1H12*

On the other hand, we are less optimistic on Ping An and New China Life. Ping An is trading at 1.15x 2013E PEV. In our view, the company faces multiple slowdowns, in the divisions of Life, Banking, Securities and Trust. More importantly, its Life operations could be cannibalized by peers, in respect to long term regular premium and critical illness products. Therefore, we have a SELL recommendation on Ping An. New China Life is trading at a low valuation of 0.90x 2013E PEV. Nevertheless, the company failed to deliver up to market expectation on product restructuring and NBM improvement in 1H12. Besides, its premium growth continued to decelerate year to date. Hence we are not convinced of its prospects and have a HOLD recommendation on the stock.

**CH INS: Sector valuation summary**

Name	China Life			Ping An			China Pacific			New China Life			China Taiping		
Stock code	2628.hk			2318.hk			2601.hk			1336.hk			966.hk		
Share Price (HK\$)	22.40			58.60			23.45			24.85			12.18		
ABCI Rec.	BUY			SELL			BUY			HOLD			BUY		
Target Price (HK\$)	26.45			58.04			27.93			24.85			13.42		
Upside / Downside (%)	18.08			(0.96)			19.08			(0.02)			10.20		
	2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E
EVPS (HK\$)	12.61	15.17	17.24	36.24	44.59	51.14	16.08	18.99	21.07	19.14	23.87	27.62	9.96	12.09	13.97
YoY Growth (%)	0.37	20.23	13.64	15.65	23.04	14.68	5.39	18.11	10.98	(31.39)	24.71	15.72	7.78	21.38	15.52
VNB (HK\$)	0.87	0.89	0.92	2.67	2.45	2.47	0.93	0.93	0.98	1.70	1.83	1.83	0.69	0.70	0.69
YoY Growth (%)	4.02	2.02	3.90	10.33	(8.09)	0.94	12.45	(0.57)	5.97	(63.83)	7.17	0.30	28.22	2.26	(1.40)
NBM (APE basis - %)	33.86	38.00	37.00	40.67	37.00	35.00	34.19	37.00	37.00	22.37	25.00	23.50	27.87	30.00	29.00
Gross Inv't Yield (%)	3.52	3.57	4.31	3.59	3.36	4.04	3.43	4.26	4.52	3.83	3.81	3.90	3.42	3.51	4.09
APE Growth (%)	(9.58)	(10.00)	5.00	(2.88)	0.00	5.00	(6.29)	(5.00)	7.00	(22.97)	(5.00)	5.00	(19.00)	(5.00)	2.00
PEV (x)	1.78	1.48	1.30	1.62	1.31	1.15	1.46	1.23	1.11	1.30	1.04	0.90	1.22	1.01	0.87
VNB (x)	11.25	8.15	5.60	8.38	5.71	3.02	4.26	0.92	(1.60)	3.35	0.54	(1.51)	3.22	0.13	(2.57)
PER (x)	28.37	21.60	17.07	19.56	14.74	12.98	19.93	20.06	18.74	16.43	18.34	14.54	42.03	15.38	12.60
PBV (x)	2.21	1.88	1.71	2.22	1.87	1.64	2.58	2.11	2.00	2.03	1.69	1.48	1.83	1.41	1.20

Source: Bloomberg, Company data, ABCI Securities

**Trading at historical trough valuation**

*Expecting sector valuation recovery towards end-2012 and 2013*

China Insurance experienced a major de-rating since early 2011. Currently, all Chinese insurers are trading at or close to historical trough valuations. With a turnaround of industry fundamentals, we believe the sector can recover in trading valuation towards end-2012 and in 2013.

*China Life trading considerably higher than its recent low*

China Life traded up to 5.43x forward PEV and 92.8x forward VNB at its peak in 2007. The company traded at an average forward PEV of 2.52x and forward VNB of 26.3x. At its recent low, it traded at 1.12x 2012E PEV and 2.1x 2012E VNB. Currently, the stock trades at 1.48x 2012E PEV and 8.2x 2012E VNB.



**CH INS: China Life - share price & valuation**

		2004	2005	2006	2007	2008	2009	2010	2011	2012E
Share Price (HK\$)	Hi	6.55	6.90	27.20	52.00	39.85	41.00	39.35	32.65	24.35
	Lo	3.85	4.85	7.05	19.26	16.70	19.90	29.70	17.24	17.06
	Av	4.99	5.61	12.92	31.97	28.08	30.64	34.32	24.95	20.81
PEV(X)	Hi	2.06 x	1.67 x	4.22 x	5.43 x	4.13 x	3.58 x	3.13 x	2.59 x	1.61 x
	Lo	1.21 x	1.17 x	1.09 x	2.01 x	1.73 x	1.74 x	2.36 x	1.37 x	1.12 x
	Av	1.57 x	1.36 x	2.01 x	3.34 x	2.91 x	2.67 x	2.73 x	1.98 x	1.37 x
EVPS YoY Growth (%)			30%	56%	49%	1%	19%	10%	0%	20%
VNB(X)	Hi	14.67 x	10.21 x	55.99 x	92.84 x	54.03 x	41.54 x	32.02 x	23.03 x	10.34 x
	Lo	2.92 x	2.65 x	1.65 x	21.19 x	12.62 x	11.87 x	20.48 x	5.32 x	2.13 x
	Av	7.87 x	5.44 x	17.48 x	49.00 x	32.97 x	26.97 x	26.00 x	14.18 x	6.36 x
VNB YoY Growth (%)			18%	37%	23%	22%	27%	18%	4%	2%

Source: Bloomberg, Company data, ABCI Securities

*Ping An trading somehow higher than its recent low*

Ping An traded up to 5.30x forward PEV and 90.5x forward VNB at its peak in 2007. The company traded at an average forward PEV of 2.29x and forward VNB of 20.4x. At its recent low, it traded at 1.09x 2012E PEV and 1.6x 2012E VNB. Currently, the stock trades at 1.31x 2012E PEV and 5.7x 2012E VNB.

**CH INS: Ping An - share price & valuation**

		2004	2005	2006	2007	2008	2009	2010	2011	2012E
Share Price (HK\$)	Hi	13.80	14.45	44.90	117.00	82.55	75.60	94.40	88.30	68.35
	Lo	9.50	11.75	14.95	32.35	24.00	30.35	58.00	38.30	48.70
	Av	11.51	12.88	23.79	62.83	53.29	56.01	70.47	70.49	60.36
PEV(X)	Hi	2.44 x	1.91 x	2.62 x	5.30 x	4.35 x	3.28 x	3.01 x	2.44 x	1.53 x
	Lo	1.68 x	1.55 x	0.87 x	1.47 x	1.26 x	1.32 x	1.85 x	1.06 x	1.09 x
	Av	2.04 x	1.70 x	1.39 x	2.85 x	2.81 x	2.43 x	2.25 x	1.95 x	1.35 x
EVPS YoY Growth (%)			34%	126%	29%	-14%	21%	36%	16%	23%
VNB(X)	Hi	13.71 x	9.68 x	33.54 x	90.51 x	48.16 x	28.81 x	26.09 x	19.52 x	9.18 x
	Lo	6.47 x	5.88 x	(2.62x)	9.80 x	3.80 x	4.00 x	11.03 x	0.77 x	1.55 x
	Av	9.86 x	7.47 x	8.05 x	38.86 x	25.99 x	18.07 x	16.19 x	12.84 x	6.08 x
VNB YoY Growth (%)			20%	17%	27%	26%	38%	33%	10%	-3%

Source: Bloomberg, Company data, ABCI Securities

*China Pacific trading close to its recent low*

China Pacific was listed in HKEx since Dec 2009. The stock traded up to 2.38x forward PEV and 27.7x forward VNB in the same month. The company traded at an average forward PEV of 1.89x and forward VNB of 16.6x. At its recent low, it traded at 1.16x 2012E PEV and 3.2x 2012E VNB. Currently, the stock trades at 1.23x 2012E PEV and 0.9x 2012E VNB.

*New China Life trading close its recent low*

New China Life was listed in HKEx since Dec 2011. The stock traded up to 1.52x forward PEV and 6.8x forward VNB earlier in 2012. The company traded at an average forward PEV of 1.40x and forward VNB of 4.6x. At its recent low, it traded at 0.90x 2012E PEV and (1.3)x 2012E VNB. Currently, the stock trades at 1.04x 2012E PEV and 0.5x 2012E VNB.

**CH INS: China Pacific & New China Life - share price & valuation**

		CHINA PACIFIC				NEW CHINA LIFE		
		2009	2010	2011	2012E	2011	2012E	
Share Price (HK\$)	Hi	30.95	35.85	35.35	28.50	Hi	28.10	36.28
	Lo	28.00	27.95	20.15	21.50	Lo	23.41	21.55
	Av	29.91	31.17	31.15	24.74	Av	24.90	29.04
PEV(X)	Hi	2.38 x	2.35 x	2.20 x	1.54 x	Hi	1.47 x	1.52 x
	Lo	2.16 x	1.83 x	1.25 x	1.16 x	Lo	1.22 x	0.90 x
	Av	2.30 x	2.04 x	1.94 x	1.34 x	Av	1.30 x	1.22 x
EVPS YoY Growth (%)		26%	18%	5%	15%		-31%	25%
VNB(X)	Hi	27.70 x	24.79 x	20.63 x	10.53 x	Hi	5.26 x	6.80 x
	Lo	23.15 x	15.28 x	4.36 x	3.19 x	Lo	2.51 x	(1.27x)
	Av	26.09 x	19.16 x	16.13 x	6.59 x	Av	3.38 x	2.84 x
VNB YoY Growth (%)		23%	28%	12%	2%		-64%	7%

Source: Bloomberg, Company data, ABCI Securities

*China Taiping trading higher than its recent low*

China Taiping traded up to 5.42x forward PEV and 101.1x forward VNB at its peak in 2007. The company traded at an average forward PEV of 2.31x and forward VNB of 26.1x. At its recent low, it traded at 0.85x 2012E PEV and (2.6)x 2012E VNB. Currently, the stock trades at 1.01x 2012E PEV and 0.1x 2012E VNB.



**CH INS: China Taiping - share price & valuation**

		2006	2007	2008	2009	2010	2011	2012E
Share Price (HK\$)	Hi	9.80	26.45	24.80	30.15	30.00	25.60	18.24
	Lo	2.80	7.16	8.36	9.01	22.30	13.64	10.26
	Av	5.20	15.43	16.59	18.17	26.18	18.90	13.72
PEV(X)	Hi	2.53 x	5.42 x	3.96 x	4.34 x	3.12 x	2.57 x	1.51 x
	Lo	0.72 x	1.47 x	1.34 x	1.30 x	2.32 x	1.37 x	0.85 x
	Av	1.35 x	3.16 x	2.65 x	2.61 x	2.72 x	1.90 x	1.13 x
EVPS YoY Growth (%)			26%	28%	11%	38%	4%	21%
VNB(X)	Hi	37.00 x	101.14 x	60.90 x	58.31 x	37.94 x	22.70 x	8.73 x
	Lo	(6.65x)	10.68 x	6.91 x	5.17 x	23.61 x	5.34 x	(2.60x)
	Av	8.33 x	49.44 x	33.94 x	28.19 x	30.84 x	12.98 x	2.31 x
VNB YoY Growth (%)			33%	43%	31%	35%	28%	2%

Source: Bloomberg, Company data, ABCI Securities

**China Insurance trading close to than its all-time low**

To conclude, the sector is trading at an average forward PEV of 1.21x, compared to 1.02x at the recent low, 1.25x at the 2011 low and 1.44x at the 2008 low. While the current valuation is 18.6% higher than the recent low, it deems attractive compared to the previous troughs. As a result, coupled with a turnaround of industry fundamentals, we call for an attractive entry point of Chinese insurers at present.

**CH INS: Cycles & Valuation**

(HK\$)	Current	PEV (x)	2007 high	PEV (x)	2008 Low	PEV (x)	2010 high	PEV (x)	2011 low	PEV (x)	2012 low	PEV (x)
China Life	22.40	1.48 x	52.00	5.43 x	16.70	1.73 x	39.35	3.13 x	17.24	1.37 x	17.06	1.12 x
Ping An	58.60	1.31 x	117.00	5.30 x	24.00	1.26 x	94.40	3.01 x	38.30	1.06 x	48.70	1.09 x
China Pacific	23.45	1.23 x					35.85	2.35 x	20.15	1.25 x	21.50	1.16 x
New China Life	24.85	1.04 x							23.41	1.22 x	21.55	0.90 x
China Taiping	12.18	1.01 x	26.45	5.42 x	8.36	1.34 x	30.00	3.12 x	13.64	1.37 x	10.26	0.85 x

(HK\$)	Current	VNB (x)	2007 high	VNB (x)	2008 Low	VNB (x)	2010 high	VNB (x)	2011 low	VNB (x)	2012 low	VNB (x)
China Life	22.40	8.15 x	52.00	92.84 x	16.70	12.62 x	39.35	32.02 x	17.24	5.32 x	17.06	2.13 x
Ping An	58.60	5.71 x	117.00	90.51 x	24.00	1.26 x	94.40	26.09 x	38.30	0.77 x	48.70	1.55 x
China Pacific	23.45	4.80 x					35.85	24.79 x	20.15	4.36 x	21.50	3.19 x
New China Life	24.85	0.54 x							23.41	2.51 x	21.55	(1.27x)
China Taiping	12.18	0.13 x	26.45	101.14 x	8.36	6.91 x	30.00	37.94 x	13.64	5.34 x	10.26	(2.60x)

Source: Bloomberg, ABCI Securities

**Performance against benchmarks since 2011 lows**

**China Insurance underperformed MSCI China and HSI most of the times during 2012**

China Insurance outperformed MSCI China but underperformed HSI since the market low on 4 Oct 2011. The biggest outperformer was Ping An, up 51.6%, followed by 55.8% up by market leader P&C and 29.9% up by China Life. But since then, the sector underperformed the two benchmarks most of the times. Since the market high on 29 Feb, the sector underperformed MSCI China by 5.5% and HSI by 12.9%. Until recently, we witnessed that the sector underperformance against benchmarks has narrowed since the release of 1H12 results. The sector traded up 2.5% in average, peer-performing MSCI China (up 1.4%) and HSI (up 3.7%). In conclusion, the market may have turned more optimistic towards the sector's fundamentals, as reflected in 1H12 results. We believe the sector is going to reverse its underperformance against major benchmarks from now onwards.



**CH INS: Share Price Performance against benchmarks**

Company	Stock code	Current (HK\$)	13-Aug	24-Jul	5-Jun	29-Feb	25-Nov	4-Oct
China Life	2628.hk	22.40	21.95	20.85	17.08	24.20	19.34	17.24
Ping An	2318.hk	58.60	60.85	59.25	53.90	67.85	52.00	38.65
China Pacific	2601.hk	23.45	24.95	24.90	21.65	27.95	21.70	20.15
New China Life	1336.hk	24.85	24.30	23.95	29.40	34.20	25.65	-
Market leader P&C	NA	12.18	8.78	8.31	8.01	10.94	10.02	7.82
China Taiping	966.hk	9.52	11.54	11.40	11.70	18.12	14.50	13.90
Hang Seng Index	HSI	20,840	20,292	18,877	18,185	21,680	17,682	16,250
MSCI China	MXCN	55.43	54.90	52.04	51.67	62.48	50.89	44.74

Company	Versus MXCN	Versus HSI	From Aug 12 High	From Jul 12 Low	From Jun 12 Low	From Feb 12 High	From Nov 11 Low	From Oct 11 Low
China Life	Outperform	Outperform	2.1%	7.4%	31.1%	-7.4%	15.8%	29.9%
Ping An	Outperform	Outperform	-3.7%	-1.1%	8.7%	-13.6%	12.7%	51.6%
China Pacific	Underperform	Underperform	-6.0%	-5.8%	8.3%	-16.1%	8.1%	16.4%
New China Life	Underperform	Underperform	2.3%	3.8%	-15.5%	-27.3%	-3.1%	-
Market leader P&C	Outperform	Outperform	38.7%	46.6%	52.1%	11.3%	21.6%	55.8%
China Taiping	Underperform	Underperform	-17.5%	-16.5%	-18.6%	-47.5%	-34.3%	-31.5%
Sector simple av.	Outperform	Underperform	2.6%	5.7%	11.0%	-16.8%	3.4%	24.4%
Big three av.	Outperform	Outperform	-2.6%	0.2%	16.1%	-12.4%	12.2%	32.6%
Hang Seng Index			2.7%	10.4%	14.6%	-3.9%	17.9%	28.2%
MSCI China			1.0%	6.5%	7.3%	-11.3%	8.9%	23.9%

Source: Bloomberg, company data, ABCI Securities

**Long-short ideas**

**Long China Life or China Pacific, Short Ping An**

We recommend to long either China Life or China Pacific and short Ping An towards end-2012. We believe China Life and China Pacific will outperform Ping An continuously, due to the contrasting fundamental development. Currently, China Life is trading at 1.30x and China Pacific is trading at 1.11x 2013E PEV. Ping An is trading at 1.15x.

**China Life will continue to trade at a valuation premium against Ping An**

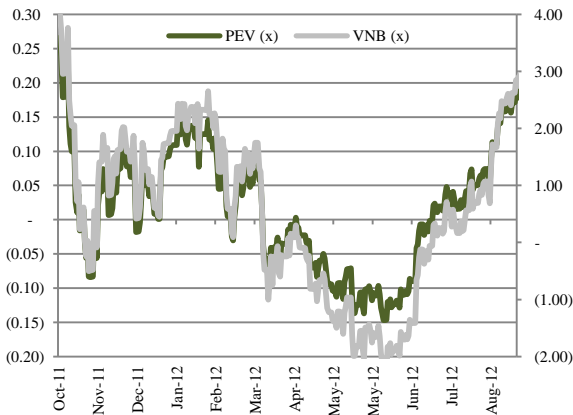
Historically, China Life traded in a consistent pattern against Ping An during the periods when they operated with contrasting fundamental development. Ping An was more popular among investors from Oct 2011 to Jun 2012. Its operations was perceived to be more balanced and of a higher quality. Meanwhile, China Life was despised for its continuous slowdown in life underwriting. Consequently, China Life traded down against Ping An, from a valuation premium of 0.27x PEV in Oct 2011, to a discount of 0.15x PEV in Jun 2012. Since then, China Life became the market favorite again, in light of the recovery of its life operations and its status as an anchor index stock. In the meantime, Ping An suffered from losing market shares in regular premium sales to peers. China Life regained its trading premium against Ping An at 0.16x PEV as of the recent close. We believe China Life will continue to outperform Ping An in fundamental development in 2H12 and 2013. Therefore, we expect China Life's trading premium against Ping An to expand further from now.

**China Pacific will trade up against Ping An on a favorable valuation gap**

Historically, China Pacific traded in range bounds against Ping An. Both companies are composite insurers with heavy focus on Life and P&C. Therefore, we recommend to long China Pacific against Ping An, based on the respective valuation gap. At present, China Pacific is trading at a discount of 0.13x PEV to Ping An, compared to the historical average of 0.04x. Also, China Pacific may outperform Ping An in Life underwriting in the coming 12 months, as inferred from 1H12 results. Therefore we believe this is a good trade to long China Pacific and short Ping An at present.

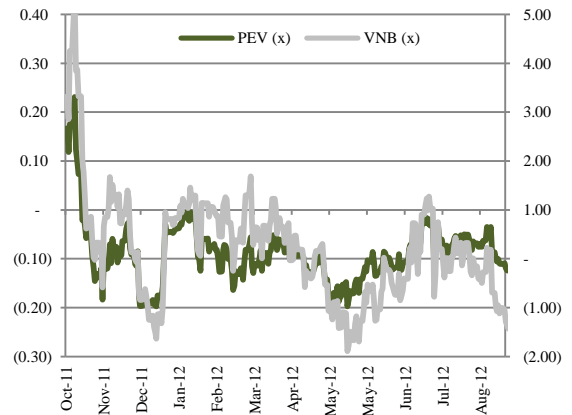


CH INS: China Life vs Ping An in PEV & VNB



Source: Bloomberg, company data, ABCI Securities

CH INS: China Pacific vs Ping An in PEV & VNB



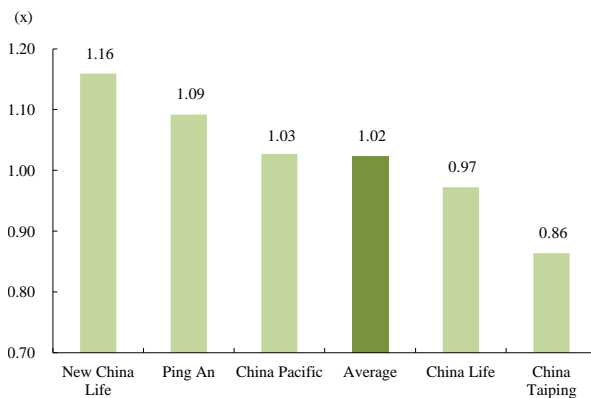
Source: Bloomberg, company data, ABCI Securities

Sector volatility, liquidity & momentum

China Taiping and New China Life are most volatile

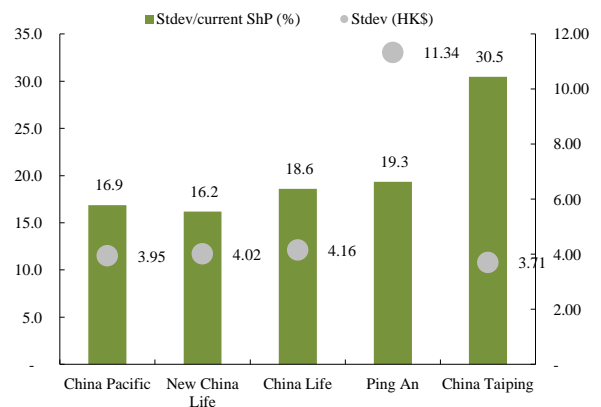
China Taiping is the most volatile stock in the sector. In terms of the standard deviation (stdev) of share price, China Taiping is the highest. One stdev represents 30.5% of its current share price. This is followed by 19.3% of Ping An and 18.6% of China Life. On the other hand, New China Life has the highest trading beta of 1.16x, followed by 1.09x of Ping An and 1.03x of China Pacific. The sector average is 1.02x. In a market uptrend, high beta stocks and stocks with high stdev are likely to generate high return.

CH INS: Trading Betas on HSI



Source: Bloomberg, company data, ABCI Securities

CH INS: Standard Deviation on Chinese insurers



Source: Bloomberg, company data, ABCI Securities

China Life has the highest H-share free-float, China Taiping and New China Life are the least liquid

The volume of trading H-shares free-float for New China Life and China Taiping is the lowest, at 51% and 46% respectively. This limits their liquidity in our view. In contrast, China Life enjoys the highest liquidity with 100% H-shares free float. In terms of 20 days average daily turnover, CTIH is the lowest at US\$3.9m per day. If fund managers intend to build or sell a US\$50m position, it takes up to 3.82 days. We assume a 30% threshold of order execution per day, in order to avoid impact cost. New China Life is the second lowest in trading volume. It takes 1.9 days to build or sell a US\$50m position.



