



ZhongAn Online P&C (ZA, 6060 HK) China's online-only insurer capitalizing on the FinTech boom

- Application of FinTech is key to success in a highly competitive insurance market. We expect ZA's GWP to grow at 57% CAGR in 2016-19E
- To evolve further, direct sales would need to be established in coming years to reduce reliance on ecosystem partners
- Monetizing FinTech and expanding into life insurance will be positive catalysts
- ZA is trading at 15.5x FY17E P/S, in line with Alibaba (trailing P/S 15.9x)
- Valuation range of RMB 68-85/share represents 12-15x fwd. FY18E P/S

Entering the second stage of development in insurance ecosystem. Its GWP grew at 107% CAGR in 2014-16 and 84%YoY in 9M17. As the largest online-only P&C insurance player, its ranking in the P&C insurance market increased from 31st in 2015 to 25th in 2016 and 20th in 8M17. It relies heavily on ecosystem partners to attract customers.

Share price has gained 27.2% since IPO, representing 15.5x FY17E P/S or 5.4x FY17E P/B. The counter's current market valuation is comparable to that of Alibaba (BABA US), one of its major ecosystem partners increase client flow to ZA, is trading at 15.9x trailing P/S. We believe market has factored in ZA's capability to evolving into the third stage of development – increasing customers' stickiness and direct sales capability, reducing reliance on sales channels of its ecosystem partners, lowering expense ratio of insurance and enhancing shareholders' value from core business.

Monetizing its FinTech and expanding to life insurance business are positive factors to shareholders' value in the long run. ZA had an exceptionally low loss ratio in P&C insurance business, thanks to its FinTech application. Its loss ratio was 52.8% in 1H17, vs. the top three P&C insurers with a loss ratio of 58.8-60.9% in 1H17. Current insurance law in China prohibits ZA to apply for long-term life insurance business license – a legal hurdle that ZA would need to resolve in the future.

Investment income will boost top and bottom lines in 4Q17E and 2018E. ZA raised net proceeds of HK\$ 13.6 bn from issuing new shares in Sep-Oct. We estimate net investment assets will increase to RMB 19.0 bn at end-2017E, up 143%YoY.

12-mth TP at RMB76.5 (or HK\$ 90). We believe the market valuation of Alibaba would be a good proxy for ZA's pricing. Our TP represents the mid-point of the valuation range of RMB 68-85/share, or 12-15x FY18E P/S, comparable to the P/S range of Alibaba.

Risk factors: (1) Higher-than-expected combined ratio; (2) Turnaround may occur later than expected;(3) Heavy reliance on ecosystem partners; (4) New business risks; (5) Investment risks; (6) Customer complaints; (7) Keen market competition; (8) No dividend record; (9) Expiration of lock-up period of pre-IPO investors.

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Total income (RMB mn)	2,509.3	3,412.7	5,410.1	8,363.7	11,787.1
Chg(YoY)	206.9%	36.0%	58.5%	54.6%	40.9%
Basic sales/ share (RMB)	2.162	2.751	4.167	5.690	8.019
Chg(YoY)	164.5%	27.2%	51.5%	36.6%	40.9%
P/S (x)	-	23.5	15.5	11.4	8.1
Net profit	44.3	9.4	(603.5)	153.0	471.2
Chg(YoY)	19.7%	(78.8%)	-	-	208.1%
Basic EPS (RMB)	0.036	0.008	(0.411)	0.104	0.321
Chg(YoY)	(3.5%)	(78.8%)	-	-	208.1%
PER (x)	-	-	-	620.6	201.5
NBV (RMB/share)	5.560	5.529	11.923	12.396	12.613
P/B (x)	-	11.7	5.4	5.2	5.1

Source(s): the Company, ABCI Securities estimates

Company Report

Nov 8, 2017

Rating: BUY

TP: HK\$ 90.0

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Share price (HK\$)	75.95
52 wk High/Low (HK\$)	97.8/63.0
IPO px (HK\$)/ px chg	59.70/27.2%
Est. share price return	18.5%
Est. dividend yield	-
Est. total return	18.5%
Previous Rating and TP	-
Previous Report Date	-

