

21 August 2012

## Equity Focus

### China Pacific (2601 HK) – Unrated Life & health industry

#### Key Data

H-share price (HK\$)	25.20
Target price (HK\$)	NA
Upside potential (%)	NA
52Wk H/L(HK\$)	31.0 / 19.8
Issued shares:	
H-shares (mn)	2,313
A-shares (mn)	6,287
H-share mkt cap (HK\$m)	211,963
30-day avg vol (HK\$m)	339.4
Major shareholder (%):	
Fortune Investments (Baosteel)	17.4
Shenergy Group	16.6

Source: Company, Bloomberg, ABCI Securities

#### Premium composition 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

Source: Company

#### Share performance (%)

	Absolute	Relative*
1-mth	(4.2)	(7.5)
3-mth	13.0	10.7
6-mth	(6.5)	6.0

Source: Bloomberg

\*Relative to MSCI China

#### 1 year price performance



Source: Bloomberg

#### Analyst:

Name: Francis Chan

Tel: (852) 2147 8311

Email: [francischan@abci.com.hk](mailto:francischan@abci.com.hk)

#### Failed to excite the market (1H12 result review)

China Pacific just released its 1H12 results, with net profit at Rmb2,638mn, down 54.6% YoY and in-line with Bloomberg consensus. Embedded value (EV) came in at Rmb121.8bn, up 7.3% HoH or 3.9% stronger than the street consensus of Rmb117.2bn. Value of New Business (VNB) recorded Rmb4,061mn, up 6.0% YoY or 2.5% lower than the street consensus of Rmb4,166mn. Its share price rose by 15% since the market low on 5 Jun 2012, in light of market expectation on a strong VNB growth. Therefore, we view the below-expectation VNB a major disappointment to the market. As of 17 Aug, the stock closed at HK\$25.20, or 1.37x 2012E PEV and 6.3x 2012E VNB.

**Life VNB not up to expectation.** Only a 6% YoY growth in VNB was reported, versus 8.8% YoY of consensus. While such growth may still top its peers, the company failed to outgrow market expectation, despite a 3.7ppt YoY expansion in New Business Margins (NBM) and continuous improvement in new premium sales mix. This may limit investors' expectation on its 2012E VNB (consensus at Rmb7.4bn, up 10.2% YoY).

**P&C reporting lower underwriting profits.** Combined ratios edged up 3.1ppt YoY to 94.2% for the half. This was partly attributed to the Beijing Flooding and latest insurance pricing rule on scarp values of automobiles by CIRC. As such, underwriting profits declined to Rmb1.5bn, down 21.4% YoY. We expect such trend to continue for the company in 2H12.

**Investment tide is turning.** The company recorded gross investment yield of 3.9% in 1H12, better than 2.5% reported in 2H11. Net investment yield rose by 50bps YoY to 4.9%, benefiting from higher-return negotiated deposits and policy loans. With the narrowing of unrealized equity losses, China Pacific could report further improvement in investments for 2H12.

**Risk factors:** Better/worse-than-expected investments and underwriting performance, looser/tighter-than-expected industry regulations

#### Valuation

FY ended Dec 31	2008	2009	2010	2011
Revenue (Rmb mn)	76,267	104,189	141,327	155,517
Chg (YoY)		36.6	35.6	10.0
Net profit (Rmb mn)	2,569	7,356	8,557	8,313
Chg (YoY)		186.3	16.3	(2.8)
EPS (HK\$)	0.38	1.08	0.55	0.61
PER (x)	66.55	23.31	21.25	21.41
BPS (HK\$)	7.24	9.99	11.30	11.05
P/B (x)	3.48	2.52	2.23	2.28
EVPS (HK\$)	10.27	12.98	15.26	16.08
PEV (x)	2.45	1.94	1.65	1.57
VNB (HK\$)	0.53	0.65	0.83	0.93
VNB (x)	25.77	16.32	9.58	6.13