**CH INS: H-shares Liquidity**

	China Life	Ping An	China Pacific	New China Life	China Taiping
Total # of Shares	28,265	7,916	9,062	3,120	1,706
H-shares total	7,441	3,130	2,313	1,034	1,706
H-share free float	7,441	1,820	1,469	530	786
% of H-share Free Float	100	58	63	51	46

Source: Bloomberg, company data, ABCI Securities

**CH INS: Trading days for building or selling positions**

US\$	20D Av Turnover	CL	PA	CPIC	NCI	CTIH
		90.50	88.85	56.38	7.73	3.93
3	mn Position	0.01	0.01	0.02	0.12	0.23
5	mn Position	0.02	0.02	0.03	0.19	0.38
10	mn Position	0.03	0.03	0.05	0.39	0.76
20	mn Position	0.07	0.07	0.11	0.78	1.53
50	mn Position	0.17	0.17	0.27	1.94	3.82

Source: Bloomberg, company data, ABCI Securities

**Weak trading momentum for China Insurance, China Life and Ping An trading at discount to A-share listing**

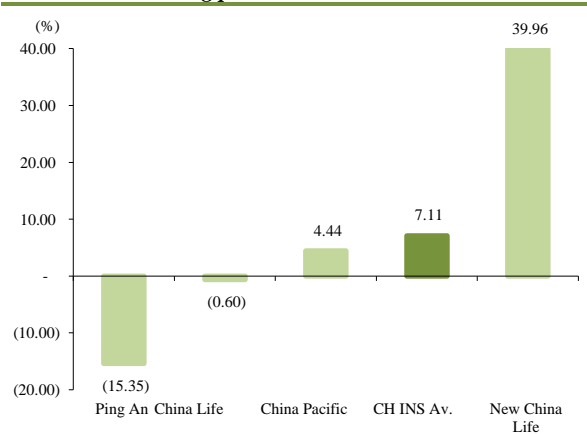
The sector has a strengthening trading momentum at present. Three out of the five stocks trade above their 50-day moving average. This implies growing momentum in the mid term. Only China Life traded above their 200-day moving average, implying the stock as the bellwether for a sector recovery. The relative strength index (RSI) 14-day ranges from 51.9 to 69.0 for all the stocks. All insurers are currently overbought. Lastly, China Life and Ping An at a discount to A-share listing at present. Historically H-share insurers traded more expensively than A-shares insurers. The sector averaged a trading premium of 7.1% against A-share listing.

**CH INS: Technical Trading Data**

(HKS)	CL	PA	CPIC	NCI	CTIH
Current Price	22.40	58.60	23.45	24.85	12.18
50D MA	21.59	59.00	23.98	23.41	11.09
Midterm Momentum	Higher	Lower	Lower	Higher	Higher
200D MA	20.78	59.75	24.42	-	13.71
Long term Momentum	Higher	Lower	Lower		Lower
RSI 14D	56.03	51.99	51.87	63.33	69.00
Overbought / Oversold	Overbought	Overbought	Overbought	Overbought	Overbought
Bbg. Cons. Target	23.09	70.95	29.45	31.19	14.90
Implied Upside	3%	21%	26%	25%	22%
Analyst Rec. (1 Lo - 5 Hi)	3.32	4.09	4.26	3.87	3.76

Source: Bloomberg, company data, ABCI Securities

**CH INS: A-H trading premiums / discounts**



Source: Bloomberg, company data, ABCI Securities

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## Recommendations: identifying the up-swingers

We initiated research coverage on China Insurance with an Overweight rating. In terms of stock picks, we identify based on the swing factors in the company fundamentals. Our top picks are China Life and China Pacific. Our top sell is Ping An. On the other hand, we recommend BUY on China Taiping and HOLD on New China Life.

### China Life (2628.hk) - Goliath returns

(BUY, TP: HK\$26.45)

China Life returns as a market favorite in style. After years-long underperformance, the company has outperformed peers and overall market since Jun 2012. We expect the insurer to win in the new game of ‘margin over volume’. Also, China Life’s EV is the most sensitive to A-share market recovery. Based on these, we initiate coverage on China Life with a BUY recommendation.

### China Pacific (2601.hk) - The preferred composite play

(BUY, TP: HK\$27.93)

We prefer China Pacific to other composite insurers. Its Life operations enjoyed the earliest turnaround among peers, as reflected in its VNB growth in 1H12. Also, the insurer embeds a balance of growth and profitability from Life and P&C. Meanwhile, Changjiang Pension is set to benefit from tax deferred pension products piloted in Shanghai. Based on these, we initiate coverage on China Pacific with a BUY recommendation.

### Ping An (2318.hk) - Multiple decelerations

(SELL, TP: HK\$58.04)

Ping An is facing multiple decelerations. Ping An Life encounters both margin and volume pressure. Ping An Bank suffers from narrowing NIM, higher NPL and inadequate capital. Ping An Securities is haunted by the shrinking volume of A-share markets. Ping An Trust may face heavy repayment risks. Based on these, we initiate coverage on Ping An with a SELL recommendation.

### China Taiping (966.hk) - An undervalued small-cap

(BUY, TP: HK\$13.42)

China Taiping has been constantly overlooked by investors due to its small-cap status. However, we see strong turnaround stories in its Reinsurance and P&C units. While we are still concerned with its Life operations, the stock is trading at only 0.82x 2013E PEV, compared to 2.31x of historical average. Based on these, we initiate coverage on China Taiping with a BUY recommendation.

### New China Life (1366.hk) - Cheap for good reasons

(HOLD, TP: HK\$24.85)

New China Life is trading at a low valuation for good reasons. The company disappointed the market by reporting the lowest NBM among peers in 1H12. Also, its premium growth decelerated fast since 1Q12. Lastly, the company’s EV is the least sensitive to equity values, and hence a potential recovery of A-share markets. Based on these, we initiate coverage on New China Life with a HOLD recommendation.



# Company Report

## China Life (2628 HK) – Buy Life & Health Insurance Industry Initiation

### Key data

H-share price (HK\$)	22.40
Target price (HK\$)	26.45
Upside potential (%)	18.08
52Wk H/L(HK\$)	24.7 / 17.0
Issued shares:	
H-shares (mn)	7,441
A-shares (mn)	20,823
H-share mkt cap (HK\$m)	652,243
30-day avg vol (HK\$m)	687.0
Major shareholders (%):	
China Life Group	68.4
JPMorgan Chase	4.9

Source: Company & Bloomberg

### Revenue breakdown in 2011 (%)

Net earned premiums (NEP)	85.8
Investment income	13.4
Other income	0.8

\*Based on 2011 results

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	8.2	4.5
3-mth	12.2	8.7
6-mth	11.2	16.8

\*Relative to MSCI China

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

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## Goliath returns

**China Life returns as a market favorite in style. After years-long underperformance, the company has outperformed peers and overall market since Jun 2012. We expect the insurer to win in the new game of ‘margin over volume’. Also, China Life’s EV is the most sensitive to A-share market recovery. Based on these, we initiate coverage on China Life with a BUY recommendation.**

**A winner in the margin game.** China Life will win in the new game of ‘margin over volume’ in our opinion. On one hand, the insurer has more room for improvement on regular FYP sales, as compared to peers. On the other hand, its new critical illness product ‘Kang Ning CI’ has been a blockbuster in the market. Both regular premium and CI products embed high NBM. We expect China Life to extend its strength in these areas into 2013. Per our estimates, China Life will enjoy a NBM of 37% - 38%.

**EV sensitive to investment upturn.** 10% change in equity values will lead to 5.4% change in China Life’s EV in 1H12. This is high compared to major peers. In 1H12, China Life allocated Rmb164.5bn, or 9.9% of investment portfolio, in equity. We expect the insurer to benefit the most from the upcoming recovery of A-share markets.

**Anchor index stock.** China Life is an anchor index stock in MSCI China and Hang Seng Index. Most importantly, the stock was heavily underweight by institutional investors since early 2011. Therefore, the stock can benefit from any positive fund flow to Hong Kong stock market, and portfolio reshuffling by institutional investors from now.

**Initiate coverage with a BUY rating; TP of HK\$26.45.** We derive an appraisal value of Rmb598,097 mn for 2013E, also adopting it as TP, or HK\$26.45/ share. The implied valuation of our TP is 1.53x 2013E PEV and 10.0x 2013E VNB. This represents 18.1% upside potential from the current share price. We initiate coverage of China Life 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)	385,838	370,899	371,959	413,524	444,326
Chg (YoY)	13.7	(3.9)	0.3	11.2	7.4
Net profit (Rmb mn)	33,626	18,331	23,828	29,669	36,288
Chg (YoY)	2.3	(45.5)	30.0	24.5	22.3
EPS (HK\$)	1.42	0.79	1.04	1.31	1.69
PER (x)	15.8	28.4	21.6	17.1	13.2
BPS (HK\$)	8.8	8.3	9.7	10.7	12.5
P/B (x)	2.5	2.7	2.3	2.1	1.8
EVPS (HK\$)	12.6	12.6	15.2	17.2	20.3
PEV (x)	1.8	1.8	1.5	1.3	1.1
VNB (HK\$)	0.8	0.9	0.9	0.9	1.0
VNB (x)	11.8	11.2	8.1	5.6	2.1

Source: Company data, ABCI Securities estimates





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## Investment Positives

**A winner in the margin game.** China Life will win in the new game of ‘margin over volume’ in our opinion. Regular premium sales embed higher NBM than single ones. In 1H12, regular FYP constituted 83.4% of China Life’s APE and 33.5% of its FYP. This is compared to 85.7% - 95.5% of APE and 37.5% -68.2% of FYP for peers, implying more room for improvement.

Also, the company launched a new critical illness product, named Kang Ning CI, in Apr 2012. The product contains high protection element and of high NBM. Its sales performance was more than satisfactory. In 1H12, it contributed to about 10% of China Life’s FYP as per our channel check. In fact, China Life improved its NBM from 33.9% in 2011 to 38.0% in 1H12. The company achieved a YoY growth of 2.5% VNB, in spite of a YoY decline of 26.4% in FYP. Going forward, we believe China Life can extend its strength in regular FYP and critical illness products against its peers.

**Volume downtrend reversing.** The total premium sales started to decline YoY since 4Q11. Traditionally, China Life relied heavily on bancassurance channel, which was clogged by the new CIRC regulations. Total premiums declined by 8.6% YoY in 4M12 and FYP dropped significantly by 26.4% in 1H12. However, we witness an improving trend of total premium sales since May. In 8M12, the sales declined by a less margin of 3.2% YoY. Also, per the management, the decline of bancassurance sales may narrow in 2H12.

**EV sensitive to investment upturn.** Per the company disclosure, 10% change in equity values will lead to 5.4% change in China Life’s EV in 1H12. This is high compared to 2.8% of Ping an, 1.3% of China Pacific and 1.7% of New China Life. In 1H12, China Life allocated Rmb164.5bn, or 9.9% of investment portfolio, in equity. We expect the insurer to benefit the most from the upcoming recovery of A-share markets.

**Ample solvency.** Post the issuance of Rmb28bn sub-debt, China Life reported a solvency of 230.6%. This is the second highest in the sector. Also, it far exceeded the recommended level of 150% by CIRC.

**Anchor index stock.** China Life is an anchor index stock in MSCI China and Hang Seng Index. Its index weighting is approximately 3.0% of MSCI China and 2.6% of HSI. Most importantly, the stock was heavily underweight by institutional investors since early 2011. Therefore, the stock can benefit from any positive fund flow to Hong Kong stock market, and portfolio reshuffling by institutional investors from now.

## Investment Concerns

**Losing market shares.** As an incumbent, China Life has been losing market share since 2006. Its market share declined from 45.0% in 2006 to 32.4% in 8M12. Under the circumstance of clogged bancassurance channel, we expect China Life to continue losing shares to peers.

**Not as high EV operating margins.** In 2011, China Life’s EV operating margins was 15.9%, lower than 23.6% of Ping An, 31.1% of New China Life and 29.7% of Taiping Life. Given the high base effect, we do not expect China Life to outgrow its peers in EV in the future.



## Valuation & Recommendation

**We forecast mid-teens EV Growth.** China Life reported group EV of Rmb292,854 mn in 2011 and Rmb334,326 mn in 1H12. In 2012E, we expect the company to report investment return variance of Rmb12,000 mn, due to slightly improved capital markets in China, compared to 2011. Besides, we forecast VNB of Rmb20,399 mn in 2012E and Rmb20,855 mn in 2013E, on the back of strong NBM's averaging 37.5%. As such, we forecast the EV to reach Rmb348,533 mn in 2012E, up 19.0% YoY, and Rmb389,743 mn in 2013E, up 11.8% YoY.

**Expecting a sharp growth in earnings.** Based on a net premium growth of 6.0% YoY and gross investment yield of 4.3%, we estimate China Life to report net earnings of Rmb29,669 mn in 2013E, up 24.5% YoY from Rmb23,828 mn in 2012E. Our earnings forecast is slightly behind consensus of Rmb31,833 mn, due to more conservative assumption on insurance reserves.

**TP and recommendation.** Based on the aforementioned assumptions, we derive an appraisal value of Rmb598,097 mn for China Life in 2013E and also adopt it as our target price. It is equivalent to HK\$26.45/ share. We forecast 2013E EVPS and VNB of HK\$17.24 and HK\$0.92, respectively. The implied valuation of our TP is 1.53x 2013E PEV and 10.0x 2013E VNB. This represents 18.08% upside potential from the current share price. We initiate coverage of China Life with a BUY recommendation.



China Life: 1H12 profit & loss

	2009	2010	2011	1H10	2H10	1H11	2H11	1H12	HoH	YoY
	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	Chg (%)	Chg (%)
GWP & Policy fees	275,970	318,229	318,252	183,614	134,615	195,490	122,762	185,438	51.1	(5.1)
(-) Premiums to Reinsurers	158	177	232	90	87	124	108	151	39.8	21.8
NWP & Policy fees	275,812	318,052	318,020	183,524	134,528	195,366	122,654	185,287	51.1	(5.2)
Chg. in Unearned Premium Res.	735	(36)	256	(65)	29	517	(261)	548	(310.0)	6.0
NEP & policy fees	275,077	318,088	318,276	183,589	134,499	194,849	123,427	184,739	49.7	(5.2)
Investment income	61,583	64,993	49,851	30,612	34,381	31,315	18,536	22,366	20.7	(28.6)
Other income	2,630	2,757	2,772	1,190	1,567	1,302	1,470	1,495	1.7	14.8
<b>Total revenue</b>	<b>339,290</b>	<b>385,838</b>	<b>370,899</b>	<b>215,391</b>	<b>170,447</b>	<b>227,466</b>	<b>143,433</b>	<b>208,600</b>	<b>45.4</b>	<b>(8.3)</b>
Claims, Surrenders, Annuities /										
Maturities	(99,295)	(95,151)	(111,169)	(48,029)	(47,122)	(70,044)	(41,125)	(71,648)	74.2	2.3
Div. & Int. to PH & Net Inc. in PH Res.	(154,372)	(199,655)	(187,704)	(122,543)	(77,112)	(117,091)	(70,613)	(100,229)	41.9	(14.4)
<b>Ttl. Claims / PH Benefits</b>	<b>(253,667)</b>	<b>(294,806)</b>	<b>(298,873)</b>	<b>(170,572)</b>	<b>(124,234)</b>	<b>(187,135)</b>	<b>(111,738)</b>	<b>(171,877)</b>	<b>53.8</b>	<b>(8.2)</b>
U/W & Policy Acq. Expense	(22,936)	(27,256)	(27,434)	(13,962)	(13,294)	(15,343)	(12,091)	(14,569)	20.5	(5.0)
General & Administrative Expense	(18,719)	(20,285)	(21,549)	(8,405)	(11,880)	(9,030)	(12,519)	(9,813)	(21.6)	8.7
Other Expense	(2,927)	(4,254)	(4,743)	(1,919)	(2,335)	(2,200)	(2,543)	(2,850)	12.1	29.5
<b>Total Expenses</b>	<b>(44,582)</b>	<b>(51,795)</b>	<b>(53,726)</b>	<b>(24,286)</b>	<b>(27,509)</b>	<b>(26,573)</b>	<b>(27,153)</b>	<b>(27,232)</b>	<b>0.3</b>	<b>2.5</b>
<b>Net profit before Tax</b>	<b>41,041</b>	<b>39,237</b>	<b>18,300</b>	<b>20,533</b>	<b>18,704</b>	<b>13,758</b>	<b>4,542</b>	<b>9,491</b>	<b>109.0</b>	<b>(31.0)</b>
Associate / JV - Profits / Losses	704	1,771	2,213	1,070	701	1,169	1,044	1,521	45.7	30.1
Tax Expense	(8,709)	(7,197)	(2,022)	(3,488)	(3,709)	(1,853)	(169)	(1,271)	652.1	(31.4)
<b>Net profit after Tax</b>	<b>33,036</b>	<b>33,811</b>	<b>18,491</b>	<b>18,115</b>	<b>15,696</b>	<b>13,074</b>	<b>5,417</b>	<b>9,741</b>	<b>79.8</b>	<b>(25.5)</b>
Minority interest	(155)	(185)	(160)	(81)	(104)	(110)	(50)	(106)	112.0	(3.6)
<b>NP to China Life Shareholders</b>	<b>32,881</b>	<b>33,626</b>	<b>18,331</b>	<b>18,034</b>	<b>15,592</b>	<b>12,964</b>	<b>5,367</b>	<b>9,635</b>	<b>79.5</b>	<b>(25.7)</b>

Source: Company, ABCI Securities

China Life: Embedded Value (EV), Value of New Business (VNB) & New Business Margins (NBM)

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
ANAV	136,286	110,266	125,829	144,655	137,661	159,948	24	8
VIF	232,639	215,608	202,352	183,008	167,352	149,387	8	15
Solvency Cost	(34,598)	(33,020)	(31,688)	(29,564)	(26,572)	(24,106)	5	9
EV	334,326	292,854	296,493	298,099	278,441	285,229	14	13
EVPS (HK\$)	14.55	12.67	12.77	12.57	11.23	11.50	15	14
APE	32,842	59,646	39,888	65,968	37,134	51,374	66	(18)
VNB	12,494	20,199	12,186	19,839	11,548	17,713	56	3
NBM (APE Basis %)	38.0	33.9	30.6	30.1	31.1	34.5	4.2	7.5
FYP	81,824	163,523	111,103	190,252	111,576	156,156	56	(26)
VNB	12,494	20,199	12,186	19,839	11,548	17,713	56	3
NBM (FYP Basis %)	15.3	12.4	11.0	10.4	10.3	11.3	2.9	4.3
VNB (HK\$)	0.54	0.87	0.52	0.84	0.47	0.71	56	4

Source: Company, ABCI Securities

China Life: Investment & Yields

(%)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Cash Equivalents	5.3	3.7	5.5	3.6	3.6	3.1	1.6	(0.1)
Deposits	37.7	34.8	34.3	33.1	33.9	29.4	2.8	3.3
Bonds	42.4	44.6	43.2	45.5	48.5	49.7	(2.2)	(0.9)
Equities	9.9	12.1	13.4	14.7	11.2	15.3	(2.2)	(3.5)
Others	4.8	4.7	3.6	3.2	2.9	2.5	0.0	1.2
<b>Total Inv'ts (RMB bn)</b>	<b>1,662</b>	<b>1,495</b>	<b>1,454</b>	<b>1,336</b>	<b>1,243</b>	<b>1,172</b>	<b>11</b>	<b>14</b>
<b>Net Investment Yield (%)</b>	<b>4.5</b>	<b>4.3</b>	<b>4.3</b>	<b>3.9</b>	<b>4.1</b>	<b>3.7</b>	<b>0.2</b>	<b>0.1</b>
<b>Total Investment Yield (%)</b>	<b>2.8</b>	<b>3.5</b>	<b>4.5</b>	<b>5.2</b>	<b>5.0</b>	<b>5.8</b>	<b>(0.7)</b>	<b>(1.7)</b>

Source: Company, ABCI Securities



*China Life: Operating data*

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross premiums	185,438	318,252	195,490	318,088	183,614	275,970	51	(5)
Individual	176,499	302,012	186,858	302,753	175,520	261,715	53	(6)
Group	316	438	298	468	283	190	126	6
Short-term	8,623	15,802	8,334	14,867	7,811	14,065	15	3
FYP Regular	27,399	48,104	31,974	52,159	28,863	39,711	70	(14)
% of FYP Ind. Regular	76.1	68.1	70.1	70.2	72.0	74.6	8.0	6.0
# of agents	682,000	685,000	662,000	706,000	736,000	770,000	(0)	3
FYP Regular per agent (Rmb)	40,174	70,225	48,299	73,880	39,216	51,573	(43)	(17)
Individual FYP	72,885	147,286	102,472	174,808	103,486	142,960	(51)	(29)
Individual FYP per agent (Rmb)	106,870	215,016	154,792	247,603	140,606	185,662	(50)	(31)
Persistence 13 mo (%)	92.5	92.5	92.5	93.0	94.0	93.7	0.0	(0.0)
Solvency (%)	230.6	170.1	164.2	212.0	217.2	303.6	60.4	66.4

Source: Company, ABCI Securities

*China Life - share price & valuation*

		2004	2005	2006	2007	2008	2009	2010	2011	2012E
Share Price (HK\$)	Hi	6.55	6.90	27.20	52.00	39.85	41.00	39.35	32.65	24.35
	Lo	3.85	4.85	7.05	19.26	16.70	19.90	29.70	17.24	17.06
	Av	4.99	5.61	12.92	31.97	28.08	30.64	34.32	24.95	20.81
PEV(X)	Hi	2.06 x	1.67 x	4.22 x	5.43 x	4.13 x	3.58 x	3.13 x	2.59 x	1.61 x
	Lo	1.21 x	1.17 x	1.09 x	2.01 x	1.73 x	1.74 x	2.36 x	1.37 x	1.12 x
	Av	1.57 x	1.36 x	2.01 x	3.34 x	2.91 x	2.67 x	2.73 x	1.98 x	1.37 x
EVPS YoY Growth (%)		30%	56%	49%	1%	19%	10%	0%	20%	
VNB(X)	Hi	14.67 x	10.21 x	55.99 x	92.84 x	54.03 x	41.54 x	32.02 x	23.03 x	10.34 x
	Lo	2.92 x	2.65 x	1.65 x	21.19 x	12.62 x	11.87 x	20.48 x	5.32 x	2.13 x
	Av	7.87 x	5.44 x	17.48 x	49.00 x	32.97 x	26.97 x	26.00 x	14.18 x	6.36 x
VNB YoY Growth (%)		18%	37%	23%	22%	27%	18%	4%	2%	