Source(s): Bloomberg, ABCI Securities estimates

Key Data

Issued shares (mn)	1,469.81
H shares (mn)	469.81
Free-float (mn)	157.28
Unlisted shares (mn)	1,000.00
H-share mkt cap (HK\$m)	35,682
20 days ADT (HK\$m)	652
Short-selling starts date	Nov 10
Shareholders:	
Ant Financial	13.54%
Tencent (700 HK)	10.21%
Ping An (2318 HK)	10.21%
Sinolink (1168 HK)	5.51%

Remarks: free-float excludes lock-up shares
Source(s): the Company, Bloomberg, ABCI Securities

% to total income	1H17
Net premiums earned	85.5%
Investment related	11.1%
Others	3.4%

C-ROSS solvency	9/30/2017
Core solvency	1135.2%
Comp solvency	1135.2%

Source(s): the Company

Share performance (%)

	Absolute	Relative*
Since listing (9/28/2017)	27.2	22.3

* Relative to HSI

Source(s): Bloomberg, ABCI Securities



Investment Highlights

Entering the second stage of ecosystem evolution

Based on our analysis of ZA's insurance business model of ZA, we believe the Group has entered the second stage of ecosystem evolution. At this stage, ZA is able to offer wider range of insurance products with better risk assessment but its direct sales capability is still limited and relies heavily on partners in the ecosystem to gain customers or distribute products. Subsequently, ZA recorded strong GWP growth and low loss ratio but also a high expense ratio. Its combined ratio (loss ratio + expenses ratio) exceeds 100% (i.e. incurring underwriting loss).

Exhibit 1: Evolution in the ecosystem

Stages of Evolution	Business characteristics	Financial consequences	Years of ZA's development
Stage 1	<ul style="list-style-type: none"> Reliance on few insurance products Weak risk assessment capability Heavy reliance on a few number of ecosystem partners to distribute insurance products Low customer stickiness 	<ul style="list-style-type: none"> High GWP growth due to low base effect High loss ratio (i.e. relatively high claims payment) High expense ratio (i.e. high customer acquisition costs) High combined ratio 	2013-15
Stage 2	<ul style="list-style-type: none"> Wide range of insurance products Improving risk assessment capability Increase in the number of ecosystem partners ; heavy reliance on these partners to distribute insurance products Limited customer stickiness 	<ul style="list-style-type: none"> High GWP growth due to increases in product offering and distribution partners Lower loss ratio High expense ratio High combined ratio (>100%) 	2016-present
Stage 3	<ul style="list-style-type: none"> Wide range of insurance products Improving risk assessment capability Heavily reliance on direct sales with strong customer stickiness Low reliance on ecosystem partners to distribute insurance products 	<ul style="list-style-type: none"> High GWP growth Lower loss ratio Lower expenses ratio Lower combined ratio (<100%) 	After 2017

Remarks: GWP refers to gross written premium; loss ratio = claims incurred/net premiums earned; expenses ratio = insurance operating expenses/net premiums earned

Source(s): the Company, ABCI Securities

Exhibit 2: ZA's business development cycle

Evolution stage	1 st stage	1 st stage	2 nd stage	2 nd stage	
FY ended Dec 31	2014	2015	2016	1H2017	Comment
Number of partners in ecosystem	20	71	177	199	Increasing number of distributors to acquire customers and distribute products
GWP growth (YoY)	-	187.5%	49.3%	84.3%	High-growth stage; proven demand for ZA's products
Loss ratio	73.4%	68.5%	42.0%	52.8%	Falling trend; improving risk assessment capability
Expense ratio	35.2%	58.1%	62.7%	76.5%	Increasing trend; increasing customer acquisition costs
Combined ratio	108.6%	126.6%	104.7%	129.3%	Underwriting loss due to high customer acquisition costs