Source: Company, Bloomberg, ABCI Securities



---

## 1H12 result review

China Pacific reported 1H12 net profit of Rmb2,638mn, down 54.6% YoY. This is in-line with the Bloomberg consensus forecast of Rmb2,604mn. In our opinion, the profit decline was primarily due to weak underwriting performance and poor investment return for both life and P&C. Group investment income dropped by 17.4% YoY because of Rmb4.6bn losses on equities booked to P&L. The Life unit reported profits at Rmb1,059mn, down 62.1% YoY, partly driven by a 10.0% YoY decrease in investment income. P&C unit recorded net profits of Rmb1,568mn, down 33.0% YoY, partly due to a 39.9% decrease in investment income.

However, the tide is turning in 2H12, as indicated by management in the result briefing. During the half, there was a 6.4% HoH increase in book value to Rmb83.1bn, due to an improvement in AFS reserves (-ve Rmb5.6bn, from Rmb10.9bn at end 2012). To sum, while China Pacific failed to beat market expectation in underwriting, we see strong signs on an investment turnaround.

**Stabilized but slow growth in premiums.** Net earned premiums (NEP) reached Rmb80.9bn in 1H12, up 7.7% YoY. Life NEP grew 1.2% YoY and P&C NEP grew 9.2% YoY in 1H12. Such growth rates were achieved in a difficult environment. For Life, industry premiums increased by only 2.1% YoY in 1H12, due to the weak sales in bancassurance. China Pacific showed resilience in agency channel and offset some of losing sales through banks in 1H12. For P&C, the industry suffered from slow auto sales growth during 1H12. While P&C premium growth revived slightly towards May and Jun 2012, the growth rate decelerated fast to single digits on a YoY basis. In a nutshell, while premium growth bottomed for China Pacific in 1H12, we do not see any signs of fast recovery in 2H12.

**Investment return recovered HoH.** Total investment income rebounded 35.7% HoH to Rmb8.4bn in 1H12, from Rmb6.2bn in 2H11. This was mainly due to a stabilized A-share market (Shanghai Composite Index up 1.2% YoY) in 1H12. The company also recorded an approximate Rmb5.3bn reversal in AFS reserves for the half. This is mainly due to the rise of bond yields during the period, on top of equity losses. Gross investment yields rose 1.4ppt from 2.5% in 2H11 to 3.9% in 1H12. We expect the investment trend to reverse further in 2H12, with a stable performance of A-share market (flattish YTD).

**Higher claims and benefits.** Group claims and benefits increased 10.6% YoY to Rmb65.1bn in 1H12. This compares with growth of 1.2% for life NEP and 9.2% for P&C NEP. We believe that China Pacific booked higher Life claims and benefits expenses on the back of the declining 750-day moving average of bond yields and 58% higher surrenders during the half. With the renewed rate hike cycle by PBOC, China Pacific could face higher insurance liabilities in short term, in our opinion. Group claim expenses jumped also because of higher loss ratios for P&C unit.

**P&C underwriting trending down.** P&C underwriting profits declined 21.4% YoY to Rmb1.5bn, with a 3.1ppt YoY deterioration in combined ratio to 94.2%, in 1H12. We expect the trend of higher loss ratios to sustain, due to new pricing rule of automobile insurance on scarp value, but not purchase value, of passenger cars, imposed by CIRC. The earlier flooding in Beijing may also lead to higher loss ratios for China Pacific in 2H12.



**Solvency weakened.** Group solvency is lowered to 271% (284% in 2011) in 1H12. Life solvency weakened to 183% (187% in 2011) in 1H12. P&C solvency declined to 194% in 1H12 (233% in 2011). The group and subsidiaries' solvency decline was mainly due to higher operating expenses, according to management. We expect such trend to continue in 2H12.

**ROE edged down further.** China Pacific reported an ROE of 6.5% for 1H12, compared with 10.5% for 2011. We consider this a very low level of return at present. However, we expect the firm's ROE to rebound in 2H12, in light of better investment performance.