Source: Bloomberg, Company data, ABCI Securities



*China Life: Embedded Value*

(Rmb mn)	2009	2010	2011	2012E	2013E	1H12
Embedded value						
Adjusted net worth	159,948	144,655	110,266	139,593	157,369	136,286
Value of in-force	149,387	183,008	215,608	241,554	266,945	232,639
Cost of solvency margin	(24,106)	(29,564)	(33,020)	(32,614)	(34,571)	(34,598)
Embedded value	285,229	298,099	292,854	348,533	389,743	334,326
Vnb (long term)	17,713	19,839	20,199	20,399	20,855	12,494
Multiplier	10	9	9	10	10	
New business value (long term)	175,344	179,381	187,849	197,817	208,354	
Appraisal value	460,573	477,480	480,703	546,351	598,097	
<b>EV movement analysis</b>						
Opening embedded value	240,088	285,229	298,099	292,854	348,533	292,854
Expected return						
- SHF's	7,580	8,797	7,650	6,065	7,678	4,944
- In-force	13,519	16,433	20,131	23,717	26,571	9,234
Value of new business (VNB)	17,713	19,839	20,199	20,399	20,855	12,494
Inv't r var + Mkt val adj	15,307	(11,234)	(40,839)	12,000	(5,000)	19,429
Capital raising & dividends	(6,500)	(19,785)	(11,306)	(6,501)	(6,894)	(6,501)
OpEx var, model chg & others	(2,478)	(1,180)	(1,080)	-	(2,000)	1,872
Closing embedded value	285,229	298,099	292,854	348,533	389,743	334,326
EVPS (HK\$)	11.45	12.57	12.61	15.17	17.24	14.55
AVPS (HK\$)	18.49	20.13	20.71	23.78	26.45	
PEV implied	1.61	1.60	1.64	1.57	1.53	
VNB (HK\$)	0.71	0.84	0.87	0.89	0.92	
VNB implied (x)	9.90	9.04	9.30	9.70	9.99	
<b>EV contributions 1 (%)</b>						
Expected return on beg EV	9%	9%	9%	10%	10%	10%
IRV + MVA contribution to beg EV	6%	-4%	-14%	4%	-1%	13%
VNB contribution to beg EV	7%	7%	7%	7%	6%	9%
VNB contribution to beg VIF	14%	13%	11%	9%	9%	
EVPS (HK\$) growth	19%	10%	0%	20%	14%	
<b>EV contributions 2 (%)</b>						
Beginning EV	84%	96%	102%	84%	89%	88%
Expected return						
- SHF's	3%	3%	3%	2%	2%	1%
- In-force	5%	6%	7%	7%	7%	3%
Inv't r var + mkt val adj	5%	-4%	-14%	3%	-1%	6%
Value of new business (VNB)	6%	7%	7%	6%	5%	4%
Capital raising & dividends	-2%	-7%	-4%	-2%	-2%	-2%
OpEx var, model chg & others	-1%	0%	0%	0%	-1%	1%
Ending EV	100%	100%	100%	100%	100%	100%

Source: Company data, ABCI Securities estimates



**農銀國際**

ABC INTERNATIONAL

ABC SECURITIES COMPANY LIMITED

China Insurance

**China Life Financial Statements**

Profit & loss (Rmb mn)						Operating ratios (%)					
	2010	2011	2012E	2013E	2014E		2010	2011	2012E	2013E	2014E
<b>GWP &amp; policy fees</b>	<b>318,229</b>	<b>318,252</b>	<b>314,338</b>	<b>333,198</b>	<b>353,190</b>	Gross written premium growth	15.3%	0.0%	-1.2%	6.0%	6.0%
(-) Premiums to reinsurers	177	232	280	431	457	Net earned premium growth	15.6%	0.1%	-2.3%	6.0%	6.0%
<b>NWP &amp; policy fees</b>	<b>318,052</b>	<b>318,020</b>	<b>314,058</b>	<b>332,767</b>	<b>352,733</b>	Claims/benefits - of NEP	25.1%	34.3%	34.5%	31.5%	31.5%
Chg. in unearned premium res.	(36)	(256)	3,169	3,278	3,475	Div to PH & net inc. in PH res. of NEP	62.8%	57.1%	56.6%	60.5%	60.5%
<b>NEP &amp; policy fees</b>	<b>318,088</b>	<b>318,276</b>	<b>310,889</b>	<b>329,489</b>	<b>349,258</b>	<b>Ttl. claim/PH benefits to NEP</b>	<b>87.9%</b>	<b>91.3%</b>	<b>91.1%</b>	<b>92.0%</b>	<b>92.0%</b>
Investment income	64,993	49,851	58,031	80,844	91,718	Claims/benefits - of total revenue	20.7%	29.4%	28.8%	25.1%	24.8%
Other income	2,757	2,772	3,039	3,190	3,350	Net inc. in PH res. - of total revenue	51.7%	49.0%	47.3%	48.2%	47.6%
<b>Total revenue</b>	<b>385,838</b>	<b>370,899</b>	<b>371,959</b>	<b>413,524</b>	<b>444,326</b>	<b>Ttl. claim/PH benefits to total revenue</b>	<b>72.5%</b>	<b>78.4%</b>	<b>76.1%</b>	<b>73.3%</b>	<b>72.3%</b>
Claims, surrenders, annuities/maturities	(95,151)	(117,294)	(117,062)	(121,911)	(129,226)	Commission cost ratio	0.0%	0.0%	0.0%	0.0%	0.0%
Div. & int. to PH & net inc. in PH res.	(199,655)	(181,579)	(175,919)	(199,341)	(211,301)	General & admin. cost ratio	6.4%	6.8%	6.4%	6.8%	6.8%
<b>Ttl. claims/PH benefits</b>	<b>(294,806)</b>	<b>(298,873)</b>	<b>(292,981)</b>	<b>(321,252)</b>	<b>(340,527)</b>	Other exp. & stat. levy ratio	1.3%	1.5%	1.8%	1.6%	1.6%
Commission expenses	0	0	0	0	0	<b>Operating expense ratio</b>	<b>7.7%</b>	<b>8.3%</b>	<b>8.2%</b>	<b>8.4%</b>	<b>8.4%</b>
U/W & policy acq. expense	(27,256)	(27,434)	(27,184)	(30,012)	(31,813)	<b>Gross investment yield</b>	<b>5.2%</b>	<b>3.5%</b>	<b>3.6%</b>	<b>4.3%</b>	<b>4.3%</b>
General & administrative expense	(20,285)	(21,549)	(19,905)	(22,444)	(23,790)	<b>Solvency ratio</b>	<b>212.0%</b>	<b>170.1%</b>	<b>220.3%</b>	<b>205.2%</b>	<b>196.2%</b>
Other expense	(4,254)	(4,743)	(5,625)	(5,291)	(5,609)						
<b>Total expenses</b>	<b>(51,795)</b>	<b>(53,726)</b>	<b>(52,714)</b>	<b>(57,747)</b>	<b>(61,212)</b>						
<b>Net profit before tax</b>	<b>39,237</b>	<b>18,300</b>	<b>26,263</b>	<b>34,525</b>	<b>42,588</b>	<b>Balance sheet (Rmb mn)</b>					
Associate/JV - Profits/losses	1,771	2,213	2,669	2,936	3,230		<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
Tax expense	(7,197)	(2,022)	(4,855)	(7,492)	(9,164)	Cash	47,854	55,985	93,303	106,033	119,825
<b>Net profit after tax</b>	<b>33,811</b>	<b>18,491</b>	<b>24,078</b>	<b>29,969</b>	<b>36,654</b>	Investments	1,288,391	1,438,984	1,662,199	1,888,985	2,134,683
Minority interest	(185)	(160)	(249)	(300)	(367)	Receivables	7,274	8,253	15,974	17,611	19,416
<b>NP to China Life shareholders</b>	<b>33,626</b>	<b>18,331</b>	<b>23,828</b>	<b>29,669</b>	<b>36,288</b>	Deferred acquisition costs	0	0	0	0	0
						Fixed assets	18,946	20,231	20,321	20,321	20,321
						Other assets	48,114	60,454	72,010	72,010	72,010
<b>Financial summary</b>						<b>Total assets</b>	<b>1,410,579</b>	<b>1,583,907</b>	<b>1,863,807</b>	<b>2,104,960</b>	<b>2,366,254</b>
	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	Policyholder benefits	1,070,963	1,245,741	1,424,884	1,639,052	1,866,070
<b>EPS (HK\$)</b>	<b>1.42</b>	<b>0.79</b>	<b>1.04</b>	<b>1.31</b>	<b>1.69</b>	Policyholder deposits	70,171	69,797	68,051	71,346	74,839
<i>EPS growth (%)</i>	7.4%	-44.3%	31.3%	26.5%	29.2%	Unearned premiums	1,880	3,719	5,363	8,641	12,116
<b>PER (x)</b>	<b>15.8</b>	<b>28.4</b>	<b>21.6</b>	<b>17.1</b>	<b>13.2</b>	Claim reserves	0	0	0	0	0
<b>PBV (x)</b>	<b>2.55</b>	<b>2.72</b>	<b>2.31</b>	<b>2.10</b>	<b>1.80</b>	Payables	8,275	3,719	2,879	3,174	3,500
<b>PEV (x)</b>	<b>1.78</b>	<b>1.78</b>	<b>1.48</b>	<b>1.30</b>	<b>1.10</b>	Repo	22,660	13,000	42,529	42,529	42,529
<b>VNB multiple (x)</b>	<b>11.75</b>	<b>11.25</b>	<b>8.15</b>	<b>5.60</b>	<b>2.08</b>	Borrowings	0	29,990	57,982	57,982	57,982
<b>Dividend per share (HK\$)</b>	<b>0.48</b>	<b>0.28</b>	<b>0.30</b>	<b>0.30</b>	<b>0.30</b>	Statutory insurance fund	194	146	192	192	192
Yield (%)	2.9%	1.7%	1.8%	1.8%	1.8%	Other liabilities	25,961	24,407	37,203	38,246	39,359
Payout ratio (%)	33.6%	35.5%	28.9%	22.9%	17.7%	<b>Total liabilities</b>	<b>1,200,104</b>	<b>1,390,519</b>	<b>1,639,084</b>	<b>1,861,162</b>	<b>2,096,586</b>
<b>Return on equity (%)</b>	<b>15.9%</b>	<b>9.1%</b>	<b>11.4%</b>	<b>12.7%</b>	<b>14.1%</b>	<b>Net assets</b>	<b>210,475</b>	<b>193,388</b>	<b>224,723</b>	<b>243,798</b>	<b>269,668</b>
Return on assets (%)	2.6%	1.2%	1.4%	1.5%	1.6%	Minority interests	1,765	1,858	2,056	2,356	2,723
Tax rate (%)	17.6%	9.9%	16.8%	20.0%	20.0%	<b>Net equity to shareholders</b>	<b>208,710</b>	<b>191,530</b>	<b>222,666</b>	<b>241,442</b>	<b>266,946</b>

Source: Company data, ABCI Securities estimates



# Company Report

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

### Key data

H-share price (HK\$)	22.85
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)	211,155
30-day avg vol (HK\$m)	424.4
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	1.1	(2.4)
3-mth	(5.8)	(8.8)
6-mth	(2.5)	2.4

\*Relative to MSCI China

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 3 October 2012

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### The preferred composite play

**We prefer China Pacific to other composite insurers. Its Life operations enjoyed the earliest turnaround among peers, as reflected in its VNB growth in 1H12. Also, the insurer embeds a balance of growth and profitability from Life and P&C. Meanwhile, Changjiang Pension is set to benefit from tax deferred pension products piloted in Shanghai. Based on these, we initiate coverage on China Pacific with a BUY recommendation.**

**The earliest turnaround in Life.** We regard China Pacific as the front-runner in the recovery of Life sector. In 1H12, its FYP declined at a slower rate than major peers. Also, it sold higher portion of long term FYP than other Life insurers. In fact, China Pacific improved its NBM from 34.8% in 2011 to 36.9% in 1H12. As a result, the company achieved a YoY growth of 6.0% in VNB, the highest among peers.

**Most balanced Composite play.** Other than Life unit, China Pacific's P&C unit reported promising underwriting results in 1H12. The unit reported underwriting profits of Rmb1.5bn, with combined ratios at 94.4%. During the half, the unit contributed 58.8% of group profits. Unlike Ping An, which suffered from multiple slowdowns in different divisions, China Pacific enjoyed a more balanced growth.

**First beneficiary of tax deferred pension products.** Tax deferred pension products will be piloted in Shanghai towards end-2012. Changjiang Pension, the wholly subsidiary of China Pacific, is the market leader in the pension market in Shanghai. In 1H12, over 50% of its entrusted pension assets (Rmb29.4bn) came from Shanghai.

**Initiate coverage with a BUY rating; TP of HK\$27.93.** We derive an appraisal value of Rmb193,990 mn for 2013E, also adopting 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 19.1% upside potential from the current share price. We initiate coverage of China Pacific 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)	141,327	155,517	167,931	181,503	191,974
Chg (YoY)	35.6	10.0	8.0	8.1	5.8
Net profit (Rmb mn)	8,557	8,313	8,392	9,071	11,274
Chg (YoY)	16.3	(2.8)	1.0	8.1	24.3
EPS (HK\$)	19.8	19.9	20.1	18.7	14.3
PER (x)	11.3	11.1	13.6	14.7	16.7
BPS (HK\$)	2.1	2.1	1.7	1.6	1.4
P/B (x)	15.3	16.1	19.0	21.1	24.7
EVPS (HK\$)	1.5	1.5	1.2	1.1	0.9
PEV (x)	0.8	0.9	0.9	1.0	1.1
VNB (HK\$)	7.5	4.3	0.9	(1.6)	(5.4)
VNB (x)	19.8	19.9	20.1	18.7	14.3

Source: Company data, ABCI Securities estimates



## Investment Positives

**The earliest turnaround in Life.** China Pacific is the first insurer to turn around in Life operations, compared to major peers. In 1H12, its FYP declined at a slower rate of 17.8% YoY, relative to a 26.4% YoY decrease of China Life and a 28.1% YoY decrease of Ping An Life. Long term regular premium sales embed higher NBM than the short ones. During the same half, the portion of regular FYP with 10 years payment or above constituted 47.7% of China Pacific's FYP, up from 41.8% in 1H11. This portion is higher than 38% of China Life.

Also, the company attached a critical illness rider on Hong Fa annuity product in early 2012. The rider contains high protection element and derives high NBM. Its sales performance was satisfactory till now. As per our channel check, the product contributed to 20% of China Pacific's FYP in 1H12. Accordingly, China Pacific improved its NBM from 34.8% in 2011 to 36.9% in 1H12. The company achieved a YoY growth of 6.0% in VNB, the highest among peers. Therefore, we regard China Pacific the front-runner in the recovery of Life sector.

**Most balanced Composite play.** Other than Life unit, China Pacific's P&C unit reported promising underwriting results in 1H12. The unit reported underwriting profits of Rmb1.5bn, with combined ratios at 94.4%. Despite the sequential deterioration, the unit contributed Rmb1,570 mn, or 58.8% of group profits. Unlike Ping An, which suffered from multiple slowdowns in Life, Banking, Securities and Trust, China Pacific enjoyed a balanced growth between Life and P&C.

**First beneficiary of tax deferred pension products.** According to mainland press, tax deferred pension products will be piloted in Shanghai towards end-2012. China Pacific will serve as the first beneficiary. Changjiang Pension, the wholly subsidiary of China Pacific, is the market leader in the pension market of Shanghai. In 1H12, over 50% of its entrusted pension assets (Rmb29.4bn) came from the city.

**Ample solvency.** China Pacific is sitting with the capital raised from the H-share IPO in Dec 2009. The funding amounted to Rmb22bn. In 1H12, its solvency recorded 271.0%, the highest in the sector. This far exceeded the recommended level of 150% by CIRC.

## Investment Concerns

**EV insensitive to investment upturn.** Per the company disclosure, Equity Value-at-Risk (VaR) 10 days represents 1.3% change in China Pacific's EV in 1H12. This is low compared to 5.4% of China Life, 2.8% of Ping An and 1.7% of New China Life. In 1H12, China Pacific allocated Rmb62.4bn, or 10.6% of investment portfolio, in equity. We expect the insurer to benefit the least from the upcoming recovery of A-share markets.

**Lowest EV operating margins.** In 2011, China Pacific's EV operating margins was 11.7%, lower than 15.9% of China Life, 23.6% of Ping An, 31.1% of New China Life and 29.7% of Taiping Life. Given its excessive capital, we do not expect China Pacific to outgrow its peers in EV in the future.

**Overhang from share placements.** Carlyle still owns 7.3% or 203.7mn H-shares of China Pacific. With its low cost base, Carlyle may offload their stake from time to time. Also China Pacific placed 462 mn new shares, or





16.6% of its H-shares, to Government of Singapore Investment Corporation, Norges Bank, and Abu Dhabi Investment Authority in early Sep. There was no lock-up for these stakes. Therefore, China Pacific may face overhang of share placements from potential sellers.

### Valuation & Recommendation

**We forecast mid-teens EV Growth.** China Pacific reported group EV of Rmb113,564 mn in 2011 and Rmb121,833 mn in 1H12. In 2012E, we expect the company to report investment return variance of Rmb1,000 mn, due to slightly improved capital markets in China, compared to 2011. Besides, we forecast VNB of Rmb6,669 mn in 2012E and Rmb7,136 mn in 2013E, on the back of strong NBM's averaging 37.0%. As such, we forecast the EV to reach Rmb136,341 mn in 2012E, up 20.0% YoY, and Rmb152,780 mn in 2013E, up 12.1% YoY.

**Expecting a mild growth in earnings.** Based on a net premium growth of 3.3% YoY and gross investment yield of 4.5%, we estimate China Pacific to report net earnings of Rmb9,071 mn in 2013E, up 8.1% YoY from Rmb8,392 mn in 2012E. Our earnings forecast is behind consensus of Rmb11,117 mn, due to more conservative assumption on policyholders benefits. We estimate the company to pay higher policyholder dividends due to better investment return.

**TP and recommendation.** Based on the aforementioned assumptions, we derive an appraisal value of Rmb193,990 mn for China Pacific in 2013E and also adopt it as our target price. It is equivalent to HK\$27.93/ share. Our appraisal value consists of the valuation of P&C unit at Rmb37,237 mn (1.3x 2013E PBV) and that of holding company at Rmb29,262 mn (1.0x 2013E PBV). We forecast 2013E EVPS and VNB of HK\$21.07 and HK\$0.98, respectively. The implied valuation of our TP is 1.33x 2013E PEV and 7.0x 2013E VNB. This represents 19.1% upside potential from the current share price. We initiate coverage of China Pacific with a BUY recommendation.



**China Pacific: 1H12 profit & loss**

	2009	2010	2011	1H10	2H10	1H11	2H11	1H12	Change	Change
	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	(h-h %)	(y-y %)
<b>GWP &amp; Policy fees</b>	96,342	139,555	154,958	76,066	63,489	86,875	68,083	90,511	33	4
(-) Premiums to Reinsurers	(9,791)	(13,661)	(13,384)	(7,500)	(5,209)	(7,306)	(6,078)	(6,625)	9	(9)
<b>NWP &amp; Policy fees</b>	86,551	125,894	141,574	68,566	58,280	79,569	62,005	83,886	35	5
Chg. in Unearned Premium Res.	(2,424)	(6,143)	(4,336)	(5,379)	(1,814)	(4,447)	111	(2,983)	(2,787)	(33)
<b>NEP &amp; policy fees</b>	84,127	119,751	137,238	63,187	56,466	75,122	62,116	80,903	30	8
Investment Income	19,316	20,657	16,392	9,131	11,651	10,187	6,205	8,419	36	(17)
Other Income	746	919	1,887	460	462	496	1,391	590	(58)	19
<b>Total Revenue</b>	104,189	141,327	155,517	72,778	68,579	85,805	69,712	89,912	29	5
Claims, Surrenders, Annuities / Maturities	(31,916)	(37,847)	(49,518)	(17,827)	(19,972)	(23,399)	(26,119)	(28,748)	10	23
Div. & Int. to PH & Net Inc. in PH Res.	(37,058)	(59,241)	(62,127)	(33,339)	(25,902)	(35,514)	(26,613)	(36,394)	37	2
<b>Ttl. Claims / PH Benefits</b>	(72,897)	(102,209)	(111,645)	(53,701)	(48,460)	(58,913)	(52,732)	(65,142)	24	11
General & Administrative Expense	(21,475)	(28,063)	(33,120)	(13,813)	(14,368)	(16,629)	(16,491)	(19,248)	17	16
Finance Expense	(396)	(373)	(848)	(205)	(168)	(311)	(537)	(1,072)	100	245
<b>Total Operating Expense</b>	(21,871)	(28,436)	(33,968)	(14,018)	(14,536)	(16,940)	(17,028)	(20,320)	19	20
<b>Total Expenses</b>	(94,768)	(130,645)	(145,613)	(67,719)	(62,996)	(78,781)	(66,832)	(86,431)	29	10
<b>Net profit before tax</b>	9,421	10,682	9,904	5,059	5,583	7,024	2,880	3,481	21	(50)
Associate / JV - Profits / Losses	85	(12)	495	(22)	(38)	495	0	0		
Tax Expense	(2,033)	(2,005)	(2,006)	(999)	(1,096)	(1,636)	(370)	(813)	120	(50)
<b>Net profit after tax</b>	7,473	8,665	8,393	4,038	4,449	5,883	2,510	2,668	6	(55)
Minority Interest	(117)	(108)	(80)	(63)	(45)	(67)	(13)	(30)	131	(55)
<b>NP to CPIC shareholders</b>	7,356	8,557	8,313	3,975	4,404	5,816	2,497	2,638	6	(55)

Source: Company, ABCI Securities

**China Pacific: Embedded Value (EV), Value of New Business (VNB) & New Business Margins (NBM)**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
ANAV	76,824	72,664	71,261	75,905	74,321	72,368	6	8
VIF	56,604	51,959	48,903	43,991	38,628	33,971	9	16
Solvency Cost	(11,595)	(11,059)	(10,156)	(9,212)	(8,226)	(7,516)	5	14
EV	121,833	113,564	110,008	110,089	104,723	98,371	7	11
EVPS (HK\$)	17.42	16.15	15.58	15.26	13.97	12.98	8	12
APE	11,016	19,304	11,951	20,601	10,910	15,273	50	(8)
VNB	4,061	6,714	3,830	6,100	3,238	5,000	41	6
NBM (APE Basis - (%))	36.86	34.78	32.05	29.61	29.68	32.74	2.1	4.8
FYP	24,942	46,936	30,353	54,186	32,091	38,147	50	(18)
VNB	4,061	6,714	3,830	6,100	3,238	5,000	41	6
NBM (FYP Basis - (%))	16.28	14.30	12.62	11.26	10.09	13.11	2.0	3.7
VNB (HK\$)	0.58	0.93	0.54	0.85	0.43	0.66	50	7
Group solvency	271	284	298	357			(13.0)	(27.0)