Source(s): the Company, ABCI Securities



Pressing need to evolve into the third stage of ecosystem development

In the second stage of evolution, ZA has demonstrated both its product development and risk assessment capabilities. Underwriting profit, however, was eroded by partners in the ecosystem; consequently, enhancement in shareholders' value has been compromised. Although equity value increased from RMB1.02/share at end-2014 to RMB 5.29/share at end-June 2017 and is expected to strengthen to RMB 11.92/share at end-Dec 2017, the jump is mainly due to issuance of new shares in 2015 and 2017 (issued 240.3mn shares at RMB24.0/share in June 2015; issued 229.19mn shares at HK\$ 59.7/share in Sep-Oct 2017). To enhance shareholders' value internally, ZA's business model would need to evolve further into the third stage – establishing online direct sales and reducing profit-sharing to partners (i.e. reducing expense ratio). The stock (HK\$ 75.95) is trading at 15.5x FY2017E P/S and 5.4x FY17E P/B. In our view, the counter is priced at a huge premium based on the investors' speculation on the Group's ability to enhance shareholders' value in the medium term.

Potential to diversify into life business

ZA is pursuing to diversify into life insurance business. Currently, ZA, with a P&C insurance license, is able to offer short-term life insurance products (mainly accident and health insurance products) but is prohibited from offering long-term life insurance products. The GWP of its short-term life insurance products grew at 107.2% CAGR in 2014-16 and registered an 84.3% YoY jump in 1H17. With its strong GWP growth in short-term life insurance business, it is only natural the Group will expand into the long-term life insurance business. Nonetheless, establishing a profitable long-term insurance business present multiple hurdles, especially on the legal side.

The hurdles that ZA will come across to obtain a life insurance license include:

1. Under the current law, an entity is not allowed to conduct both the long-term life insurance business and P&C insurance business. Hence, ZA cannot apply for life insurance business license alone. The Group would need a new organization structure to conduct long-term life insurance business.
2. So far, CIRC has not granted any internet-only life insurance license. In the last few years, CIRC has only granted the internet-only P&C insurance license.
3. If ZA intends to apply for the less restrictive life insurance license, it would need to allocate more resources to develop offline insurance business – a move that may not be entirely align with its existing online-only P&C insurance business model.
4. Even ZA obtains internet-only life insurance license or the less restrictive life insurance license, its business model would still need to evolve further to the third stage of ecosystem development (i.e. increasing direct sales and reducing profit-sharing to ecosystem partners to enhance shareholders' value).

Monetizing FinTech applications

ZA has a proven track record of evolving from stage one to stage two in the ecosystem through the application of FinTech. ZA has applied AI, big data, and cloud computing technologies to different business aspects such as induction of customers from third parties, risk assessments, customer pricing, claims verification, claims payment, CRM, etc. ZA is capitalizing its technology know-how to provide tech solutions to other FIs such as insurers and consumer finance providers. In July 2016, ZA incorporated ZhongAn Technology to monetize on technology. For 1H17, ZA Tech recorded a revenue of RMB 2.9 mn. The Group is rendering technology services to Ping An Insurance in connection with auto insurance products.

In our view, ZA's FinTech is attractive to FI customers based on the following reasons.

1. The loss ratio of ZA sharply declined from 73.4% in FY14 to 42.0% in FY16. The loss ratios of market leaders in P&C insurance business is over 50%. For 2016, the loss ratios of PICC P&C, Ping An and CPIC were 63.5%, 61.2% and 54.4%, respectively. The relatively low loss ratio of ZA demonstrates its risk assessment, pricing, claim verification and payment modules are effective in controlling risk and improving underwriting performance.
2. The online-only P&C license held by ZA is highly restrictive. The Group is not allowed to conduct the P&C business offline. Even with such restriction, GWP of ZA grew at 107% CAGR in 2014-16. In terms of GWP, ZA's ranking among the P&C insurers improved from 31st in 2015 to 25th in 2016 and further to 20th in 8M17. There were 84 P&C insurers in China as of Aug 2017, and ZA obtained a relatively high ranking since its commencement in late 2013. ZA's CRM modules, including induction of customers from third parties, interface between ZA and its partners in the ecosystem, and premium and claims reconciliation are highly efficient and effective.