**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



## EV & VNB review

According to our analysis, group EV increased 7.3% HoH to Rmb121.8bn. This translates to 7.9% EVPS growth YoY, including the impact from Rmb appreciation. Group EVPS increased from HK\$16.15 in 2H11 to HK\$17.42 in 1H12. We also calculate that the annualised premium equivalent (APE) decreased 7.8% YoY to Rmb11.0bn in 1H12. This compares with a 17.8% YoY decline in FYP for the period. There was a concurrent accretion in NBM (APE basis), climbing to 36.9%, from 32.1% in 1H11. This is consistent with the trend of NBM (FYP basis), rising to 16.3% (15.4% per company disclosure) in 1H12, compared with 12.6% in 1H11.

### China Pacific: Embedded Value (EV) Movement Analysis

	2006	2007	2008	2009	2010	2011	1H11	1H12
	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn
<b>Embedded Value</b>								
Adjusted net worth	11,287	60,740	51,876	72,368	75,905	72,664	71,261	76,824
Value of in-force	13,375	19,235	24,103	33,971	43,991	51,959	48,903	56,604
Cost of solvency margin	(4,329)	(5,220)	(6,000)	(7,516)	(9,212)	(11,059)	(10,156)	(11,595)
Embedded value	20,333	74,755	69,669	98,371	110,089	113,564	110,008	121,833
Vnb (long term)	2,139	2,964	3,589	4,915	6,100	6,714	3,830	4,061
<b>EV Movement Analysis</b>								
Opening Embedded Value		20,333	74,755	69,669	98,371	110,098		
Expected return								
- SHF's		587	3,158	2,698	3,763	3,947		
- In-force		1,538	2,212	2,772	2,578	3,307		
Value of New Business (VNB)		2,964	3,589	4,915	6,100	6,714		
Inv't R Var + Mkt Val Adj		15,000	(15,000)	(226)	(2,556)	(9,223)		
Capital Raising & Dividends		32,000	-	18,080	(2,580)	(3,010)		
OpEx Var, Model Chg & Others		2,333	955	463	4,527	1,731		
Closing Embedded Value		74,755	69,669	98,371	110,098	113,564		
EVPS (HK\$)		10.41	10.27	12.98	15.26	16.15		
VNB (HK\$)				0.65	0.83	0.95		
<b>EV Contributions 1</b>								
Expected Return on Beg EV		10%	7%	8%	6%	7%		
IRV + MVA Contribution to Beg EV		74%	-20%	0%	-3%	-8%		
VNB Contribution to Beg EV		15%	5%	7%	6%	6%		
VNB Contribution to Beg VIF		22%	19%	20%	18%	15%		
EVPS (HK\$) Growth		120%	-1%	26%	18%	6%		
<b>EV Contributions 2</b>								
Beginning EV		27%	107%	71%	89%	97%		
Expected return								
- SHF's		1%	5%	3%	3%	3%		
- In-force		2%	3%	3%	2%	3%		
Inv't R Var + Mkt Val Adj		20%	-22%	0%	-2%	-8%		
Value of New Business (VNB)		4%	5%	5%	5%	6%		
Capital Raising & Dividends		43%	0%	18%	-2%	-3%		
OpEx Var, Model Chg & Others		3%	1%	0%	4%	2%		
Ending EV		100%	100%	100%	100%	100%		

Source: Company, ABCI Securities



---

## Disclosures

### Analyst Certification

I, Chan Wing Fu, 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.

### Disclosures of Interests

ABC International Securities Company Limited and/or its member companies ("ABC") may pursue financial interests to the companies mentioned in the report.

### Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABC International Securities Company Limited is under no obligation to update or keep current the information contained herein. ABC International Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABC International Securities Company Limited, into other areas, units, groups or affiliates of ABC International Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABC International Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABC International Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

---

Copyright 2012 ABC International Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABC International Securities Company Limited.

**Office address: ABC International Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**