Source: Company, ABCI Securities



**China Pacific: Investment & Yields**

(%)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Cash Equivalents	4.8	2.9	3.4	4.1	5.7	8.3	1.9	1.4
Deposits	28.8	26.3	26.1	24.6	23.7	23.6	2.5	2.7
Bonds	54.7	59.3	51.6	58.4	55.1	50.8	(4.6)	3.1
Equities	10.6	10.3	12.9	11.6	10.9	12.3	0.4	(2.3)
Infrastructure	1.1	1.3	6.0	1.3	4.6	5.0	(0.2)	(4.9)
<b>Total Inv'ts (RMB bn)</b>	<b>586.6</b>	<b>522.5</b>	<b>490.5</b>	<b>435.8</b>	<b>395.1</b>	<b>366.0</b>	<b>12</b>	<b>20</b>
<b>Ann. Net Inv't Yield (%)</b>	<b>4.9</b>	<b>4.7</b>	<b>4.4</b>	<b>4.3</b>	<b>4.2</b>	<b>4.1</b>	<b>0.3</b>	<b>0.4</b>
<b>Ann. Total Inv't Yield (%)</b>	<b>3.9</b>	<b>3.7</b>	<b>4.4</b>	<b>5.2</b>	<b>4.3</b>	<b>5.0</b>	<b>(0.7)</b>	<b>(1.5)</b>

Source: Company, ABCI Securities

**China Pacific: Life operating data**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross Premiums	55,229	93,203	54,574	87,873	48,959	61,998	43	1
Individual	28,210	42,818	23,212	35,525	18,615	29,570	44	22
Bancassurance	21,709	44,450	28,006	48,201	28,385	29,514	32	(22)
Direct sales & new channels	5,310	5,935	3,178	4,147	1,861	2,914	93	67
FYP	24,942	46,936	30,353	54,186	32,091	38,147	50	(18)
Regular Individual FYP	6,880	10,065	6,030	8,389	4,511	6,880	71	14
Ind. Agents #	270,000	292,000	282,000	280,000	252,000	254,000	(8)	(4)
Regular FYP per head (Rmb)	25,481	34,469	42,766	29,961	35,802	27,087	(26)	(40)
Persistency 13 mo - Ind. (%)	91.6	92.7	93.1	92.0	92.0	87.1	(1.1)	(1.5)
Persistency 25 mo - Ind. (%)	90.6	89.8	89.9	84.0	82.0	82.0	0.8	0.7
Solvency (%)	183	187	192	241	236	208	(4.0)	(9.0)

Source: Company, ABCI Securities

**China Pacific: P&C operating data**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross Premiums	35,246	61,687	32,267	51,622	27,078	34,289	20	9
Motor	26,226	47,409	23,812	39,636	20,242	25,449	11	10
Other P&C	9,020	14,278	8,455	11,986	6,836	8,840	55	7
Loss Ratios (%)	59.6	58.6	56.6	57.4	54.5	61.0	1.0	3.0
Expense Ratios (%)	34.6	34.5	34.5	36.3	40.0	36.5	0.1	0.1
Combined Ratios (%)	94.2	93.1	91.1	93.7	94.5	97.5	1.1	3.1
Solvency (%)	194	233	175	167			(39.0)	19.1

Source: Company, ABCI Securities

**China Pacific - share price & valuation**

		CHINA PACIFIC			
		2009	2010	2011	2012E
Share Price (HK\$)	Hi	30.95	35.85	35.35	28.50
	Lo	28.00	27.95	20.15	21.50
	Av	29.91	31.17	31.15	24.74
PEV(X)	Hi	2.38 x	2.35 x	2.20 x	1.54 x
	Lo	2.16 x	1.83 x	1.25 x	1.16 x
	Av	2.30 x	2.04 x	1.94 x	1.34 x
EVPS YoY Growth (%)		26%	18%	5%	15%
VNB(X)	Hi	27.70 x	24.79 x	20.63 x	10.53 x
	Lo	23.15 x	15.28 x	4.36 x	3.19 x
	Av	26.09 x	19.16 x	16.13 x	6.59 x
VNB YoY Growth (%)		23%	28%	12%	2%

Source: Bloomberg, Company data, ABCI Securities



*China Pacific: Embedded Value*

(Rmb mn)	2009	2010	2011	2012E	2013E	1H12
<b>Embedded value</b>						
Adjusted net worth	72,368	75,905	72,664	87,328	94,227	76,824
Value of in-force	33,971	43,991	52,671	60,287	70,046	56,604
Cost of solvency margin	(7,516)	(9,212)	(11,059)	(11,274)	(11,494)	(11,595)
Embedded value	98,371	110,089	113,564	136,341	152,780	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	193,990	
<b>EV movement analysis</b>						
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	4,541	
- In-force	2,772	2,578	3,307	6,057	6,933	
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	1,000	
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	152,780	
EVPS (HK\$)	12.98	15.26	16.08	18.99	21.07	
AVPS (HK\$)	20.06	24.73	28.30	28.64	27.93	
PEV implied	1.55	1.62	1.76	1.51	1.33	
VNB (HK\$)	0.65	0.83	0.93	0.93	0.98	
VNB implied (x)	10.91	11.41	13.08	10.39	6.96	
<b>EV contributions 1 (%)</b>						
Expected return on beg EV	8%	6%	7%	9%	8%	
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%	12%	
EVPS (HK\$) growth	26%	18%	5%	18%	11%	
<b>EV contributions 2 (%)</b>						
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



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ABC INTERNATIONAL

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China Insurance

**China Pacific: Financial Statements**

Profit & loss (Rmb mn)						Operating ratios (%)					
	2010	2011	2012E	2013E	2014E		2010	2011	2012E	2013E	2014E
<b>GWP &amp; policy fees</b>	<b>134,963</b>	<b>154,958</b>	<b>162,698</b>	<b>171,765</b>	<b>180,789</b>	Gross written premium growth	40.1%	11.0%	5.0%	5.6%	5.3%
(-) Premiums to reinsurers	(13,148)	(13,384)	(12,679)	(14,087)	(15,158)	Net earned premium growth	39.3%	14.6%	5.1%	3.3%	4.9%
<b>NWP &amp; policy fees</b>	<b>121,815</b>	<b>141,574</b>	<b>150,020</b>	<b>157,678</b>	<b>165,632</b>	Claims/benefits - of NEP	30.2%	36.1%	34.9%	37.0%	37.6%
Chg. in unearned premium res.	(4,656)	(4,336)	(5,765)	(8,734)	(9,414)	Div to PH & net inc. in PH res. of NEP	50.7%	40.9%	42.9%	44.3%	43.3%
<b>NEP &amp; policy fees</b>	<b>117,159</b>	<b>137,238</b>	<b>144,255</b>	<b>148,944</b>	<b>156,218</b>	<b>Ttl. claim/PH benefits to NEP</b>	<b>80.9%</b>	<b>76.9%</b>	<b>77.8%</b>	<b>81.4%</b>	<b>80.9%</b>
Investment income	18,403	16,392	21,570	30,129	32,943	Claims/benefits - of total revenue	25.9%	31.8%	30.0%	30.4%	30.6%
Other income	812	1,887	2,107	2,430	2,814	Net inc. in PH res. - of total revenue	43.6%	36.0%	36.8%	36.4%	35.2%
<b>Total revenue</b>	<b>136,374</b>	<b>155,517</b>	<b>167,931</b>	<b>181,503</b>	<b>191,974</b>	<b>Ttl. claim/PH benefits to total revenue</b>	<b>69.5%</b>	<b>67.9%</b>	<b>66.9%</b>	<b>66.8%</b>	<b>65.8%</b>
Claims, surrenders, annuities/mortgages	(35,354)	(49,518)	(50,403)	(55,153)	(58,763)	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)	(61,864)	(66,016)	(67,614)	General & admin. cost ratio	21.0%	21.3%	22.0%	21.0%	21.1%
<b>Ttl. claims/PH benefits</b>	<b>(99,225)</b>	<b>(111,645)</b>	<b>(118,061)</b>	<b>(129,537)</b>	<b>(134,947)</b>	Other exp. & stat. levy ratio					
Commission expenses	-	-	-	-	-	<b>Total expense ratio</b>	<b>94.1%</b>	<b>93.6%</b>	<b>93.6%</b>	<b>93.6%</b>	<b>92.5%</b>
General & administrative expense	(28,637)	(33,120)	(36,904)	(38,175)	(40,455)	<b>Gross investment yield</b>	<b>4.5%</b>	<b>3.4%</b>	<b>4.3%</b>	<b>4.5%</b>	<b>4.5%</b>
Finance expense	(410)	(848)	(2,144)	(2,144)	(2,144)	<b>CPIC Life</b>	<b>259.3%</b>	<b>187.3%</b>	<b>181.9%</b>	<b>177.7%</b>	<b>180.6%</b>
Other expense	0	0	0	0	0	<b>CPIC P&amp;C</b>	<b>206.1%</b>	<b>233.1%</b>	<b>222.6%</b>	<b>227.5%</b>	<b>230.6%</b>
<b>Total operating expense</b>	<b>(29,047)</b>	<b>(33,968)</b>	<b>(39,048)</b>	<b>(40,319)</b>	<b>(42,599)</b>						
<b>Total expenses</b>	<b>(128,272)</b>	<b>(145,613)</b>	<b>(157,109)</b>	<b>(169,856)</b>	<b>(177,546)</b>	<b>Balance sheet (Rmb mn)</b>					
<b>Net profit before tax</b>	<b>8,102</b>	<b>9,904</b>	<b>10,822</b>	<b>11,647</b>	<b>14,428</b>		<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
Associate/JV - Profits/losses	100	495	21	18	15	Financial assets	433,385	522,530	626,959	728,737	835,459
Tax expense	(1,615)	(2,006)	(2,320)	(2,458)	(2,999)	Reinsurance assets	12,347	14,118	14,959	16,493	18,183
<b>Net profit after tax</b>	<b>6,587</b>	<b>8,393</b>	<b>8,523</b>	<b>9,207</b>	<b>11,443</b>	Insurance receivables	5,409	6,252	10,202	11,247	12,400
Minority interest	(38)	(80)	(131)	(136)	(169)	PP&E	6,831	7,833	7,987	7,827	7,671
<b>NP to CPIC shareholders</b>	<b>6,550</b>	<b>8,313</b>	<b>8,392</b>	<b>9,071</b>	<b>11,274</b>	Others	17,739	19,879	29,263	29,943	31,136
						<b>Assets</b>	<b>475,711</b>	<b>570,612</b>	<b>689,370</b>	<b>794,247</b>	<b>904,849</b>
<b>Financial summary</b>						Insurance contract liabilities	302,640	374,931	437,425	514,433	593,469
	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	Investment contract liabilities	52,690	47,182	46,261	49,079	52,068
<b>EPS (RMB)</b>	<b>0.76</b>	<b>1.18</b>	<b>1.17</b>	<b>1.25</b>	<b>1.64</b>	Financial liabilities	19,836	58,847	91,405	105,610	122,679
<i>EPS growth (%)</i>	-20.0%	-0.7%	-0.7%	7.0%	31.3%	Deferred revenue	-	-	-	-	-
<b>PER (x)</b>	<b>35.1</b>	<b>19.9</b>	<b>20.1</b>	<b>18.7</b>	<b>14.3</b>	Others	27,476	11,597	13,771	18,709	22,113
<b>PBV (x)</b>	<b>2.95</b>	<b>2.12</b>	<b>1.72</b>	<b>1.60</b>	<b>1.41</b>	<b>Liabilities</b>	<b>402,642</b>	<b>492,557</b>	<b>588,862</b>	<b>687,830</b>	<b>790,329</b>
<b>PEV (x)</b>	<b>2.18</b>	<b>1.46</b>	<b>1.23</b>	<b>1.11</b>	<b>0.95</b>	Net assets	<b>76,605</b>	<b>76,796</b>	<b>99,113</b>	<b>104,886</b>	<b>112,819</b>
<b>VNB multiple (x)</b>	<b>26.71</b>	<b>4.26</b>	<b>0.92</b>	<b>-1.60</b>	<b>-5.40</b>	Minority interests	1,202	1,259	1,395	1,531	1,700
<b>Dividend per share (RMB)</b>	<b>0.40</b>	<b>0.35</b>	<b>0.35</b>	<b>0.35</b>	<b>0.35</b>	<b>Net equity to shareholders</b>	<b>77,854</b>	<b>78,055</b>	<b>100,518</b>	<b>106,417</b>	<b>114,520</b>
Yield (%)	1.5%	1.8%	1.8%	1.9%	2.0%						
Payout ratio (%)	52.5%	29.7%	29.9%	28.0%	21.3%						
<b>Return on equity (%)</b>	<b>8.5%</b>	<b>10.4%</b>	<b>9.4%</b>	<b>8.8%</b>	<b>10.2%</b>						
Return on assets (%)	1.5%	1.6%	1.3%	1.2%	1.3%						
Tax rate (%)	19.9%	20.3%	21.4%	21.1%	20.8%						

Source: Company data, ABCI Securities estimates



# Company Report

## Ping An (2318 HK) – Sell Life & Health Insurance Industry Initiation

### Key data

H-share price (HK\$)	58.60
Target price (HK\$)	58.04
Upside potential (%)	(0.96)
52Wk H/L(HK\$)	68.6 / 37.4
Issued shares:	
H-shares (mn)	3,130
A-shares (mn)	4,786
H-share mkt cap (HK\$m)	431,068
30-day avg vol (HK\$m)	589.7
Major shareholder (%):	
HSBC	15.6
Shenzhen Investments	6.1

Source: Company & Bloomberg

### Segmental profit composition in 2011 (%)

Life	44.2
P&C	22.0
Banking	35.3
Securities & Others	(1.5)

\*Based on 2011 results

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	3.4	(0.2)
3-mth	(5.0)	(8.0)
6-mth	(0.2)	4.9

\*Relative to MSCI China

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 3 October 2012

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## Multiple decelerations

**Ping An is facing multiple decelerations. Ping An Life encounters both margin and volume pressure. Ping An Bank suffers from narrowing NIM, higher NPL and inadequate capital. Ping An Securities is haunted by the shrinking volume of A-share markets. Ping An Trust may face heavy repayment risks. Based on these, we initiate coverage on Ping An with a SELL recommendation.**

**A loser in the margin game.** Ping An Life faces severe competition from major peers. China Life, China Pacific and New China Life have shifted focus to long term regular premiums through bancassurance channel. This cannibalizes Ping An's regular premium sales. Also they launched new critical illness products in 1H12. These out-competed Ping An mainstream products. As a result, Ping An's NBM dropped from 39.5% in 2011 to 35.2% in 1H12. The company achieved a YoY decline of 8.6% in VNB, the worst among peers.

**Owning a Joint Stock Bank.** Ping An is a drag to Ping An Group, as joint stock banks are not investors' favorites for now. Investors are concerned with the impact from interest rate liberalization and asset quality problems. Furthermore, the bank reported worse-than-peers NIM, NPL and capital ratios in 1H12. We are pessimistic on its outlook.

**Securities and Trust trending down.** Ping An Securities reported weak commission income and earnings due to low turnover in A-share. This trend may not reverse anytime soon. Ping An Trust is highly leveraged and may face heavy repayment risk in a worsening economy

**Initiate coverage with a SELL rating; TP of HK\$58.04.** We derive an appraisal value of Rmb367,556 mn for 2013E, also adopting it as TP, or HK\$58.04/ share. The implied valuation of our TP is 1.13x 2013E PEV and 1.6x 2013E VNB. This represents 0.9% downside potential from the current share price. We initiate coverage of Ping An with a SELL recommendation.

**Risk factors:** better-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)	194,349	250,744	299,656	331,281	358,086
Chg (YoY)	31.5	29.0	19.5	10.6	8.1
Net profit (Rmb mn)	17,311	19,475	25,590	28,601	30,435
Chg (YoY)	24.7	12.5	31.4	11.8	6.4
EPS (HK\$)	2.70	3.00	3.98	4.52	5.07
PER (x)	21.7	19.6	14.7	13.0	11.5
BPS (HK\$)	18.2	26.4	31.4	35.7	42.1
P/B (x)	3.2	2.2	1.9	1.6	1.4
EVPS (HK\$)	31.3	36.2	44.6	51.1	60.6
PEV (x)	1.9	1.6	1.3	1.1	1.0
VNB (HK\$)	2.4	2.7	2.5	2.5	2.7
VNB (x)	11.3	8.4	5.7	3.0	(0.7)

Source: Company data, ABCI Securities estimates



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## Investment Concerns

**A loser in the margin game.** Ping An will be a loser in the new game of ‘margin over volume’ in our opinion. Regular premium sales embed higher NBM than single ones. In 1H12, regular FYP constituted 95.5% of Ping An’s APE and 68.2% of its FYP. This is the highest among peers, implying little room for further improvement.

Meanwhile, Ping An faces severe competition from major Life insurers. Ping An Life reported flattish growth in APE in 1H12. However, its VNB declined by 8.6% YoY. This implies lower NBM for its regular premium sales (95.5% of total FYP). China Life, China Pacific and New China Life were pushing long term regular premium sales through bancassurance channel in 1H12. But Ping An was behind due to the under-development of its bancassurance distribution.

Also, these three insurers launched new critical illness products in 1H12. These products were all well received in the market, and they embedded high NBM. However, Ping An still relied heavily on participating and universal products, with no major initiative in the CI market. In fact, Ping An’s NBM dropped from 39.5% in 2011 to 35.2% in 1H12. The company achieved a YoY decline of 8.6% in VNB, the worst among peers. Going forward, we believe Ping An will continue to lose out in regular FYP and critical illness products against its peers.

**Volume weakness continues.** In 1H12, Ping An’s FYP dropped significantly by 28.1%, the worst among peers. Per our channel check, Ping An recorded a very sharp decline in Universal Life products. Currently, crediting rates of Universal Life products averages 3.8-4.0%, which is behind 2 - 5 year time deposit rates set by PBOC. Traditionally, this product contributed 35-40% of FYP. Therefore, we expect Ping An to remain weak in volume growth going forward.

**Owning a Joint Stock Bank.** Ping An owns 52% of Ping An Bank (previously Shenzhen Development Bank, 000001 CH, NR). Currently the market does not hold a positive view towards the mid-sized joint stock banks, in light of the potential interest rate liberalization and asset quality problems. In fact, the bank was not performing well in 1H12. Its net interest margins (NIM) narrowed to 2.42%, relative to 2.53% in 2011. In the same half, NIM of most Chinese banks remained flattish, as compared to 2011. Its NPL ratio rose to 0.73% from 0.53% in 1H12. Most Chinese banks reported sequential improvement in NPL ratios. Lastly, its Core Tier I CAR remained weak in 8.44%. Investors may be concerned with any potential fund raising by SDB, which will in turn weaken the capital position of Ping An Group.

**Securities & Trust trending down.** In 1H12, Ping An Securities suffered from a 73.3% YoY decline in net profits. Its commission income dropped by 85.9% YoY, and securities underwriting income fell by 64.8% YoY. While we anticipate a recovery of A-share market towards the end of PBOC rate cut cycle, we are concerned with the underlying business quality of Ping An Securities. Ping An Trust is the fifth largest trust in China, with an AUM of Rmb196.2bn in 2011. The trust is also highly leveraged at 14 – 15x. China is experiencing a sharp slowdown in GDP growth (7.4% YoY in 3Q12 per Bloomberg economic forecast). Repayment risk is hence rising for the trust. We are not optimistic to the profitability of Ping An Trust, given the rising repayment risk.



**Inadequate solvency.** In 1H12, Ping An Group reported a solvency of 176.7%. Ping An Life and Ping An P&C reported solvency ratios of 167.3% and 164.5% respectively. This is among the lowest in the sector. Also, this is not much higher than the recommended level of 150% by CIRC.

### Investment Positive

**Resilient performance of P&C.** Ping An P&C is the only bright spot for Ping An. In 1H12, it reported net profits of Rmb2,746 mn, with its combined ratios at 93.1%. This is slightly better than 93.5% in 2011. We estimated the unit to report a ROE of 23.9% in the half. Ping An P&C has 31.4% of its premiums sold through new sales channels. We expect its performance to remain solid in 2H12E and 2013E.

**Anchor index stock.** Ping An is an anchor index stock in MSCI China and Hang Seng Index. Its index weighting is approximately 2.5% of MSCI China and 1.9% of HSI. Therefore, the stock can benefit from any positive fund flow to Hong Kong stock market.

### Valuation & Recommendation

**We forecast mid-teens EV Growth.** Ping An reported group EV of Rmb235,627 mn in 2011 and Rmb259,005 mn in 1H12. In 2012E, we expect the company to report investment return variance of Rmb5,000 mn, due to slightly improved capital markets in China, compared to 2011. Besides, we forecast VNB of Rmb15,778 mn in 2012E and Rmb15,671 mn in 2013E, on the back of weakening NBM's averaging 36.0%. As such, we forecast the EV to reach Rmb286,986 mn in 2012E, up 21.8% YoY, and Rmb323,842 mn in 2013E, up 12.8% YoY.

**Expecting earnings growth.** Based on a net premium growth of 6.7% YoY and gross investment yield of 4.0%, we estimate Ping An to report net earnings of Rmb25,590 mn in 2013E, up 31.4% YoY from Rmb19,475 mn in 2012E. Our earnings forecast is far behind consensus of Rmb29,642 mn, due to more conservative assumption on insurance reserves.

**TP and recommendation.** Based on the aforementioned assumptions, we derive an appraisal value of Rmb367,556 mn for Ping An in 2013E and also adopt it as our target price. It is equivalent to HK\$58.04/ share. Our appraisal value includes the valuation of Rmb40,466 mn (1.45x PBV) of P&C, Rmb55,073 mn (1.06x PBV) of Banking, Rmb13,559 mn of Financial Services (8.0x PER) and Rmb32,943 mn (1.0x PBV) of Corporate office. We forecast 2013E EVPS and VNB of HK\$51.14 and HK\$2.47, respectively. The implied valuation of our TP is 1.13x 2013E PEV and 1.6x 2013E VNB. This represents 0.96% downside potential from the current share price. We initiate coverage of Ping An with a SELL recommendation.