Net loss widened in 1HFY17

ZA reported a net loss of RMB 286.8mn for 1H17, against a net loss of RMB 228.3 mn for 1H16. GWP and net premium earned grew by 84.3% YoY and 50.5% YoY to RMB 2.49 bn and RMB 1.96 bn for 1H17. The increase in net loss for 1H17 was mainly due to 1) the increase in loss ratio to 52.8% in 1H17 (up 11.8ppt YoY); 2) the increase in expense ratio to 76.5% in 1H17 (up 5.7ppt YoY). We believe the increase in loss ratio was due to increasing sales proportion of short-term life insurance products (accident insurance or health insurance) that usually have a relatively high loss ratio. The proportion of short-term life insurance written premium increased from 32.5% in 1H16 to 36.4% in 2H16 and 42.3% in 1H17.

Net loss enlarged further in 3Q17

According to the 3Q solvency report issued by ZA, the unaudited and unconsolidated net loss of ZA enlarged by 137.5% QoQ to RMB 404.0 mn in 3Q17 against a net loss of RMB 170.1 mn in 2Q17 or a net profit of RMB 161.8 mn in 3Q16. Insurance business income grew 4.1% QoQ or 76.7%YoY to RMB1.6 bn in 3Q17. Despite the increase in premium income in 3Q17, net loss widened. We believe pre-listing expenses and the high expense ratio in insurance business had led to the increased net loss in 3Q17.

Earnings outlook

ZA completed new share issuance in Sep-Oct 2017 and raised total net proceeds of HK\$ 13,271mn (global offering of HK\$ 11,531mn and over-allotment option of HK\$ 1,740 mn), or ~RMB 11,300 mn. In the short term, the huge amount of net proceeds will enhance investment income and is able to pare down the negative impacts of a high expense ratio. In 1H17, ZA reported a total annualized investment yield of 3.3% for 1H17. Assuming an investment yield of 3.0%-4.0%, we estimate net proceeds from new shares issued will generate an investment return of RMB 339mn- RMB 452mn per annum.

For 2018E-19E, we expect ZA would still be relying on its ecosystem partners for customer induction although the dependence will gradually lessen over time. High expense ratio would drag down underwriting profit in 2017E-18E but in late 2018E or 2019E, a turnaround would occur.

Exhibit 3: Assumptions

Assumptions on insurance business	2014	2015	2016	2017F	2018F	2019F
Growth:						
<i>ST life insurance written premiums</i>		567.0%	300.9%	110.0%	60.0%	55.0%
<i>P&C insurance written premiums</i>		165.0%	11.8%	50.0%	45.0%	40.0%
GWP		187.5%	49.3%	70.9%	51.4%	46.8%
Retention ratio (NWP/GWP)	99.1%	99.5%	98.8%	97.0%	98.0%	98.0%
Net chg unearned premium reserve/NWP	(9.5%)	(15.5%)	(4.2%)	(18.0%)	(18.0%)	(18.0%)
Claims paid/GWP:						
<i>ST life insurance written premiums</i>	(4.5%)	(6.8%)	(9.5%)	(11.0%)	(11.0%)	(11.0%)
<i>P&C insurance written premiums</i>	(65.2%)	(59.0%)	(55.3%)	(52.0%)	(52.0%)	(52.0%)
Claims paid ceded to reinsurers / premiums ceded to reinsurers	7.5%	155.5%	18.4%	6.0%	6.0%	6.0%
Net change in insurance contract liabilities / NWP	(4.1%)	(6.1%)	(0.6%)	(7.0%)	(7.0%)	(7.0%)
Handling charges (net) / NWP	(2.1%)	(4.4%)	(8.5%)	(10.0%)	(8.0%)	(7.0%)
Technical service / GWP	(11.9%)	(25.9%)	(32.1%)	(32.0%)	(30.0%)	(29.0%)