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China Insurance

**Ping An: 1H12 profit & loss**

	2009	2010	2011	1H10	2H10	1H11	2H11	1H12	Change	Change
	Rmb mn	Rmb mn	Rmb mn	Rmb mn	Rmb mn	Rmb mn	Rmb mn	Rmb mn	(h-h %)	(y-y %)
GWP & Policy fees	112,213	159,384	207,802	85,079	74,305	116,080	91,722	127,812	39.3	10.1
(-) Premiums to Reinsurers	(6,347)	(8,181)	(10,970)	(4,542)	(3,639)	(5,857)	(5,113)	(7,173)	40.3	22.5
NWP & Policy fees	105,866	151,203	196,832	80,537	70,666	110,223	86,609	120,639	39.3	9.4
Chg. in Unearned Premium Res.	(5,483)	(10,079)	(10,170)	(5,952)	(4,127)	(6,824)	(3,346)	(5,068)	51.5	(25.7)
NEP & policy fees	100,383	141,124	186,662	74,585	66,539	103,399	83,263	115,571	38.8	11.8
Investment Income	32,023	31,083	29,265	10,909	20,154	15,912	13,353	14,960	12.0	(6.0)
Net Interest Income of Bk. Op.	4,210	9,331	18,882	2,786	6,544	3,548	15,334	16,866	10.0	375.4
Fee & Comm. Inc.	5,794	8,159	11,220	2,264	3,812	3,094	8,126	4,422	(45.6)	42.9
Other income	5,383	4,652	3,665	4,341	3,322	3,547	118	6,092	5,062.7	71.8
<b>Total Revenue</b>	<b>147,793</b>	<b>194,349</b>	<b>249,694</b>	<b>94,885</b>	<b>100,370</b>	<b>129,500</b>	<b>120,194</b>	<b>157,911</b>	<b>31.4</b>	<b>21.9</b>
Claims, Surrenders, Annuities / Maturities	(36,906)	(52,311)	(53,816)	(20,823)	(31,488)	(30,784)	(23,032)	(33,399)	45.0	8.5
Div. & Int. to PH & Net Inc. in PH Res.	(47,183)	(62,766)	(91,948)	(35,571)	(27,424)	(52,588)	(39,360)	(57,053)	45.0	8.5
Ttl. Claims / PH Benefits	(84,089)	(115,077)	(145,764)	(56,394)	(58,912)	(83,372)	(62,392)	(90,452)	45.0	8.5
Commission Expenses	(12,013)	(14,545)	(17,767)	(7,663)	(6,302)	(9,388)	(8,379)	(11,141)	33.0	18.7
General & Administrative Expense	(26,271)	(34,385)	(50,575)	(15,611)	(18,782)	(19,160)	(31,415)	(30,439)	(3.1)	58.9
Loan Loss Provisions	(194)	(626)	(1,704)	(110)	(543)	(261)	(1,443)	(1,536)	6.4	488.5
Other Expense	(5,489)	(8,834)	(4,926)	(3,181)	(7,010)	(2,212)	(2,714)	(3,804)	40.2	72.0
Total Expenses	(43,967)	(58,390)	(74,972)	(26,565)	(32,637)	(31,021)	(43,951)	(46,920)	6.8	51.3
Net profit before tax	19,737	20,882	28,958	11,926	8,822	15,107	13,851	20,539	48.3	36.0
Associate / JV - Profits / Losses	182	1,465	1,068	282	1,465	1,159	(91)	(18)	(80.2)	(101.6)
Tax Expense	(5,437)	(4,409)	(7,444)	(2,342)	(2,038)	(3,268)	(4,176)	(2,994)	(28.3)	(8.4)
Net Profit after Tax	14,482	17,938	22,582	9,866	8,249	12,998	9,584	17,527	82.9	34.8
Minority Interest	(599)	(627)	(3,107)	(255)	(364)	(241)	(2,866)	(3,568)	24.5	1,380.5
NP to Ping An Shareholders	13,883	17,311	19,475	9,611	7,885	12,757	6,718	13,959	107.8	9.4

Source: Company, ABCI Securities

**Ping An: Embedded Value (EV), Value of New Business (VNB) & New Business Margins (NBM)**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Group ANAV	152,826	139,446	146,020	123,573	112,865	94,606	10	5
ANAV of Life Biz	50,019	48,219	46,252	43,673	42,557	40,052	4	8
-ve Spread Bk	(8,251)	(8,549)	(9,005)	(9,858)	(10,504)	(11,614)	(3)	(8)
VIF after 1999	137,977	126,099	116,877	104,816	98,838	86,579	9	18
Solvency Cost	(23,547)	(21,369)	(19,928)	(17,545)	(16,862)	(14,314)	10	18
Group EV	259,005	235,627	233,966	200,986	184,338	155,258	10	11
Life EV	156,198	144,400	134,198	121,086	114,029	100,704	8	16
Group solvency (%)	177	190	200	198	218	302	10	(23)
APE	26,058	42,643	26,059	43,907	26,612	31,406	57	(0)
VNB	9,160	16,822	10,148	15,507	9,122	11,805	35	(9)
NBM (APE Basis - %)	35.2	39.5	38.9	35.3	34.3	37.6	(4.3)	(3.3)
FYP	33,502	70,917	46,610	76,050	45,297	64,984	38	(28)
VNB	9,160	16,822	10,148	15,507	9,122	11,805	35	(9)
NBM (FYP Basis - %)	27.3	23.7	21.8	20.4	20.1	18.2	3.6	5.8
VNB (HK\$ per share)	1.42	2.60	1.56	2.41	1.36	1.82	34.13	(8.33)

Source: Company, ABCI Securities

**Ping An - share price & valuation**

		2004	2005	2006	2007	2008	2009	2010	2011	2012E
Share Price (HK\$)	Hi	13.80	14.45	44.90	117.00	82.55	75.60	94.40	88.30	68.35
	Lo	9.50	11.75	14.95	32.35	24.00	30.35	58.00	38.30	48.70
	Av	11.51	12.88	23.79	62.83	53.29	56.01	70.47	70.49	60.36
PEV(X)	Hi	2.44 x	1.91 x	2.62 x	5.30 x	4.35 x	3.28 x	3.01 x	2.44 x	1.53 x
	Lo	1.68 x	1.55 x	0.87 x	1.47 x	1.26 x	1.32 x	1.85 x	1.06 x	1.09 x
	Av	2.04 x	1.70 x	1.39 x	2.85 x	2.81 x	2.43 x	2.25 x	1.95 x	1.35 x
EVPS YoY Growth (%)			34%	126%	29%	-14%	21%	36%	16%	23%
VNB(X)	Hi	13.71 x	9.68 x	33.54 x	90.51 x	48.16 x	28.81 x	26.09 x	19.52 x	9.18 x
	Lo	6.47 x	5.88 x	(2.62x)	9.80 x	3.80 x	4.00 x	11.03 x	0.77 x	1.55 x
	Av	9.86 x	7.47 x	8.05 x	38.86 x	25.99 x	18.07 x	16.19 x	12.84 x	6.08 x
VNB YoY Growth (%)			20%	17%	27%	26%	38%	33%	10%	-3%

Source: Bloomberg, Company data, ABCI Securities



**Ping An: Segmental profits**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Life	7,031	9,974	6,762	8,417	6,551	10,374	119	4
P&C	2,746	4,979	2,693	3,865	1,088	675	20	2
Banking	6,731	7,977	2,397	2,882	1,104	1,080	21	181
Securities & Others	1,019	1,604	1,146	2,774	1,123	2,353	122	(11)
Consolidation Adj.		(1,952)						
Net Profit	17,527	22,582	12,998	17,938	9,866	14,482	83	35
Mix (%)								
Life	40.1	44.2	52.0	46.9	66.4	71.6	(4.1)	(11.9)
P&C	15.7	22.0	20.7	21.5	11.0	4.7	(6.4)	(5.1)
Banking	38.4	35.3	18.4	16.1	11.2	7.5	3.1	20.0
Securities & Others	5.8	7.1	8.8	15.5	11.4	16.2	(1.3)	(3.0)
Consolidation Adj.		(8.6)						

Source: Company, ABCI Securities

**Ping An: Investment & Yields**

(%)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Cash Equivalents	8	7	9	11	11	12	2	(1)
Deposits	23	20	19	18	16	16	3	4
Bonds	55	61	59	60	64	61	(6)	(4)
Equities	13	12	12	10	8	9	1	1
Infrastructures	0.9	1.0	1.2	1.2	1.4	3.3	(0.1)	(0.3)
Total Investments (RMB bn)	986	867	838	763	656	590	14	18
Net Inv't Yield	4.5	4.5	4.3	4.2	4.1	3.9	0.0	0.2
Total Inv't Yield	3.7	4.0	4.1	4.9	3.7	6.4	(0.3)	(0.4)
AFS Reserves (RMB mn)	(8,367)	(14,412)	(4,702)	(175)	208	4,612	(42)	78

Source: Company, ABCI Securities



**Ping An: Life operating data**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross Premiums	114,837	187,256	112,630	164,448	93,125	134,503	54	2
Individual	102,367	159,990	94,860	130,146	73,358	99,863	57	8
Bancassurance	7,598	18,941	13,459	27,783	16,269	27,783	39	(44)
Group	4,872	8,324	4,311	7,204	3,498	6,857	21	13
Individual FYP	21,822	45,833	22,963	42,699	23,840	31,024	(5)	(5)
Ind. Agents #	493,589	486,911	474,600	453,392	411,709	416,570	1	4
FYP per agent (Rmb)	6,787	14,565	9,821	7,922	10,311	6,261	43	(31)
# of Ind. Customers ('000)	51,888	49,784	47,926	45,318	43,044	40,737	4	8
Persistency 13 mo (%)	94	94	95	93	94	91	(1)	(2)
Solvency (%)	167	156	158	180	206	227	11	9

Source: Company, ABCI Securities

**Ping An: P&C operating data**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross Premiums	48,914	83,708	40,922	62,507	30,191	38,774	14	20
Motor	36,660	65,292	30,792	49,420	22,990	29,561	6	19
Other P&C	12,254	18,416	10,130	13,087	7,201	9,213	48	21
Loss Ratios (%)	58.5	57.8	58.2	55.4	55.8	57.0	0.7	0.3
Expense Ratios (%)	34.6	35.7	34.7	37.8	40.7	41.9	(1.1)	(0.1)
Combined Ratios (%)	93.1	93.5	92.9	93.2	96.5	98.9	(0.4)	0.2
Solvency (%)	165	166	196	180	136	144	(2)	(31)

Source: Company, ABCI Securities

**Ping An: Banking operating data**

(Rmb mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Net interest margin (%)	2.42	2.53	2.44	2.33	2.10	1.89	(0.11)	(0.02)
Total loans	682,906	620,642	144,414	130,798	120,621	107,562	10	373
Corporate loans	485,228	413,019	96,399	85,427	81,565	67,828	17	403
Retail loans + Bills	197,678	207,623	48,015	45,371	39,056	39,734	(5)	312
NPL (%)	0.73	0.53	0.32	0.41	0.45	0.46	0.20	0.41
Provision coverage (%)	238	321	286	211	157	156	(83)	(48)
CAR (%)	11.40	11.51	10.78	10.96	11.80	13.00	(0.11)	0.62

Source: Company, ABCI Securities



**Ping An: Embedded Value**

(Rmb mn)	2009	2010	2011	2012E	2013E	1H12
<b>Group embedded value</b>						
Life insurance EV	100,703	121,086	144,400	174,406	201,218	156,198
Life insurance NBV	49,620	19,695	5,154	23,061	24,295	
Life insurance AV	150,323	140,781	149,554	197,467	225,514	
<b>Valuation of non-life businesses</b>						
P&C insurance	10,581	61,975	73,663	45,432	40,466	
Banking	35,195	51,251	64,517	52,710	55,073	
Financial services	22,284	32,003	11,202	12,077	13,559	
Corporate office and unallocated	2,043	5,145	35,023	33,923	32,943	
Book value of other businesses	54,554	79,900	91,227	112,580	122,623	102,807
Group EV	155,257	200,986	235,627	286,986	323,842	259,005
Group AV	220,426	291,154	333,958	341,609	367,556	
<b>Life embedded value</b>						
Adjusted net worth	40,052	43,673	48,219	67,455	90,272	50,019
Value of in-force	74,965	94,958	117,550	129,218	134,146	129,726
Cost of solvency margin	-14,314	-17,545	-21,369	-22,266	-23,200	-23,547
Embedded value	100,703	121,086	144,400	174,406	201,218	156,198
Vnb (long term)	11,805	15,507	17,343	15,778	15,671	9,160
Multiplier	4	1	0	1	2	
New business value (long term)	49,620	19,695	5,154	23,061	24,295	
Appraisal value	150,323	140,781	149,554	197,467	225,514	
<b>EV movement analysis</b>						
Opening embedded value	69,643	100,703	121,086	144,400	174,406	
Expected return						
- SHF's	1,419	2,203	2,402	2,652	3,710	
- In-force	6,107	7,620	9,846	12,931	14,214	
Value of new business (VNB)	11,805	15,507	17,343	15,778	15,671	
Inv't r var + mkt val adj	8,393	(1,327)	(12,268)	5,000	(1,000)	
Capital raising & dividends	748	(1,967)	7,968	(4,354)	(3,483)	
OpEx var, model chg & others	2,588	(1,653)	(1,977)	(2,000)	(2,300)	
Closing embedded value	100,703	121,086	144,400	174,406	201,218	
EVPS (HK\$)	15.56	18.88	22.21	27.10	31.77	
Group EVPS (HK\$)	23.05	31.34	36.24	44.59	51.14	
AVPS (HK\$)	32.73	45.39	51.36	53.08	58.04	
PEV implied	1.42	1.45	1.42	1.19	1.13	
VNB (HK\$)	1.82	2.42	2.67	2.45	2.47	
VNB implied (x)	5.30	5.81	5.67	3.46	2.79	
<b>EV contributions 1 (%)</b>						
Expected return on beg EV	11%	10%	10%	11%	10%	
IRV + MVA contribution to beg EV	12%	-1%	-10%	3%	-1%	
VNB contribution to beg EV	17%	15%	14%	11%	9%	
VNB contribution to beg VIF	21%	21%	18%	13%	12%	
EVPS (HK\$) growth	45%	21%	18%	22%	17%	
<b>EV contributions 2 (%)</b>						
Beginning EV	69%	83%	84%	83%	87%	
Expected return						
- SHF's	1%	2%	2%	2%	2%	
- In-force	6%	6%	7%	7%	7%	
Inv't r var + mkt val adj	8%	-1%	-8%	3%	0%	
Value of new business (VNB)	12%	13%	12%	9%	8%	
Capital raising & dividends	1%	-2%	6%	-2%	-2%	
OpEx var, model chg & others	3%	-1%	-1%	-1%	-1%	
Ending EV	100%	100%	100%	100%	100%	

Source: Company data, ABCI Securities estimates



Ping An: Financial Statements

Profit & loss (Rmb mn)						Operating ratios (%)					
	2010	2011	2012E	2013E	2014E		2010	2011	2012E	2013E	2014E
<b>GWP &amp; policy fees</b>	<b>159,384</b>	<b>159,384</b>	<b>207,802</b>	<b>227,420</b>	<b>247,310</b>	Gross written premium growth	42.0%	30.4%	9.4%	8.7%	9.0%
(-) Premiums to reinsurers	(8,181)	(8,181)	(10,970)	(14,806)	(17,598)	Net earned premium growth	40.6%	32.3%	12.3%	6.7%	8.4%
<b>NWP &amp; policy fees</b>	<b>151,203</b>	<b>151,203</b>	<b>196,832</b>	<b>212,614</b>	<b>229,712</b>	Claims/benefits - of NEP	38.6%	41.3%	43.4%	40.9%	41.6%
Chg. in unearned premium res.	(10,079)	(10,079)	(10,170)	(2,927)	(6,068)	Div to PH & net inc. in PH res. of NEP	42.9%	36.8%	34.7%	37.0%	35.5%
<b>NEP &amp; policy fees</b>	<b>141,124</b>	<b>141,124</b>	<b>186,662</b>	<b>209,688</b>	<b>223,644</b>	<b>Ttl. claim/PH benefits to NEP</b>	<b>81.5%</b>	<b>78.1%</b>	<b>78.1%</b>	<b>77.9%</b>	<b>77.1%</b>
Investment income	31,083	31,083	29,265	32,862	45,490	Claims/benefits - of total revenue	28.0%	30.7%	30.4%	27.6%	28.2%
Net interest income of bk. op.	9,331	9,331	18,882	33,966	36,725	Net inc. in PH res. - of total revenue	31.2%	27.4%	24.3%	25.0%	24.0%
Fee & comm. inc.	8,159	8,159	12,270	15,631	17,652	<b>Ttl. claim/PH benefits to total revenue</b>	<b>59.2%</b>	<b>58.1%</b>	<b>54.7%</b>	<b>52.6%</b>	<b>52.2%</b>
Other income	4,652	4,652	3,665	7,509	7,769	Commission cost ratio	7.5%	7.1%	7.1%	8.6%	8.7%
<b>Total revenue</b>	<b>194,349</b>	<b>194,349</b>	<b>250,744</b>	<b>299,656</b>	<b>331,281</b>	General & admin. cost ratio	22.6%	23.2%	25.3%	25.3%	25.8%
Claims, surrenders, annuities/mortgages	(54,503)	(54,503)	(77,061)	(91,005)	(91,465)	<b>Operating expense ratio</b>	<b>30.0%</b>	<b>25.5%</b>	<b>35.8%</b>	<b>35.1%</b>	<b>32.4%</b>
Div. & int. to PH & net inc. in PH res.	(60,574)	(60,574)	(68,703)	(72,829)	(82,745)	<b>Cost to income ratio</b>	<b>89.3%</b>	<b>88.5%</b>	<b>87.1%</b>	<b>86.6%</b>	<b>86.7%</b>
<b>Ttl. claims/PH benefits</b>	<b>(115,077)</b>	<b>(115,077)</b>	<b>(145,764)</b>	<b>(163,834)</b>	<b>(174,210)</b>	<b>Gross investment yield</b>	<b>4.6%</b>	<b>3.6%</b>	<b>3.4%</b>	<b>4.0%</b>	<b>3.9%</b>
Commission expenses	(14,545)	(14,545)	(17,767)	(21,368)	(28,620)	<b>Group solvency</b>	<b>197.9%</b>	<b>166.7%</b>	<b>160.2%</b>	<b>161.2%</b>	<b>152.1%</b>
General & administrative expense	(34,385)	(34,385)	(50,575)	(66,513)	(76,436)	<b>Ping An life solvency</b>	<b>180.2%</b>	<b>156.1%</b>	<b>185.5%</b>	<b>203.8%</b>	<b>186.8%</b>
Loan loss provisions	(626)	(626)	(1,704)	(3,229)	(3,555)	<b>Ping An P&amp;C solvency</b>	<b>179.6%</b>	<b>166.1%</b>	<b>144.0%</b>	<b>146.4%</b>	<b>141.7%</b>
Other expense	(8,834)	(8,834)	(5,976)	(5,972)	(3,944)						
<b>Total expenses</b>	<b>(58,390)</b>	<b>(58,390)</b>	<b>(76,022)</b>	<b>(97,082)</b>	<b>(112,556)</b>						
<b>Net profit before tax</b>	<b>20,882</b>	<b>20,882</b>	<b>28,958</b>	<b>38,740</b>	<b>44,515</b>	<b>Balance sheet (Rmb mn)</b>					
Associate/JV - Profits/losses	1,465	1,465	1,068	(2)	31		<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
Tax expense	(4,409)	(4,409)	(7,444)	(5,900)	(7,950)	Cash	203,315	261,006	425,648	469,277	517,378
<b>Net profit after tax</b>	<b>17,938</b>	<b>17,938</b>	<b>22,582</b>	<b>32,838</b>	<b>36,596</b>	Investments	648,893	899,232	1,088,707	1,160,928	1,279,076
Minority interest	(627)	(627)	(3,107)	(7,248)	(7,995)	Receivables	6,414	182,816	144,938	159,794	176,173
<b>NP to Ping An shareholders</b>	<b>17,311</b>	<b>17,311</b>	<b>19,475</b>	<b>25,590</b>	<b>28,601</b>	Deferred acquisition costs	0	0	0	0	0
						Fixed assets	8,170	16,027	16,956	16,956	16,956
<b>Financial summary</b>						Policy loans, PH assets & inv. associates	304,835	926,343	1,066,710	1,189,267	1,331,951
	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	<b>Total assets</b>	<b>1,171,627</b>	<b>2,285,424</b>	<b>2,742,960</b>	<b>2,996,222</b>	<b>3,321,534</b>
<b>EPS (HK\$)</b>	<b>2.70</b>	<b>3.00</b>	<b>3.98</b>	<b>4.52</b>	<b>5.07</b>	Deposits	175,963	836,049	946,002	1,072,956	1,216,946
<i>EPS growth (%)</i>	19.8%	11.0%	32.7%	13.6%	12.4%	Borrowings	146,672	295,429	498,663	534,168	572,201
<b>PER (x)</b>	<b>21.7</b>	<b>19.6</b>	<b>14.7</b>	<b>13.0</b>	<b>11.5</b>	Payables	35,548	120,962	82,741	91,222	100,572
<b>PBV (x)</b>	<b>3.22</b>	<b>2.22</b>	<b>1.87</b>	<b>1.64</b>	<b>1.39</b>	Policyholder liabilities	669,938	791,215	921,686	1,009,660	1,101,727
<b>PEV (x)</b>	<b>1.87</b>	<b>1.62</b>	<b>1.31</b>	<b>1.15</b>	<b>0.97</b>	Other	26,623	70,427	91,722	61,825	77,614
<b>VNB multiple (x)</b>	<b>11.3</b>	<b>8.4</b>	<b>5.7</b>	<b>3.0</b>	<b>-0.7</b>	<b>Total liabilities</b>	<b>1,054,744</b>	<b>2,114,082</b>	<b>2,540,814</b>	<b>2,769,830</b>	<b>3,069,060</b>
<b>Dividend per share (HK\$)</b>	<b>0.55</b>	<b>0.49</b>	<b>0.68</b>	<b>0.69</b>	<b>0.73</b>	<b>Net assets</b>	<b>116,883</b>	<b>171,342</b>	<b>202,145</b>	<b>226,392</b>	<b>252,473</b>
Yield (%)	1.1%	0.8%	1.2%	1.2%	1.2%	Minority interests	4,853	40,475	50,599	58,594	67,420
Payout ratio (%)	24.0%	16.1%	17.0%	15.2%	14.3%	<b>Net equity to shareholders</b>	<b>112,030</b>	<b>130,867</b>	<b>151,546</b>	<b>167,798</b>	<b>185,053</b>
<b>Return on equity (%)</b>	<b>16.6%</b>	<b>13.5%</b>	<b>13.7%</b>	<b>13.3%</b>	<b>12.7%</b>						
Return on assets (%)	1.8%	1.2%	1.1%	1.1%	1.0%						
Tax rate (%)	21.1%	25.7%	15.2%	17.9%	17.9%						

Source: Company data, ABCI Securities estimates



# Company Report

## New China Life (1336 HK) – Hold Life & Health Insurance Industry Initiation

### Key data

H-share price (HK\$)	24.85
Target price (HK\$)	24.85
Upside potential (%)	0.0
52Wk H/L(HK\$)	36.9 / 22.6
Issued shares:	
H-shares (mn)	1,034
A-shares (mn)	3,117
H-share mkt cap (HK\$m)	88,760
30-day avg vol (HK\$m)	57.2
Major shareholder (%):	
Central Huijin	31.2
Baosteel Group	15.1

Source: Company & Bloomberg

### Revenue breakdown in 2011 (%)

Net earned premiums (NEP)	88.1
Investment income	11.7
Other income	0.2

\*Based on 2011 results

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	9.2	3.7
3-mth	(14.7)	(20.4)
6-mth	(20.4)	(21.4)

\*Relative to MSCI China

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 3 October 2012

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### Cheap for good reasons

**New China Life is trading at a low valuation for good reasons. The company disappointed the market by reporting the lowest NBM among peers in 1H12. Also, its premium growth decelerated fast since 1Q12. Lastly, the company's EV is the least sensitive to equity values, and hence a potential recovery of A-share markets. Based on these, we initiate coverage on New China Life with a HOLD recommendation.**

**With the lowest NBM.** New China Life reported its NBM at 23.3% in 1H12. It has improved by only 0.9ppt HoH. Also, its NBM is the lowest among peers. As a result, the company suffered from a YoY decline of 1.4% in VNB. All these undershot the market expectation. Therefore, we hold a negative stance towards its Life underwriting going forward.