NWP: net written premium

Source(s): the Company, ABCI Securities estimates



Exhibit 4: Restated income statement for clarification purposes

(RMB mn)	2014	2015	2016	2017F	2018F	2019F
GWP	794.1	2,283.0	3,408.0	5,824.4	8,819.4	12,945.5
Net premiums earned	712.2	1,921.5	3,225.4	4,632.7	7,087.3	10,403.0
Add: other incomes (investment & other operating income)	105.4	587.9	187.3	707.6	922.0	998.5
Total income	817.5	2,509.3	3,412.7	5,340.4	8,009.3	11,401.5
Loss ratio	73.4%	68.5%	42.0%	52.0%	50.4%	49.1%
Expenses ratio	35.2%	58.1%	62.7%	75.7%	62.6%	56.3%
Combined ratio (loss & expenses ratios)	108.6%	126.6%	127.8%	127.8%	113.1%	105.4%
Less: net claims incurred & insurance operating expenses	(773.4)	(2,432.6)	(3,377.0)	(6,031.6)	(8,159.7)	(11,158.8)
Total income after claims and insurance operating expenses	44.1	76.7	35.7	(621.5)	203.9	628.3
Net adjustments (gain or loss)	(7.5)	(17.1)	(22.7)	(2.0)	0.0	0.0
Pre-tax profit	36.6	59.6	13.0	(623.5)	203.9	628.3

Remarks: The statement is restated to help readers understand the impacts of combined ratios on profitability

Source(s): the Company, ABCI Securities estimates

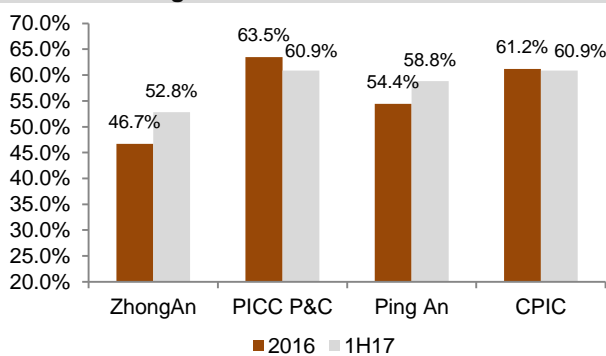
Compared with the top three P&C insurers (PICC P&C, Ping An, and CPIC), ZA had a lower loss ratio but a higher expense ratio in FY14-16. The low loss ratio implied ZA is meticulous at risk assessment and product pricing of its insurance products. Its high expense ratio is mainly driven by two factors – high payout to ecosystem partners and high internal operating costs. ZA's rising expense ratio is mainly caused by payment to its ecosystem partners.

Exhibit 5: Composition of ZA's expense ratio

	2014	2015	2016	1Q17
Net premiums earned (RMB mn)	712.2	1,921.5	3,225.4	886.8
Expense ratio	35.2%	58.1%	62.7%	78.4%
Implied insurance operating expenses (RMB mn)	250.7	1,116.4	2,022.3	695.2
Breakdown of insurance operating expenses:				
<i>Expense payment to ecosystem partners (including handling charges, commission, technical service fee, net) (RMB mn)</i>	110.6	691.3	1,380.0	453.5
<i>Expense to other use in insurance operation (RMB mn)</i>	140.1	425.1	642.4	241.7
Expense ratio (for ecosystem partners)	15.5%	36.0%	42.8%	51.1%
Expense ratio (for other insurance operation)	19.7%	22.1%	19.9%	27.3%