**EV insensitive to investment upturn.** 10% change in equity values will lead to 1.7% change in New China Life's EV in 1H12. This is low compared to 5.4% of China Life, 2.8% of Ping An, 5.5% of China Taiping. In 1H12, New China Life allocated Rmb33.4bn, or 7.4% of investment portfolio, in equity. We expect the insurer to benefit the least from the upcoming recovery of A-share markets.

**Trading at a low valuation.** New China Life closed at HK\$23.1, 17.5% lower than its H-share IPO price of HK\$28.0. It is trading at 0.90x 2013E PEV and (1.5)x 2013E VNB, much cheaper than the sector average of 1.07x 2013E PEV. We expect New China Life to grow its EVPS by 24.7% YoY in 2012E and 15.7% YoY in 2013E. In spite of several weaknesses in its operations, the stock is trading at a very low valuation.

**Initiate coverage with a BUY rating; TP of HK\$24.85.** We derive an appraisal value of Rmb62,016 mn for 2013E, also adopting it as TP, or HK\$24.85/ share. The implied valuation of our TP is 0.90x 2013E PEV and (1.5)x 2013E VNB. This represents nil upside potential from the current share price. We initiate coverage of New China Life with a HOLD recommendation.

**Risk factors:** better or worse-than-expected underwriting and investment performance, looser or tighter-than-expected regulations

### Results and valuation

FY ended Dec 31	2010	2011	2012E	2013E	2014E
Revenue (Rmb mn)	102,709	108,610	123,043	137,935	153,513
Chg (YoY)	39.0	5.7	13.3	12.1	11.3
Net profit (Rmb mn)	2,249	2,799	3,435	4,266	5,145
Chg (YoY)	(15.5)	24.5	22.7	24.2	20.6
EPS (HK\$)	2.23	1.51	1.35	1.71	2.18
PER (x)	11.1	16.4	18.3	14.5	11.4
BPS (HK\$)	6.5	12.3	14.7	16.8	20.2
P/B (x)	3.8	2.0	1.7	1.5	1.2
EVPS (HK\$)	27.9	19.1	23.9	27.6	33.5
PEV (x)	0.9	1.3	1.0	0.9	0.7
VNB (HK\$)	4.71	1.70	1.83	1.83	1.90
VNB (x)	(0.6)	3.4	0.5	(1.5)	(4.6)

Source: Company data, ABCI Securities estimates



## Investment Positives

**Trading at a low valuation.** New China Life closed at HK\$24.85, 11.3% lower than its H-share IPO price of HK\$28.0. It is trading at 0.90x 2013E PEV and (1.5)x 2013E VNB, much cheaper than the sector average of 1.07x 2013E PEV. We expect New China Life to grow its EVPS by 24.7% YoY in 2012E and 15.7% YoY in 2013E. In spite of several weaknesses in its operations, the stock is trading at a very low valuation.

**Potential entry to MSCI China-H Index.** New China Life A-share was included into MSCI China A Index in May. Also, the stock was included in FTSE China Index upon its IPO in Dec 2011. Currently, New China Life is trading at a market cap of US\$3.0bn and H-share free float market cap of US\$1.0. This is compared to US\$2.6bn and US\$1.2bn of China Taiping. China Taiping is currently a constituent of MSCI China, with about 0.3% weighting. As a result, we believe there is a genuine chance for New China Life to be included into MSCI China H Index. This will in turn attract more passive institutional fund flow to the stock.

**High EV operating margins.** In 2011, New China Life's EV operating margins was 31.1% 15.9%, higher than 15.9% of China Life, 23.6% of Ping An and 29.7% of Taiping Life. Given the low base effect, we expect New China Life to outgrow its peers in EV in the future.

## Investment Concerns

**With the lowest NBM.** Investors put high hope on New China Life for its margin improvement and VNB growth in early 2012. However, the company failed to deliver up to market expectation on these fronts in 1H12. In fact, New China Life reported its NBM 23.3% in 1H12. It has improved by only 0.9ppt HoH, in spite of a higher contribution from long term regular premium sales. Also, its NBM is the lowest among peers. Its peers averaged 35.5% ion NBM during the same half. As a result, the company suffered from a YoY decline of 1.4% in VNB. Therefore, we are not optimistic of the Life underwriting of New China Life going forward.

**Volume weakening.** The total premium growth has started to decelerate for New China Life since 2Q12. Total premiums grew 5.8% YoY in 8M12, compared with 16.0% YoY in 3M12. FYP dropped by 6.6% in 1H12. We expect further deceleration for its premium growth in 2H12.

**EV insensitive to investment upturn.** Per the company disclosure, 10% change in equity values will lead to 1.7% change in New China Life's EV in 1H12. This is low compared to 5.4% of China Life, 2.8% of Ping An, 5.5% of China Taiping. In 1H12, New China Life allocated Rmb33.4bn, or 7.4% of investment portfolio, in equity. We expect the insurer to benefit the least from the upcoming recovery of A-share markets.



## Valuation & Recommendation

**We forecast high-teens EV Growth.** New China Life reported group EV of Rmb48,991 mn in 2011 and Rmb56,149 mn in 1H12. In 2012E, we expect the company to report investment return variance of Rmb2,600 mn, due to slightly improved capital markets in China, compared to 2011. Besides, we forecast VNB of Rmb4,630 mn in 2012E and Rmb4,570 mn in 2013E, on the back of weak NBM's averaging 24.3%. As such, we forecast the EV to reach Rmb60,536 mn in 2012E, up 23.6% YoY, and Rmb68,933 mn in 2013E, up 13.9% YoY.

**Expecting earnings growth.** Based on a net premium growth of 6.0% YoY and gross investment yield of 4.3%, we estimate China Life to report net earnings of Rmb4,266 mn in 2013E, up 24.2% YoY from Rmb3,435 mn in 2012E. Our earnings forecast is in-line with consensus of Rmb4,250 mn.

**TP and recommendation.** Based on the aforementioned assumptions, we derive an appraisal value of Rmb62,016 mn for New China Life in 2013E and also adopt it as our target price. It is equivalent to HK\$24.85/ share. We forecast 2013E EVPS and VNB of HK\$27.62 and HK\$1.83, respectively. The implied valuation of our TP is 0.90x 2013E PEV and (1.5)x 2013E VNB. This represents nil upside potential from the current share price. We initiate coverage of New China Life with a HOLD recommendation.





**New China Life: 1H12 profit & loss**

	2009	2010	2011	1H10	2H10	1H11	2H11	1H12	HoH	YoY
	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn	Chg (%)	Chg (%)
GWP & Policy fees	65,422	91,956	95,151	53,675	38,281	50,843	44,308	56,114	27	10
(-) Premiums to Reinsurers	(30)	(32)	(584)	(18)	(14)	(238)	(346)	(40)	(88)	(83)
NWP & Policy fees	65,452	91,988	95,735	53,693	38,295	51,081	44,654	56,154	26	10
Chg. in Unearned Premium Res.	(72)	(128)	(71)	(165)	37	(193)	122	(227)	(286)	18
NEP & policy fees	65,380	91,860	95,664	53,528	38,332	50,888	44,776	55,927	25	10
Investment income	8,362	10,521	12,754	4,114	6,407	6,813	5,941	7,303	23	7
Other income	164	328	192	118	210	101	91	83	(9)	(18)
<b>Total revenue</b>	<b>73,906</b>	<b>102,709</b>	<b>108,610</b>	<b>57,760</b>	<b>44,949</b>	<b>57,802</b>	<b>50,808</b>	<b>63,313</b>	<b>25</b>	<b>10</b>
Claims & Life insurance benefits	(10,763)	(13,250)	(21,178)	(5,908)	(7,342)	(9,896)	(11,282)	(12,046)	7	22
Div. & Int. to PH & Net Inc. in PH Res.	(46,961)	(71,133)	(66,608)	(43,333)	(27,800)	(37,966)	(28,642)	(40,494)	41	7
Ttl. Claims / PH Benefits	(57,724)	(84,383)	(87,786)	(49,241)	(35,142)	(47,862)	(39,924)	(52,540)	32	10
U/W & Policy Acq. Expense	(5,623)	(7,252)	(7,317)	(3,884)	(3,368)	(3,689)	(3,628)	(3,825)	5	4
General & Administrative Expense	(7,206)	(8,410)	(9,229)	(3,925)	(4,485)	(3,998)	(5,231)	(4,517)	(14)	13
Other Expense	(509)	(147)	(199)	194	(341)	108	(307)	(135)	(56)	(225)
<b>Total Expenses</b>	<b>(13,338)</b>	<b>(15,809)</b>	<b>(16,745)</b>	<b>(7,615)</b>	<b>(8,194)</b>	<b>(7,579)</b>	<b>(9,166)</b>	<b>(8,477)</b>	<b>(8)</b>	<b>12</b>
Net profit before Tax	2,844	2,517	4,079	904	1,613	2,361	1,718	2,296	34	(3)
Associate P&L and Finance Cost	(193)	(262)	(804)	(62)	(200)	(311)	(493)	(788)	60	153
Tax Expense	10	(5)	(475)	(265)	260	(275)	(200)	397	(299)	(244)
Net profit after Tax	2,661	2,250	2,800	577	1,673	1,775	1,025	1,905	86	7
Minority interest	(1)	(1)	(1)	0	(1)	0	(1)	(1)	0	0
NP to New China Life Shareholders	2,660	2,249	2,799	577	1,672	1,775	1,024	1,904	86	7

Source: Company, ABCI Securities

**New China Life: Embedded Value (EV), Value of New Business (VNB) & New Business Margins (NBM)**

(Rmb mn)	1H12	2011	1H11	2010	2009	% HoH	% YoY
ANAV	26,348	21,966	17,673	6,400		20	49
VIF	40,257	36,818	33,798	29,866		9	19
Solvency Cost	(10,456)	(9,793)	(9,149)	(8,181)		7	14
EV	56,150	48,991	42,322	28,085		15	33
EVPS (HK\$)	22.16	19.22	19.70	27.85		15	12
APE	10,040	19,494	11,302	25,297	20,466	23	(11)
VNB	2,338	4,360	4,710	4,741		18	(1)
NBM (APE Basis %)	23.29	22.37	41.67	18.74		0.92	2.30
FYP	22,523	42,863	24,112	55,966	44,769	20	(7)
VNB	2,338	4,360	4,710	4,741		18	(1)
NBM (FYP Basis %)	10.38	10.17	19.53	8.47		0.21	0.54
VNB (HK\$)	0.92	1.71	2.19	4.70		52	(16)

Source: Company, ABCI Securities

**New China Life: Investment & Yields**

(%)	1H12	2011	1H11	2010	2009	% HoH	% YoY
Cash Equivalents	6.8	5.6	5.8	9.3	6.4	1.2	1.0
Deposits	36.0	32.9	30.2	18.9	9.6	3.1	5.8
Bonds	46.8	50.9	52.3	56.2	70.2	(4.1)	(5.5)
Equities	7.4	7.8	9.2	13.3	11.7	(0.4)	(1.8)
Others	3.0	2.8	2.5	2.3	2.1	0.2	0.5
<b>Total Inv'ts (RMB bn)</b>	<b>453</b>	<b>374</b>	<b>335</b>	<b>293</b>	<b>197</b>	<b>21.1</b>	<b>35.4</b>
<b>Net Investment Yield (%)</b>	<b>4.40</b>	<b>4.10</b>	<b>4.00</b>	<b>3.80</b>	<b>3.90</b>	<b>0.30</b>	<b>0.40</b>
<b>Total Investment Yield (%)</b>	<b>3.60</b>	<b>3.80</b>	<b>4.40</b>	<b>4.30</b>	<b>4.60</b>	<b>(0.20)</b>	<b>(0.80)</b>

Source: Company, ABCI Securities



***New China Life: Operating data***

(Rmb mn)	1H12	2011	1H11	2010	2009	% HoH	% YoY
Gross premiums	55,950	94,797	50,662	91,679	65,040	27	10
Individual Agency	23,030	35,871	18,791	28,688	20,248	35	23
Banc.	31,393	56,692	30,731	61,690	43,962	21	2
Wealth Management	622	932	368	221		10	69
Group	905	1,302	772	1,080	830	71	17
FYP Regular	8,653	16,897	9,879	21,889	17,766	23	(12)
% of FYP Ind. Regular	38.4	39.4	41.0	39.1	39.7	(1.0)	(2.6)
# of agents	207,000	200,000	204,380	198,771	226,776	3	1
FYP Regular per agent (Rmb)	41,802	44,390	24,009	47,924	29,637	(6)	74
Individual FYP	5,851	9,758	5,374	10,416	7,299	(40)	9
Individual FYP per agent (Rmb)	28,266	48,790	26,294	52,402	32,186	(42)	7
Persistence 13 mo (%)	90.6	91.5	92.4	91.7	89.4	(0.9)	(1.8)
Solvency (%)	159	156.0	106.1	35.0	36.2	2.8	52.7

Source: Company, ABCI Securities

***New China Life - share price & valuation***

		NEW CHINA LIFE	
		2011	2012E
Share Price (HK\$)	Hi	28.10	36.28
	Lo	23.41	21.55
	Av	24.90	29.04
PEV(X)	Hi	1.47 x	1.52 x
	Lo	1.22 x	0.90 x
	Av	1.30 x	1.22 x
EVPS YoY Growth (%)		-31%	25%
VNB(X)	Hi	5.26 x	6.80 x
	Lo	2.51 x	(1.27x)
	Av	3.38 x	2.84 x
VNB YoY Growth (%)		-64%	7%

Source: Bloomberg, Company data, ABCI Securities



*New China Life: Embedded Value*

(Rmb mn)	2010	2011	2012E	2013E	1H12
Embedded value					
Adjusted net worth	6,400	21,966	27,501	29,766	26,348
Value of in-force	29,866	36,818	44,004	51,231	40,257
Cost of solvency margin	(8,181)	(9,793)	(10,968)	(12,065)	(10,456)
Embedded value	28,085	48,991	60,536	68,933	56,149
Vnb (long term)	4,741	4,360	4,630	4,570	2,419
Multiplier	(2)	(1)	(2)	(2)	
New business value (long term)	(9,515)	(5,297)	(7,802)	(6,917)	
Appraisal value	18,570	43,694	52,734	62,016	
<b>EV movement analysis</b>					
Opening embedded value	20,333	28,383	49,290	60,536	48,991
Expected return					
- SHF's	300	333	1,142	1,430	535
- In-force	2,654	3,525	4,234	5,060	1,895
Value of new business (VNB)	5,095	4,681	4,971	4,906	2,419
Inv't r var + Mkt val adj	(203)	(11,894)	2,600	(2,000)	2,539
Capital raising & dividends	-	25,621	(500)	-	(221)
OpEx var, model chg & others	204	(1,359)	(1,200)	(1,000)	(9)
Closing embedded value	28,383	49,290	60,536	68,933	56,149
EVPS (HK\$)	27.89	19.14	23.87	27.62	22.16
AVPS (HK\$)	18.44	17.07	20.79	24.85	
PEV implied	0.66	0.89	0.87	0.90	
VNB (HK\$)	4.71	1.70	1.83	1.83	
VNB implied (x)	(2.01)	(1.21)	(1.69)	(1.51)	
<b>EV contributions 1 (%)</b>					
Expected return on beg EV		14%	11%	11%	5%
IRV + MVA contribution to beg EV		-42%	5%	-3%	5%
VNB contribution to beg EV		17%	10%	8%	5%
VNB contribution to beg VIF		16%	14%	11%	6%
EVPS (HK\$) growth		-31%	25%	16%	
<b>EV contributions 2 (%)</b>					
Beginning EV	72%	58%	81%	88%	87%
Expected return					
- SHF's	1%	1%	2%	2%	
- In-force	9%	7%	7%	7%	4%
Inv't r var + mkt val adj	-1%	-24%	4%	-3%	5%
Value of new business (VNB)	18%	9%	8%	7%	4%
Capital raising & dividends	0%	52%	-1%	0%	0%
OpEx var, model chg & others	1%	-3%	-2%	-1%	0%
Ending EV	100%	100%	100%	100%	100%

Source: Company data, ABCI Securities estimates



New China Life Financial Statements

Profit & loss (Rmb mn)						Operating ratios (%)					
	2010	2011	2012E	2013E	2014E		2010	2011	2012E	2013E	2014E
<b>GWP &amp; policy fees</b>	<b>91,956</b>	<b>95,151</b>	<b>106,569</b>	<b>117,226</b>	<b>128,949</b>	Gross written premium growth	40.6%	3.5%	12.0%	10.0%	10.0%
(-) Premiums to reinsurers	32	584	213	234	258	Net earned premium growth	40.5%	4.1%	11.5%	10.0%	10.0%
<b>NWP &amp; policy fees</b>	<b>91,988</b>	<b>95,735</b>	<b>106,782</b>	<b>117,460</b>	<b>129,207</b>	Claims/benefits - % of NEP	90.9%	91.1%	92.8%	93.5%	94.5%
Chg. in unearned premium res.	(128)	(71)	(107)	(117)	(129)	Div to PH & net inc. in PH res. % of NEP	0.8%	0.7%	1.0%	1.0%	1.0%
<b>NEP &amp; policy fees</b>	<b>91,860</b>	<b>95,664</b>	<b>106,675</b>	<b>117,343</b>	<b>129,077</b>	<b>Ttl. claim/PH benefits to NEP</b>	<b>91.8%</b>	<b>91.7%</b>	<b>93.8%</b>	<b>94.5%</b>	<b>95.5%</b>
Investment income	10,521	12,754	16,194	20,411	24,245	Claims/benefits - % of total revenue	81.4%	80.2%	80.5%	79.5%	79.5%
Other income	328	192	173	181	191	Net inc. in PH res. - % of total revenue	0.8%	0.6%	0.9%	0.9%	0.8%
<b>Total revenue</b>	<b>102,709</b>	<b>108,610</b>	<b>123,043</b>	<b>137,935</b>	<b>153,513</b>	<b>Ttl. claim/PH benefits to total revenue</b>	<b>82.2%</b>	<b>80.8%</b>	<b>81.3%</b>	<b>80.4%</b>	<b>80.3%</b>
Insurance benefits & claims	(83,611)	(87,151)	(98,995)	(109,716)	(121,978)	Commission cost ratio	7.9%	7.6%	7.0%	7.2%	7.2%
Investment contract benefits	(772)	(635)	(1,067)	(1,173)	(1,291)	General & admin. cost ratio	9.2%	9.6%	8.5%	8.5%	8.5%
<b>Total Claims / PH Benefits</b>	<b>(84,383)</b>	<b>(87,786)</b>	<b>(100,062)</b>	<b>(110,889)</b>	<b>(123,269)</b>	Other exp. & stat. levy ratio	0.2%	0.2%	0.2%	0.2%	0.2%
Commission and brokerage expenses	(7,252)	(7,317)	(7,467)	(8,449)	(9,294)	<b>Operating expense ratio</b>	<b>17.2%</b>	<b>17.5%</b>	<b>15.7%</b>	<b>15.9%</b>	<b>15.9%</b>
Administrative expenses	(8,410)	(9,229)	(9,067)	(9,974)	(10,972)	<b>New investment yield</b>	3.8%	4.1%	4.3%	4.2%	4.1%
Other expenses	(147)	(199)	(213)	(235)	(258)	<b>Gross investment yield</b>	4.3%	3.8%	3.8%	3.9%	3.9%
<b>Total Operating Expenses</b>	<b>(15,809)</b>	<b>(16,745)</b>	<b>(16,748)</b>	<b>(18,658)</b>	<b>(20,523)</b>	<b>Solvency ratio</b>	35.0%	155.9%	179.9%	162.8%	149.6%
<b>Finance Expenses</b>	<b>(263)</b>	<b>(806)</b>	<b>(2,417)</b>	<b>(2,701)</b>	<b>(2,860)</b>						
Associate / JV - Profits / Losses	1	2	2	2	2						
<b>Net profit before tax</b>	<b>2,255</b>	<b>3,275</b>	<b>3,818</b>	<b>5,690</b>	<b>6,863</b>	<b>Balance sheet (Rmb mn)</b>					
Tax expense	(5)	(475)	(382)	(1,422)	(1,716)		<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
<b>Net profit after tax</b>	<b>2,250</b>	<b>2,800</b>	<b>3,436</b>	<b>4,267</b>	<b>5,147</b>	Cash	27,368	21,095	28,624	39,867	46,896
Minority interest	1	1	1	2	2	Investments	265,498	352,861	448,436	529,666	623,052
<b>NP to NCI shareholders</b>	<b>2,249</b>	<b>2,799</b>	<b>3,435</b>	<b>4,266</b>	<b>5,145</b>	PP&E / Investment Properties	3,435	4,735	4,972	5,220	5,481
						Reinsurance Assets	4,535	4,202	4,415	4,650	4,907
						Premium Receivables	979	1,395	1,443	1,617	1,778
						Other assets	2,751	2,483	3,889	3,722	6,735
						<b>Total Assets</b>	<b>304,566</b>	<b>386,771</b>	<b>491,779</b>	<b>584,742</b>	<b>688,851</b>
<b>Financial summary</b>						Long-term insurance contracts liabilities	233,821	292,818	379,762	472,239	571,755
	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	Short-term insurance contracts liabilities	804	996	1,114	1,225	1,347
<b>EPS (HK\$)</b>	<b>2.23</b>	<b>1.51</b>	<b>1.35</b>	<b>1.71</b>	<b>2.18</b>	Investment contracts	19,912	19,001	20,068	21,241	22,532
<i>EPS growth (%)</i>	-11.7%	-32.2%	-10.4%	26.2%	27.4%	Borrowings (Sub-debt)	0	5,073	15,214	17,000	18,000
<b>PER (x)</b>	<b>11.1</b>	<b>16.4</b>	<b>18.3</b>	<b>14.5</b>	<b>11.4</b>	Financial assets under repo agreement	24,712	32,481	33,089	25,361	21,449
<b>PBV (x)</b>	<b>3.81</b>	<b>2.03</b>	<b>1.69</b>	<b>1.48</b>	<b>1.23</b>	Unearned premiums	390	504	522	584	643
<b>PEV (x)</b>	<b>0.89</b>	<b>1.30</b>	<b>1.04</b>	<b>0.90</b>	<b>0.74</b>	Other Liabilities	18,354	4,585	4,763	5,076	5,462
<b>VNB multiple (x)</b>	<b>(0.65)</b>	<b>3.35</b>	<b>0.54</b>	<b>(1.51)</b>	<b>(4.55)</b>	<b>Total liabilities</b>	<b>297,993</b>	<b>355,458</b>	<b>454,530</b>	<b>542,726</b>	<b>641,187</b>
<b>Dividend per share (HK\$)</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>Net assets</b>	<b>6,573</b>	<b>31,313</b>	<b>37,249</b>	<b>42,016</b>	<b>47,663</b>
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	Minority interests	6	7	9	11	13
Payout ratio (%)	0.0%	0.0%	0.0%	0.0%	0.0%	<b>Net equity to shareholders</b>	<b>6,567</b>	<b>31,306</b>	<b>37,240</b>	<b>42,005</b>	<b>47,650</b>
<b>Return on equity (%)</b>	<b>41.6%</b>	<b>14.8%</b>	<b>10.0%</b>	<b>10.8%</b>	<b>11.5%</b>						
Return on assets (%)	0.9%	0.8%	0.8%	0.8%	0.8%						
Tax rate (%)	0.2%	14.5%	10.0%	25.0%	25.0%						

Source: Company data, ABCI Securities estimates



# Company Report

## China Taiping (966 HK) – Buy Life & Health Insurance Industry Initiation

### Key data

H-share price (HK\$)	12.18
Target price (HK\$)	13.42
Upside potential (%)	10.20
52Wk H/L(HK\$)	18.6 / 10.1
Issued shares:	1,714
Market cap (HK\$mn)	20,778
30-day avg vol (HK\$mn)	26.2
Major shareholders (%):	
China Taiping Insurance Gp	37.7
Easiwell	8.1

Source: Company & Bloomberg

### Segmental profits in 2011 (%)

Life	78.9
P&C	97.2
Reinsurance	(19.0)
Corporate & eliminations	(57.1)

\*Based on 2011 results

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	18.5	14.4
3-mth	(2.9)	(5.9)
6-mth	(19.8)	(15.7)

\*Relative to MSCI China

Source: Bloomberg

### 1 year price performance



Source: Bloomberg

### Analyst

Report Date: 3 October 2012

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### An undervalued small-cap

China Taiping has been constantly overlooked by investors due to its small-cap status. However, we see strong turnaround stories in its Reinsurance and P&C units. While we are still concerned with its Life operations, the stock is trading at only 0.87x 2013E PEV, compared to 2.31x of historical average. Based on these, we initiate coverage on China Taiping with a BUY recommendation.