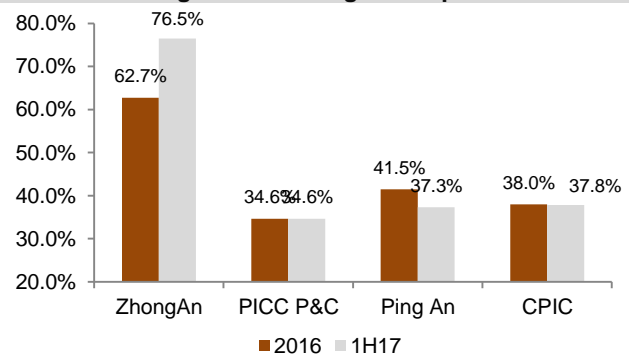
Source(s): the Company, ABCI Securities

Exhibit 6: ZhongAn had the lowest loss ratio



Source(s): Companies, ABCI Securities

Exhibit 7: ZhongAn had the highest expense ratio



Source(s): Companies, ABCI Securities



Competition landscape of online-only insurance market

Exhibit 8: Internet-only insurance market – ZA ranked the largest

	2014	2015	2016	8M17
Online-only P&C insurers premium income (RMB mn) :				
ZhongAn Online P&C Insurance Co., Ltd.	794.1	2,283.0	3,408.0	3,621.5
TK.CN Insurance Co., Ltd.	-	0.4	674.9	1,119.0
E An Property & Casualty Insurance Co Ltd	-	-	221.5	614.8
Answern Property & Casualty Insurance Co., Ltd	-	-	75.1	283.4
Subtotal of 4 Internet-only insurers	794.1	2,283.5	4,379.6	5,638.7
<i>Chg(YoY)</i>	-	187.6%	91.8%	145.6%
Overall China's P&C insurance market	754,440.1	842,326.5	926,616.8	690,105.6
<i>Chg(YoY)</i>	-	11.6%	10.0%	14.4%
P&C insurance premium change (YoY) :				
ZhongAn Online P&C Insurance Co., Ltd.	-	187.5%	49.3%	85.3%
TK.CN Insurance Co., Ltd.	-	-	154799.8%	355.6%
E An Property & Casualty Insurance Co Ltd	-	-	-	781.2%
Answern Property & Casualty Insurance Co., Ltd	-	-	-	969.6%
P&C insurance market share (% total P&C insurance mkt)				
ZhongAn Online P&C Insurance Co., Ltd.	0.11%	0.27%	0.37%	0.52%
TK.CN Insurance Co., Ltd.	-	0.00%	0.07%	0.16%
E An Property & Casualty Insurance Co Ltd	-	-	0.02%	0.09%
Answern Property & Casualty Insurance Co., Ltd	-	-	0.01%	0.04%
Total of 4 Internet insurers	0.11%	0.27%	0.47%	0.82%
Number of Internet-only P&C insurers in operation	1	2	4	4
Total number of P&C insurers	65	73	81	84
Market ranking of ZA among Internet-only P&C insurers (in terms of P&C insurance premium)	1	1	1	1
Market ranking of ZA among P&C insurers (in terms of P&C insurance premium)	43	31	25	20

Source(s): CIRC, ABCI Securities

According to the Insurance Association of China, there were 62 P&C insurers conducting online insurance business in 1Q17. The internet insurance market represented 4.19% of total P&C insurance market in terms of P&C premium income in 1Q17. The four internet-only P&C insurers captured 15.42% market share of internet insurance market in 1Q17. Meanwhile, the remaining 58 insurers (including Ping An, PICC, and CPIC) captured an 84.58% market share. Hence, the competitors of ZA are not only internet-only insurers but also other P&C insurers conducting their businesses both online and offline.

ZA is ranked the largest internet-only P&C insurers in China, but it has a tiny market share in terms of total P&C insurance premium. For 8M17, ZA captured 0.52% market share and was ranked 20 among 84 P&C insurers. All four internet-only insurers jointly captured 0.82% market share in 8M17.

In terms of growth momentum, internet-only P&C insurers achieved an outstanding premium income growth. For 8M17, ZA registered 85.3%YoY growth in premium income and all four internet-only P&C insurers grew by 145.6% YoY in aggregate over the same period. Meanwhile, P&C insurers as a whole grew by 14.4% YoY in 8M17.

In terms of business scale, the combined market size of internet-only P&C insurers is still miniscule (less than 1% of market share), presenting not much of a threat to major P&C insurers. On the contrary, major P&C insurers have already developed their online insurance business and are a much larger threat to the internet-only P&C insurers.



Business model Analysis

Currently, ZA aims to provide P&C insurance products (including accident insurance, bond insurance, health insurance, liability insurance, credit insurance, cargo insurance, household property, shipping return insurance, etc.) to six major ecosystems (lifestyle consumption, consumer finance, health, auto, travel, and others). The China P&C insurance market is highly competitive with 62 domestic insurers and 22 Sino-foreign insurers in operation in Aug 2017. Moreover, the market is highly concentrated, with the top five and top 10 P&C insurers (all of them are domestic insurers) capturing 73.7% and 85.5% of total P&C premium incomes in 2016. ZA was set up in 2013 and commenced its insurance business in 2014. So far, market ranking of ZA rose from 31st in 2015 to 25th in 2016 and further to 20th in 8M17 by total P&C premium incomes in the corresponding periods. ZA is the first online-only licensed P&C insurer. In our view, the online-only license is highly restrictive and ZA can only conduct its P&C insurance business online while most of its larger competitors can conduct its business both online and offline.