**Reinsurance recovery at sight.** TPRE reported heavy net losses in 2H11 and in 1H12, mainly due to three major natural disasters in 2011. In 2H12 and 2013, we expect the unit to benefit from the increase of global reinsurance pricing and fading residual claims from 2011. We expect TPRE to report net profits of HK\$103 mn in 2012E, against net loss of HK\$94 mn in 2011. The swing factor totals HK\$197 mn.

**P&C returning to underwriting profits.** TPI started making underwriting profits of Rmb53 mn in 1H12, against losses during 2008-10. We expect the unit to achieve better economies of scale in operations, when premium income surpassed Rmb6.0 bn in 2012E (Rmb5.8bn in 2011). TPI's turnaround is another investment merit for China Taiping.

**Attractive valuation.** China Taiping closed at HK\$11.50, down 20.4% year to date. It is trading at 0.87x 2013E PEV and (2.6)x 2013E VNB, much cheaper than the sector average of 1.07x 2013E PEV. We expect China Taiping to grow its EVPS by 21.4% YoY in 2012E and 15.5% YoY in 2013E. Despite the weakness of its Life operations, the stock is trading at a very attractive low valuation.

**Initiate coverage with a BUY rating; TP of HK\$13.42.** We derive an appraisal value of HK\$23,006 mn for 2013E, also adopting it as TP, or HK\$13.42/ share. The implied valuation of our TP is 0.96x 2013E PEV and 1.1x 2013E VNB. This represents 10.2% upside potential from the current share price. We initiate coverage of China Taiping 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 (HK\$ mn)	51,815	53,169	59,449	64,930	69,928
Chg (YoY)	53	3	12	9	8
Net profit (HK\$ mn)	2,248	495	1,357	1,657	1,915
Chg (YoY)	172	(78)	174	22	16
EPS (HK\$)	1.3	0.3	0.8	1.0	1.1
PER (x)	9.2	42.0	15.4	12.6	10.9
BPS (HK\$)	7.5	6.7	7.6	8.6	8.6
P/B (x)	1.6	1.8	1.4	1.2	1.0
EVPS (HK\$)	9.2	10.0	12.1	14.0	16.0
PEV (x)	1.3	1.2	1.0	0.9	0.8
VNB (HK\$)	0.5	0.7	0.7	0.7	0.7
VNB (x)	5.5	3.2	0.1	(2.6)	(5.4)

Source: Company data, ABCI Securities estimates



## Investment Positives

**Reinsurance recovery at sight.** TPRE, the reinsurance arm of China Taiping, reported net losses of HK\$248 mn in 2H11 and HK\$75 mn in 1H12. This is mainly because of the three major natural disasters in 2011, namely; flooding in Thailand, earthquake / tsunami in Japan and earthquake in New Zealand. The claim ratio was as high as 113% in 2H11 and 1H12. In 2H12 and 2013, we expect the unit to benefit from the increase of global reinsurance pricing and fading residual claims from 2011. We expect TPRE to report net profits of HK\$103 mn in 2012E, against net loss of HK\$94 mn in 2011. The swing factor totals HK\$197 mn for China Taiping. We forecast TPRE's ROE to normalize to 14% in 2013E, compared to (4)% in 2011 and 4% in 2012E.

**P&C returning to underwriting profits.** TPI, the China P&C arm of China Taiping, continued to make underwriting losses since the beginning of operations. But in 1H12, it turned profitable in underwriting, with a combined ratio at 98%. This is attributable to the falling claim ratio. TPI reported underwriting profits of Rmb53 mn, compared to losses of Rmb347mn in 2008. We expect the unit to achieve better economies of scale in operations, when annualized premiums surpassed Rmb6.0 bn in 2012E (Rmb5.8bn in 2011). The turnaround of TPI is another major investment merit for China Taiping.

**Attractive valuation.** China Taiping closed at HK\$11.50, down 20.4% year to date. It is trading at 0.87x 2013E PEV and (2.6)x 2013E VNB, much cheaper than the sector average of 1.07x 2013E PEV. We expect China Taiping to grow its EVPS by 21.4% YoY in 2012E and 15.5% YoY in 2013E. Despite the weakness of its Life operations, the stock is trading at a very attractive valuation.

**EV sensitive to investment upturn.** Per the company disclosure, 10% change in equity values will lead to 5.5% change in China Taiping's EV in 1H12. This is high compared to 5.4% of China Life, 2.8% of Ping An, 1.3% of China Pacific and 1.7% of New China Life. In 1H12, Taiping Life allocated Rmb13.4bn, or 7.8% of investment portfolio, in equity. We expect the insurer to benefit from the upcoming recovery of A-share markets.

## Investment Concerns

**Life under margin pressure.** In 1H12, Taiping Life reported VNB of HK\$1,283 mn, up 2.4% YoY. However, the unit could have reported a 15% YoY decline in VNB, if not for the change in actuarial assumptions. During the same half, the company lower discount rate from 11.5% to 11.0%, and increase long term investment assumption from 4.5% to 5.0%. Excluding such impact, Taiping Life will report VNB at HK\$1,065 mn. The implied NBM was only 26.5%, flattish HoH. In the meantime, all of its peers reported better NBM. The firm pushed health and critical illness products along with its peers earlier this year. However, its products were sold through bancassurance channels and were not well received. Also, the unit has optimized its regular premium product structure. Further room for improvement could be limited.

**Limped by small-cap status.** China Taiping has been constantly overlooked by insituitional investors, due to its small market cap and low index weighting in major benchmarks compared to its peer group. At present, its market cap is US\$2.6bn, compared to US\$80.5bn of China Life, US\$59.4bn of Ping An and US\$26.5bn of China Pacific. In MSCI China, its index



weighting is 0.3%, smaller than 3.0% of China Life, 2.5% of Ping An and 0.8% of China Pacific. For not being a major index stock, CTIH does not appeal to many mutual fund investors. As a result, despite its recovering fundamentals, its small-cap status may hinder its share price recovery.

**Inadequate solvency.** Taiping Life reported a solvency of 169.0%. This is the lowest in the sector. More importantly, the insurer has exceeded the limit of sub-debt issuance set by CIRC. It can no longer resort to the instrument for boosting solvency. As of now, its solvency is merely 19ppt over the recommended level of CIRC.

### Valuation & Recommendation

**We forecast high-teens EV Growth.** China Taiping reported group EV of HK\$17,074 mn in 2011 and HK\$20,505 mn in 1H12. In 2012E, we expect the company to report investment return variance of HK\$500 mn, due to slightly improved capital markets in China and Hong Kong, compared to 2011. Besides, we forecast VNB of HK\$2,412 mn in 2012E and HK\$2,379 mn in 2013E, on the back of weak NBM's averaging 29.5%. This assumption was formulated based on the latest actuarial assumption of Taiping Life. As such, we forecast the EV to reach HK\$20,725 mn in 2012E, up 21.4% YoY, and HK\$23,941 mn in 2013E, up 15.5% YoY.

**Expecting a sharp growth in earnings.** Based on a net premium growth of 6.0% YoY and gross investment yield of 4.1%, we estimate China Taiping to report net earnings of HK\$1,657 mn in 2013E, up 22.1% YoY from HK\$1,357 mn in 2012E. Because of the low base earnings in 2011, we forecast China Taiping to grow its profits by 174.4% YoY this year. Our earnings forecast is behind consensus of HK\$1,734 mn, due to more conservative assumption on policyholders benefits. We estimate the company to pay higher policyholder dividends due to better investment return.

**TP and recommendation.** Based on the aforementioned assumptions, we derive an appraisal value of HK\$23,006 mn for China Taiping in 2013E and also adopt it as our target price. It is equivalent to HK\$13.42/ share. Our appraisal value consists of the valuation of non-Life unit at HK\$6,013 mn. We forecast 2013E EVPS and VNB of HK\$13.97 and HK\$0.69, respectively. The implied valuation of our TP is 0.96x 2013E PEV and 1.1x 2013E VNB. This represents 10.2% upside potential from the current share price. We initiate coverage of China Taiping with a BUY recommendation.



China Taiping: 1H12 profit & loss

	2009	2010	2011	1H10	2H10	1H11	2H11	1H12	HoH	YoY
	HK\$mn	HK\$mn	HK\$mn	HK\$mn	HK\$mn	HK\$mn	HK\$mn	HK\$mn	(%)	(%)
GWP & Policy fees	31,023	48,759	50,098	27,273	21,486	27,159	22,939	31,489	37	16
(-) Premiums to Reinsurers	1,688	1,942	1,968	1,063	879	1,161	807	(1,295)	(260)	(212)
NWP & Policy fees	29,335	46,817	48,130	26,210	20,607	25,998	22,132	30,194	36	16
Chg. in Unearned Premium Res.	(207)	(836)	(521)	(915)	79	(596)	75	(924)	(1,335)	55
NEP & policy fees	29,128	45,981	47,609	25,295	20,686	25,402	22,207	29,270	32	15
Investment Income	4,483	5,513	5,197	2,481	3,032	3,137	2,060	2,572	25	(18)
Other Income	307	318	363	119	198	224	139	157	13	(30)
Total Revenue	33,918	51,815	53,169	27,895	23,917	28,763	24,406	31,999	31	11
Claims, Surrenders, Annuities / Maturities	(9,426)	(9,799)	(11,887)	(4,627)	(5,172)	(5,458)	(6,430)	(7,312)	14	34
Div. & Int. to PH & Net Inc. in PH Res.	(12,252)	(27,544)	(27,159)	(15,777)	(11,767)	(15,695)	(11,463)	(16,181)	41	3
Ttl. Claims / PH Benefits	(21,678)	(37,342)	(39,046)	(20,404)	(16,939)	(21,153)	(17,893)	(23,493)	31	11
Commission Expenses	(3,558)	(4,105)	(4,409)	(2,318)	(1,786)	(2,320)	(2,089)	(2,574)	23	11
General & Administrative Expense	(6,907)	(8,426)	(8,508)	(4,040)	(4,386)	(3,979)	(4,529)	(4,555)	1	14
Finance Expense	(318)	(353)	(566)	(164)	(189)	(278)	(287)	(291)	1	4
Other Expense	0	0	0	0	0	0	0	0		
Total Expenses	(10,782)	(12,884)	(13,482)	(6,523)	(6,362)	(6,577)	(6,905)	(7,419)	7	13
Net profit before Tax	1,458	1,588	641	969	616	1,033	(392)	1,087	(377)	5
Associate / JV - Profits / Losses	23	1,272	251	5	1,267	4	247	88	(64)	2,014
Tax Expense	(293)	(207)	28	(26)	(180)	15	13	(192)	(1,560)	(1,414)
Net Profit after Tax	1,188	2,653	920	948	1,702	1,052	(132)	983	(846)	(6)
Minority Interest	(362)	(409)	(425)	(345)	(63)	(326)	(99)	(447)	353	37
NP to CTIH shareholders	826	2,245	495	603	1,639	726	(230)	537	(333)	(26)

Source: Company, ABCI Securities

China Taiping: Embedded Value (EV), Value of New Business (VNB) & New Business Margins (NBM)

(HK\$ mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Taiping Life	25,815	21,574	19,110	17,511	14,187	13,626	19.7	35.1
CTIH Stake (50.05%)	12,920	10,798	9,565	8,764	7,101	6,820	19.7	35.1
Book Value of Other Biz (Excl. MI)	6,860	6,276	7,935	6,967	5,421	5,014	9.3	(13.6)
Group Embedded Value	19,780	17,074	17,500	15,731	12,522	11,834	15.8	13.0
Per Share (HK\$)								
CTIH Stake in TPL	7.54	6.34	5.62	5.15	4.17	4.01	18.8	34.1
Book Value of Other Biz (Excl. MI)	4.00	3.69	4.66	4.09	3.19	2.95	8.5	(14.2)
Group Embedded Value	11.54	10.03	10.28	9.24	7.36	6.95	15.0	12.2
(HK\$ mn)								
APE	4,024	8,464	4,477	9,297	5,413	6,948	1	(10)
VNB	1,283	2,244	1,253	1,827	1,055	1,353	29	2
NBM (APE Basis-%)	31.89	26.51	27.98	19.65	19.49	19.47	5.38	3.90
FYP	9,679	18,202	10,606	24,752	15,190	14,879	27	(9)
VNB	1,283	2,244	1,253	1,827	1,055	1,353	29	2
NBM (FYP Basis-%)	13.26	12.33	11.81	7.38	6.95	9.09	0.93	1.44

Source: Company, ABCI Securities

China Taiping: Segmental profits

(HK\$ mn)	1H12	2011	1H11	2010	1H10	% HoH	% YoY
Life	789	781	333	940	357	76	137
P&C	317	498	323	339	234	81	(2)
Reinsurance	(76)	(94)	160	373	174	(70)	(147)
Other businesses	(47)	(265)	(81)	1,002	(161)	(74)	(41)
Group net profits	983	920	736	2,653	603	434	34
(Mix - %)							
Life	80	85	45	35	59	(5)	35
P&C	32	54	44	13	39	(22)	(12)
Reinsurance	(8)	(10)	22	14	29	3	(29)
Other businesses	(5)	(29)	(11)	38	(27)	24	6
Group net profits	100	100	100	100	100		

Source: Company, ABCI Securities





**China Taiping: Life operating data**

(HK\$ mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross Premiums	23,657	38,530	21,002	37,875	21,233	21,636	35	13
Individual	9,487	14,410	7,538	10,319	5,429	6,652	38	26
Banc.	13,625	22,295	12,865	25,472	15,296	14,265	44	6
Group + Others	544	1,825	600	978	507	719	(56)	(9)
FYP Regular	3,395	7,382	3,796	7,760	4,326	6,066	(5)	(11)
(#)								
Branches or Outlets	815	832	788	740	646	611	(2)	3
Ind. Agents	51,008	46,064	46,124	50,527	57,435	60,781	11	11
FYP Regular / head (Rmb)	54,115	131,036	69,160	129,054	64,380	87,549	(13)	(22)
(%)								
Total Inv. Yield	3.60	3.60	4.10	5.00	4.80	5.50	-	(0.50)
Persistence 13 mo - Ind.	92.70	92.00	91.70	88.20	88.40	85.00	0.70	1.00
Persistence 13 mo - Banc.	88.30	93.20	93.30	94.00	93.90	92.00	(4.90)	(5.00)
Solvency	169	178	231	270	176	222	(9.00)	(62.00)

Source: Company, ABCI Securities

**China Taiping: Reinsurance operating data**

(HK\$ mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross Premiums	2,128	3,431	1,862	2,650	1,566	1,775	36	14
(%)								
Loss Ratios	77.90	74.70	65.80	62.90	54.50	65.30	3.20	12.10
Expense Ratios	32.70	31.00	35.50	31.10	36.90	27.20	1.70	(2.80)
Combined Ratios	110.60	105.70	101.30	94.00	91.40	92.50	4.90	9.30
Total Inv. Yield	4.70	2.10	3.90	6.10	5.80	6.80	2.60	0.80

Source: Company, ABCI Securities

**China Taiping: P&C operating data**

(HK\$ mn)	1H12	2011	1H11	2010	1H10	2009	% HoH	% YoY
Gross Premiums	4,508	6,994	3,456	6,135	3,041	5,106	27	30
Motor	3,488	5,559	2,658	5,021	2,447	4,150	20	31
Other P&C	1,019	1,435	798	1,114	594	957	60	28
(%)								
Loss Ratios	48.90	53.40	54.80	56.40	54.00	62.20	(4.50)	(5.90)
Expense Ratios	49.10	46.50	43.60	44.60	45.90	46.00	2.60	5.50
Combined Ratios	98.00	99.90	98.40	101.00	99.90	108.20	(1.90)	(0.40)
Total Inv. Yield	3.90	3.30	5.00	4.30	6.00	4.60	0.60	(1.10)
Solvency	168	152	153	154	156	192	16.00	15.00

Source: Company, ABCI Securities

**CH INS: China Taiping - share price & valuation**

		2006	2007	2008	2009	2010	2011	2012E
Share Price (HK\$)	Hi	9.80	26.45	24.80	30.15	30.00	25.60	18.24
	Lo	2.80	7.16	8.36	9.01	22.30	13.64	10.26
	Av	5.20	15.43	16.59	18.17	26.18	18.90	13.72
PEV(X)	Hi	2.53 x	5.42 x	3.96 x	4.34 x	3.12 x	2.57 x	1.51 x
	Lo	0.72 x	1.47 x	1.34 x	1.30 x	2.32 x	1.37 x	0.85 x
	Av	1.35 x	3.16 x	2.65 x	2.61 x	2.72 x	1.90 x	1.13 x
EVPS YoY Growth (%)			26%	28%	11%	38%	4%	21%
VNB(X)	Hi	37.00 x	101.14 x	60.90 x	58.31 x	37.94 x	22.70 x	8.73 x
	Lo	(6.65x)	10.68 x	6.91 x	5.17 x	23.61 x	5.34 x	(2.60x)
	Av	8.33 x	49.44 x	33.94 x	28.19 x	30.84 x	12.98 x	2.31 x
VNB YoY Growth (%)			33%	43%	31%	35%	28%	2%

Source: Bloomberg, Company data, ABCI Securities

*China Taiping: Embedded Value*

(HK\$ mn)	2009	2010	2011	2012E	2013E	1H12
<b>Group embedded value</b>						
Adjusted net worth	5,408	6,008	3,260	3,965	4,515	4,806
Value of in-force	10,353	14,156	23,469	26,152	30,380	24,088
Cost of solvency margin	(2,135)	(2,653)	(3,061)	(3,357)	(3,559)	(3,079)
TPL embedded value	13,626	17,511	23,668	26,760	31,336	25,815
CTIH shareholding	50.05%	50.05%	50.05%	50.05%	50.05%	50.05%
CTIH share of TPL EV	6,820	8,764	11,846	13,394	15,684	12,920
Other businesses at 1x PBV	5,014	6,967	5,228	7,331	8,257	7,585
Group embedded value	11,834	15,731	17,074	20,725	23,941	20,505
Vnb (long term)	1,353	1,827	2,359	2,412	2,379	1,055
Multiplier	7	4	1	1	1	
New business value (long term)	10,048	6,812	2,642	2,260	2,615	
CTIH shareholding	50.05%	50.05%	50.05%	50.05%	50.05%	
CTIH share of TPL NBV	5,029	3,409	1,322	1,131	1,309	
CIRe goodwill less cap. corp. exp.	(1,789)	(1,962)	(1,819)	(2,150)	(2,244)	
Group appraisal value	15,074	17,178	16,577	19,706	23,006	
<b>EV movement analysis</b>						
Opening embedded value	8,548	13,626	17,486	21,664	26,760	
Expected return						
- SHF's	154	270	300	205	250	
- In-force	733	1,139	1,248	1,479	1,648	
Value of new business (VNB)	1,353	1,827	2,359	2,412	2,379	
Inv't r var + mkt val adj	771	495	(4,024)	500	300	
Capital raising & dividends	1,590	-	1,585	-	-	
OpEx var, model chg & others	477	129	2,710	500	-	
Closing embedded value	13,626	17,486	21,664	26,760	31,336	
Group EVPS (HK\$)	6.95	9.24	9.96	12.09	13.97	
AVPS (HK\$)	8.86	10.09	9.67	11.50	13.42	
PEV implied	1.27	1.09	0.97	0.95	0.96	
VNB (HK\$)	0.40	0.54	0.69	0.70	0.69	
VNB implied (x)	7.43	3.73	1.12	0.94	1.10	
<b>EV contributions 1 (%)</b>						
Expected return on beg EV	10%	10%	9%	8%	7%	
IRV + MVA contribution to beg EV	9%	4%	-23%	2%	1%	
VNB contribution to beg EV	16%	13%	13%	10%	9%	
VNB contribution to beg VIF	20%	18%	17%	10%	9%	
EVPS (HK\$) growth	11%	33%	8%	21%	16%	
<b>EV contributions 2 (%)</b>						
Beginning EV	63%	78%	81%	81%	85%	
Expected return						
- SHF's	1%	2%	1%	1%	1%	
- In-force	5%	7%	6%	6%	5%	
Inv't r var + mkt val adj	6%	3%	-19%	2%	1%	
Value of new business (VNB)	10%	10%	11%	9%	8%	
Capital raising & dividends	12%	0%	7%	0%	0%	
OpEx var, model chg & others	3%	1%	13%	2%	0%	
Ending EV	100%	100%	100%	100%	100%	

Source: Company data, ABCI Securities estimates



China Taiping: Financial Statements

Profit & loss (HK\$ mn)						Operating ratios (%)					
	2010	2011	2012E	2013E	2014E		2010	2011	2012E	2013E	2014E
<b>GWP &amp; policy fees</b>	<b>47,100</b>	<b>50,098</b>	<b>55,975</b>	<b>59,918</b>	<b>64,139</b>	Gross written premium growth	57.2%	2.7%	11.7%	7.0%	7.0%
(-) Premiums to reinsurers	2,308	1,968	2,362	2,674	2,928	<b>Net earned premium growth</b>	<b>57.9%</b>	<b>3.5%</b>	<b>10.5%</b>	<b>6.0%</b>	<b>6.8%</b>
<b>NWP &amp; policy fees</b>	<b>44,792</b>	<b>48,130</b>	<b>53,613</b>	<b>57,244</b>	<b>61,211</b>	Claims/benefits - of NEP	21.3%	25.2%	24.7%	23.5%	23.8%
Chg. in unearned premium res.	(1,002)	(521)	(999)	(1,469)	(1,650)	Div to PH & Net Inc. in PH Res. of NEP	59.9%	56.8%	55.3%	58.3%	58.7%
<b>NEP &amp; policy fees</b>	<b>43,790</b>	<b>47,609</b>	<b>52,614</b>	<b>55,775</b>	<b>59,561</b>	<b>Ttl. claim/PH benefits to NEP</b>	<b>81.2%</b>	<b>82.0%</b>	<b>80.0%</b>	<b>81.9%</b>	<b>82.5%</b>
Investment income	4,798	5,197	6,606	8,958	10,110	Claims/benefits - of total revenue	18.9%	22.6%	21.9%	20.2%	20.3%
Other income	269	363	229	197	257	Net inc. in PH res. - of total revenue	53.2%	50.9%	49.0%	50.1%	50.0%
<b>Total revenue</b>	<b>48,857</b>	<b>53,169</b>	<b>59,449</b>	<b>64,930</b>	<b>69,928</b>	<b>Ttl. claim/PH benefits to total revenue</b>	<b>72.1%</b>	<b>73.4%</b>	<b>70.8%</b>	<b>70.3%</b>	<b>70.2%</b>
Claims, surrenders, annuities/maturities	(10,368)	(12,007)	(13,002)	(13,121)	(14,166)	Commission cost ratio	7.9%	8.3%	8.4%	8.3%	8.2%
Div. & int. to PH & net inc. in PH res.	(22,854)	(27,039)	(29,102)	(32,539)	(34,949)	General & admin. cost ratio	16.3%	16.0%	15.4%	16.0%	15.9%
<b>Ttl. claims/PH benefits</b>	<b>(33,222)</b>	<b>(39,046)</b>	<b>(42,104)</b>	<b>(45,660)</b>	<b>(49,115)</b>	Other cost ratio	0.7%	1.1%	1.0%	0.9%	0.8%
Commission expenses	(4,611)	(4,409)	(4,998)	(5,371)	(5,761)	<b>Operating expense ratio</b>	<b>24.9%</b>	<b>25.4%</b>	<b>24.8%</b>	<b>25.2%</b>	<b>24.9%</b>
General & administrative expense	(8,697)	(8,508)	(9,182)	(10,382)	(11,104)	<b>Gross investment yield</b>	<b>4.8%</b>	<b>3.4%</b>	<b>3.5%</b>	<b>4.1%</b>	<b>4.1%</b>
Finance expense	(328)	(566)	(581)	(580)	(580)	<b>TPRe solvency</b>	<b>555.8%</b>	<b>389.7%</b>	<b>360.7%</b>	<b>346.0%</b>	<b>331.5%</b>
Other expense	0	0	0	0	0	<b>Taiping life solvency</b>	<b>270.3%</b>	<b>177.7%</b>	<b>170.9%</b>	<b>168.5%</b>	<b>165.6%</b>
<b>Total expenses</b>	<b>(13,636)</b>	<b>(13,482)</b>	<b>(14,761)</b>	<b>(16,333)</b>	<b>(17,445)</b>	<b>Taiping insurance solvency</b>	<b>153.5%</b>	<b>152.2%</b>	<b>174.7%</b>	<b>171.6%</b>	<b>176.7%</b>
<b>Net profit before tax</b>	<b>1,999</b>	<b>641</b>	<b>2,585</b>	<b>2,937</b>	<b>3,369</b>	<b>Balance sheet (HK\$ mn)</b>					
Associate/JV - Profits/losses	55	251	189	203	203		<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>
Tax expense	(208)	28	(505)	(616)	(709)	PP&E	1,304	2,916	4,024	4,034	4,047
<b>Net profit after tax</b>	<b>1,846</b>	<b>920</b>	<b>2,269</b>	<b>2,524</b>	<b>2,863</b>	Bonds	86,452	116,230	137,027	151,894	170,840
Minority interest	(752)	(425)	(912)	(867)	(948)	Equities	12,245	8,669	14,307	17,098	19,240
<b>NP to CTIH shareholders</b>	<b>1,094</b>	<b>495</b>	<b>1,357</b>	<b>1,657</b>	<b>1,915</b>	Investment funds	4,251	5,672	(4,747)	9,046	10,155
<b>Financial summary</b>						Cash	29,412	37,776	57,958	52,158	59,040
	<b>2010</b>	<b>2011</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	Reinsurance recoverable	2,168	2,437	2,716	3,020	3,277
<b>EPS (HK\$)</b>	<b>0.64</b>	<b>0.29</b>	<b>0.79</b>	<b>0.97</b>	<b>1.12</b>	Interest in associates	1,179	1,580	1,609	1,609	1,609
<i>EPS growth (%)</i>	22.0%	-78.1%	173.2%	22.1%	15.6%	Other	17,473	16,091	18,752	18,752	18,752
<b>PER (x)</b>	<b>39.8</b>	<b>42.0</b>	<b>15.4</b>	<b>12.6</b>	<b>10.9</b>	<b>Assets</b>	<b>154,484</b>	<b>191,372</b>	<b>231,645</b>	<b>257,611</b>	<b>286,959</b>
<b>PBV (x)</b>	<b>3.5</b>	<b>1.8</b>	<b>1.4</b>	<b>1.2</b>	<b>1.0</b>	Life insurance funds	96,670	122,564	145,400	172,795	202,151
<b>PEV (x)</b>	<b>3.3</b>	<b>1.2</b>	<b>1.0</b>	<b>0.9</b>	<b>0.8</b>	Unearned premium	4,067	4,808	5,336	6,310	7,416
<b>VNB multiple (x)</b>	<b>36.7</b>	<b>3.2</b>	<b>0.1</b>	<b>-2.6</b>	<b>-5.4</b>	Outstanding claims	7,639	9,209	9,942	10,785	11,718
<b>Dividend per share (HK\$)</b>	<b>0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	Tax liabilities	1,491	558	1,007	1,007	1,007
Yield (%)	0.4%	0.0%	0.0%	0.0%	0.0%	Interest bearing notes	10,231	11,041	10,985	13,085	15,185
Payout ratio (%)	15.6%	0.0%	0.0%	0.0%	0.0%	Other	15,903	26,318	37,052	28,268	20,341
<b>Return on equity (%)</b>	<b>9.6%</b>	<b>4.1%</b>	<b>10.4%</b>	<b>10.3%</b>	<b>10.2%</b>	<b>Liabilities</b>	<b>136,002</b>	<b>174,498</b>	<b>209,722</b>	<b>232,250</b>	<b>257,818</b>
Return on assets (%)	0.9%	0.3%	0.6%	0.7%	0.7%	<b>Net assets</b>	<b>18,482</b>	<b>16,874</b>	<b>21,923</b>	<b>25,361</b>	<b>29,142</b>
Tax rate (%)	10.4%	-4.4%	19.6%	21.0%	21.0%	Minority interests	5,769	5,439	7,161	8,029	8,977
						<b>Net equity to shareholders</b>	<b>12,712</b>	<b>11,435</b>	<b>14,761</b>	<b>17,332</b>	<b>20,165</b>

Source: Company data, ABCI Securities estimates



## Appendix I – Industry data

### China Insurance: LIFE & P&C Gross Written Premium Data (YTD 2012)

Life Insurers	Stock Code	2010	Cumulative Premium Growth YoY (%)				Aug-12	Comments
			2011	Jun-12	Jul-12	Aug-12		
China Life	2628 HK	12.9	(4.4)	(5.1)	(5.6)	(3.2)	Accelerates	
Ping An Life	2318 HK	20.2	(25.2)	4.4	5.7	6.6	Accelerates	
China Pacific Life	2601 HK	36.1	1.3	1.2	0.9	(0.0)	Decelerates	
New China Life	1336 HK	40.2	1.2	10.4	8.0	5.8	Decelerates	
PICC Life	Not Listed	57.2	(14.6)	(2.4)	(5.3)		Decelerates	
China Taiping	966 HK	46.2	(4.7)	8.9	7.3	7.0	Flattish	
Taikang Life	Not Listed	29.5	(21.7)	(7.8)	(8.0)		Flattish	
<b>Industry</b>		<b>28.9</b>	<b>(9.0)</b>	<b>2.1</b>	<b>1.8</b>		<b>Flattish</b>	

P&C Insurers	Stock Code	2010	Cumulative Premium Growth YoY (%)				Aug-12	Comments
			2011	Jun-12	Jul-12	Aug-12		
PICC	2328 HK	28.9	12.6	10.6	10.3	10.5	Flattish	
Ping An P&C	2318 HK	61.4	34.2	19.7	19.6	19.9	Flattish	
China Pacific P&C	2601 HK	50.5	19.5	9.2	9.7	10.5	Accelerates	
<b>Industry</b>		<b>34.5</b>	<b>18.7</b>	<b>14.7</b>	<b>14.8</b>		<b>Flattish</b>	

Life Insurers	Stock Code	Jan-12	Monthly Premium Growth YoY (%)				Aug-12	Comments
			Feb-12	Jun-12	Jul-12	Aug-12		
China Life	2628 HK	11.9	(25.6)	8.5	(10.0)	20.1	Accelerates	
Ping An Life	2318 HK	16.5	6.6	14.4	19.4	17.0	Decelerates	
China Pacific Life	2601 HK	4.2	(3.4)	18.5	(2.3)	(8.4)	Decelerates	
New China Life	1336 HK	19.6	15.0	3.2	(8.6)	(12.3)	Decelerates	
PICC Life	Not Listed	(0.4)	(10.2)	30.7	(35.6)		Decelerates	
China Taiping	966 HK	10.7	9.6	6.3	(5.3)	4.5	Accelerates	
Taikang Life	Not Listed	3.6	(13.5)	(4.7)	(9.4)		Decelerates	
<b>Industry</b>		<b>12.7</b>	<b>(6.5)</b>	<b>12.1</b>	<b>(0.6)</b>		<b>Decelerates</b>	

P&C Insurers	Stock Code	Jan-12	Monthly Premium Growth YoY (%)				Aug-12	Comments
			Feb-12	Jun-12	Jul-12	Aug-12		
PICC	2328 HK	(0.5)	30.6	11.5	7.8	12.5	Accelerates	
Ping An P&C	2318 HK	9.4	39.3	21.7	19.3	22.2	Accelerates	
China Pacific P&C	2601 HK	2.0	29.8	14.5	12.8	16.9	Accelerates	
<b>Industry</b>		<b>3.9</b>	<b>38.5</b>	<b>14.1</b>	<b>15.6</b>		<b>Accelerates</b>	

Life Insurers	Stock Code	Market Share (%)			Total Premiums (Rmb mn)			Aug-12
		2010	2011	Jun-12	2010	2011	Jul-12	
China Life	2628 HK	31.7	33.3	32.4	333,040	318,253	203,298	229,300
Ping An Life	2318 HK	15.1	12.4	13.2	159,064	118,967	83,309	91,897
China Pacific Life	2601 HK	8.8	9.7	9.6	92,000	93,203	60,921	66,900
New China Life	1336 HK	8.9	9.9	9.8	93,643	94,797	62,663	68,805
PICC Life	Not Listed	7.8	7.4	7.4	82,426	70,361	45,403	
China Taiping	966 HK	3.1	3.3	3.4	33,025	31,458	21,273	23,516
Taikang Life	Not Listed	8.3	7.1	6.4	86,765	67,937	40,910	
<b>Industry</b>		<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>1,050,088</b>	<b>956,000</b>	<b>634,575</b>	

P&C Insurers	Stock Code	Market Share (%)			Total Premiums (Rmb mn)			Aug-12
		2010	2011	Jun-12	2010	2011	Jul-12	
PICC	2328 HK	38.2	36.3	36.0	153,930	173,372	115,586	130,067
Ping An P&C	2318 HK	15.4	17.4	17.4	62,116	83,333	56,584	64,664
China Pacific P&C	2601 HK	12.8	12.9	12.5	51,529	61,591	40,566	45,800
<b>Industry</b>		<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>402,689</b>	<b>477,906</b>	<b>324,072</b>	

Source: CIRC, Bloomberg, Companies



Valuation summary of Global & Regional Insurance Companies (2012E - 2013E)

Company Name	Stock Code	Nation	Trading Ccy	Share Price	Market Cap (US\$m)	20 days Vol (US\$m)	Buy Rec. (%)	PER		PBV		Div. Yield		Return on Equity	
								12E	13E	12E	13E	12E	13E	12E	13E
<b>REGIONAL LIFE / LIFE FOCUS</b>															
China Life	2628HK	CN H-share	HK\$	22.4	81,590	90.5	29.4	26.5	19.8	2.9	2.6	1.3	1.6	11.6	13.3
Ping An	2318HK	CN H-share	HK\$	58.6	59,781	88.8	61.8	18.4	15.6	2.9	2.5	0.9	1.1	16.7	17.5
China Pacific	2601HK	CN H-share	HK\$	23.5	27,385	56.4	74.3	24.4	18.1	2.4	2.2	1.5	1.7	9.8	11.9
New China Life	1336HK	CN H-share	HK\$	24.9	9,991	7.7	60.9	69.2	17.7	1.6	1.9	0.9	0.7	14.5	10.4
China Taiping	966HK	CN / HK	HK\$	12.2	2,690	3.9	52.0	16.6	12.3	1.5	1.4	0.6	1.2	9.3	11.8
ALA Group	1299HK	APAC	HK\$	28.9	44,889	226.7	74.1	18.0	16.1	1.9	1.8	1.3	1.5	11.0	11.1
Prudential PLC	2378HK	UK/Global	HK\$	102.1	33,518	0.0	66.7	11.7	10.5	2.1	1.9	3.3	3.6	18.1	17.6
Manulife	945HK	CA/Global	HK\$	93.9	21,461	2.7	44.4	14.1	8.8	1.0	0.9	4.3	4.3	6.9	10.7
AMP	AMPAU	Australia	AUD	4.3	13,102	56.2	35.7	13.6	12.8	1.7	1.7	5.9	6.4	13.0	13.2
Korea Life	088350KS	S. Korea	KRW	7,720	6,033	3.2	66.7	11.3	10.1	1.0	0.9	2.7	2.9	9.0	9.3
Samsung Life	032830KS	S. Korea	KRW	96,100	17,294	11.7	85.3	17.1	14.9	1.0	0.9	1.9	2.0	6.1	6.6
Tong Yang Life	082640KS	S. Korea	KRW	10,050	973	1.4	43.5	7.1	6.1	1.0	0.8	4.0	4.6	12.2	12.5
Great Eastern	GE SP	Singapore	SGD	15.3	5,912	0.9	100.0	12.2	13.2	1.6	1.4	3.5	3.6		
T&D	8795JP	Japan	JPY	845	7,422	27.6	40.0	15.2	13.4	0.8	0.8	2.7	2.7	5.8	6.3
Sony Financial	8729JP	Japan	JPY	1,338	7,501	14.0	52.6	15.0	13.8	1.2	1.4	1.7	1.7	9.5	10.1
Shin Kong Fin.	2888TT	Taiwan	NTD	8.2	2,351	13.1	10.5	8.5	10.3	0.9	0.8	0.3	0.7	15.1	7.8
Cathay Fin.	2882TT	Taiwan	NTD	31.5	11,687	24.7	66.7	24.8	21.4	1.5	1.4	1.5	1.6	6.0	6.5
Fubon Financial	2881TT	Taiwan	NTD	31.9	10,299	17.1	66.7	12.3	11.6	1.2	1.1	3.2	3.3	9.6	9.4
China Life	2823TT	Taiwan	NTD	27.2	2,212	29.1	58.3	13.6	12.7			1.3	1.8		
<b>Average</b>						<b>35.6</b>	<b>57.3</b>	<b>18.4</b>	<b>13.6</b>	<b>1.5</b>	<b>1.5</b>	<b>2.2</b>	<b>2.5</b>	<b>10.8</b>	<b>10.9</b>
<b>High</b>						<b>226.7</b>	<b>100.0</b>	<b>69.2</b>	<b>21.4</b>	<b>2.9</b>	<b>2.6</b>	<b>5.9</b>	<b>6.4</b>	<b>18.1</b>	<b>17.6</b>
<b>Low</b>						<b>0.0</b>	<b>10.5</b>	<b>7.1</b>	<b>6.1</b>	<b>0.7</b>	<b>0.8</b>	<b>0.3</b>	<b>0.7</b>	<b>5.8</b>	<b>6.3</b>
<b>REGIONAL P&amp;C</b>															
PICC P&C	2328HK	CN H-share	HK\$	9.5	15,036	20.4	56.3	11.1	10.5	2.6	2.2	2.5	2.7	25.3	21.5
IAG	IAG AU	Australia	AUD	4.4	9,496	39.6	50.0	12.0	10.6	1.9	1.8	5.2	5.9	16.5	17.8
QBE	QBE AU	Australia	AUD	13.0	15,995	73.9	35.7	9.6	10.0	1.3	1.2	6.6	6.8	14.3	13.5
SUNCORP	SUN AU	Australia	AUD	9.2	12,426	46.5	66.7	11.5	10.1	0.8	0.8	6.5	7.3	7.4	8.4
Samsung F&M	000810KS	S. Korea	KRW	239,000	10,188	18.8	89.2	11.9	10.7	1.3	1.2	2.0	2.2	11.2	11.8
Dongbu Ins	005830KS	S. Korea	KRW	48,400	3,083	24.7	86.5	7.0	6.3	1.2	1.0	2.8	3.1	18.3	18.2
LIG Ins	002550KS	S. Korea	KRW	26,000	1,404	3.8	88.6	5.6	5.0	0.9	0.7	3.9	4.2	18.5	17.9
Tokio Marine	8766JP	Japan	JPY	1,994	19,776	62.7	77.8	13.6	12.0	0.8	0.8	2.7	2.9	5.7	6.3
<b>Average</b>						<b>36.3</b>	<b>68.8</b>	<b>10.3</b>	<b>9.4</b>	<b>1.3</b>	<b>1.2</b>	<b>4.0</b>	<b>4.4</b>	<b>14.6</b>	<b>14.4</b>
<b>High</b>						<b>73.9</b>	<b>89.2</b>	<b>13.6</b>	<b>12.0</b>	<b>2.6</b>	<b>2.2</b>	<b>6.6</b>	<b>7.3</b>	<b>25.3</b>	<b>21.5</b>
<b>Low</b>						<b>3.8</b>	<b>35.7</b>	<b>5.6</b>	<b>5.0</b>	<b>0.8</b>	<b>0.7</b>	<b>2.0</b>	<b>2.2</b>	<b>5.7</b>	<b>6.3</b>
<b>GLOBAL INSURANCE</b>															
AFLAC	AFL US	USA	US\$	47.7	22,346	121.7	52.4	7.3	6.9	1.6	1.4	2.8	3.0	23.3	21.2
Hartford Fin.	HIG US	USA	US\$	19.3	8,411	146.6	52.9	6.0	5.3	0.4	0.4	2.1	2.8	7.4	7.8
Metlife	MET US	USA	US\$	34.5	36,637	342.8	66.7	6.6	6.2	0.7	0.6	3.0	3.3	10.6	10.3
AIG	AIG US	USA	US\$	33.2	49,013	1,458.0	57.1	7.7	9.5	0.5	0.5	-	0.2	7.7	5.3
Manulife	MFC CN	Canada	CAD	11.9	22,145	92.5	44.4	13.8	8.7	0.9	0.9	4.4	4.4	6.9	10.7
Sun Life	SLF CN	Canada	CAD	23.2	14,094	78.4	33.3	9.7	8.8	1.0	1.0	6.2	6.0	10.8	11.2
AXA	CS FP	France	EUR	12.0	21,871	87.8	67.5	6.5	6.1	0.6	0.6	6.0	6.5	10.6	11.2
Allianz	ALV GR	Germany	EUR	93.6	32,924	180.6	66.7	8.4	7.8	0.9	0.8	4.9	5.2	10.6	10.5
Aegon	AGN NA	Netherlands	EUR	4.2	6,285	29.5	46.2	6.9	6.6	0.4	0.4	4.8	5.5	5.6	5.6
ING Groep NV	INGA NA	Netherlands	EUR	6.4	18,928	144.0	51.5	6.1	5.5	0.5	0.5	0.5	3.2	7.7	8.2
Prudential PLC	PRU LN	UK/Global	GBP	813	33,717	59.5	66.7	11.7	10.5	2.1	1.9	3.3	3.5	18.1	17.6
Zurich Ins	ZURN VX	Swiss	CHF	236	26,901	66.9	48.8	8.4	7.9	1.1	1.0	7.6	7.7	12.7	12.6
<b>Average</b>						<b>234.0</b>	<b>54.5</b>	<b>8.3</b>	<b>7.5</b>	<b>0.9</b>	<b>0.8</b>	<b>3.8</b>	<b>4.3</b>	<b>11.0</b>	<b>11.0</b>
<b>High</b>						<b>1,458.0</b>	<b>67.5</b>	<b>13.8</b>	<b>10.5</b>	<b>2.1</b>	<b>1.9</b>	<b>7.6</b>	<b>7.7</b>	<b>23.3</b>	<b>21.2</b>
<b>Low</b>						<b>29.5</b>	<b>33.3</b>	<b>6.0</b>	<b>5.3</b>	<b>0.4</b>	<b>0.4</b>	<b>-</b>	<b>0.2</b>	<b>5.6</b>	<b>5.3</b>

Source: Bloomberg consensus, companies



## Disclosures

### Analyst Certification

I, Chan Wing Fu (Francis Chan), being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

### 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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