ZA's online insurance business model differentiates from most of new economy companies and traditional insurers in the following ways.

1. Customer acquisition cost -, which is mainly a variable cost, is high for ZA. The Group pays handling charges, commissions or technical service fee to business partners in the ecosystem based on customer volume introduced by the partners. Hence, its cash burn rate is driven mainly by volume of customer induction. While we agree acquiring customers from ecosystem partners are highly effective in growing its business, we are concerned that the Group may be offering an overly generous fee rate (total fees/GWP induced) to partners. ZA's GWP grew at 107% CAGR in 2014 -16 and was up 84%YoY in 1H17. In 8M17, it was ranked 20th among 84 P&C insurers.

Exhibit 9: While ZA is gaining bargaining power against its ecosystem partners, its reliance on its two major partners Alibaba and Ctrip is rising as well

Three largest ZA's ecosystem partners	Alibaba (China's largest ecommerce operators)	Ctrip (China's largest online travel agency)	Xiaoying (An online consumer finance provider)
FY16			
Business reliance = GWP induced by partners/ZA's total GWP	52.7%	20.6%	5.6%
Fee rate = Total fees paid to partners/GWP induced by partner	24.4%	69.2%	10.6%
FY15			
Business reliance = GWP induced by partner/total GWP	47.2%	13.0%	6.0%
Fee rate =Total fees paid to partner/GWP induced by partners	30.9%	87.5%	33.2%

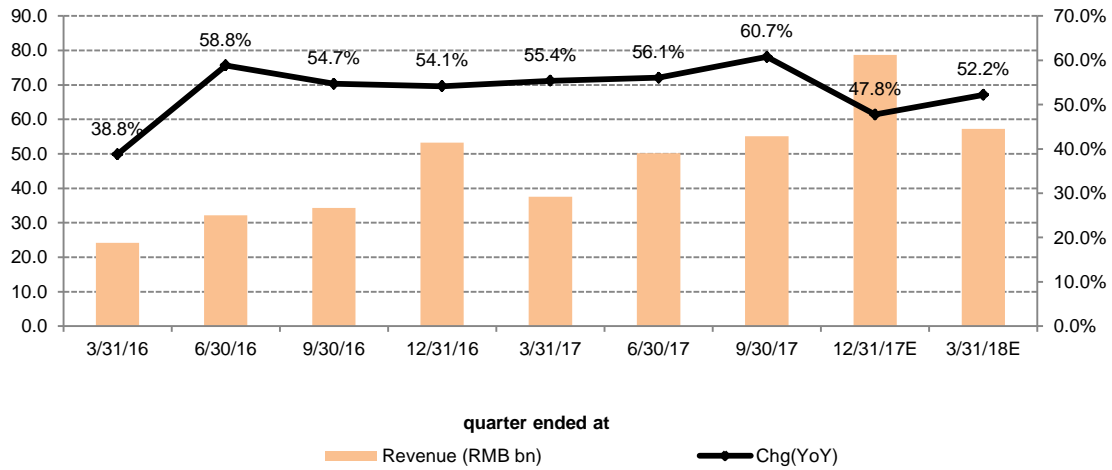
Source(s): the Company, ABCI Securities

2. ZA's increasing reliance on two ecosystem partners, Alibaba and Ctrip, to increase customer flow is positive given the two are market leaders in China's e-commerce industry. The proportion of GWP induced by the Alibaba group to ZA increased from 47.2% in 2015 to 52.7% in 2016 of ZA's total GWP; the proportion of GWP induced by the Ctrip group to ZA increased from 13.0% in 2015 to 20.6% in 2016 of ZA's total GWP. Alibaba Group and Ctrip Group jointly induced 73.3% of ZA's total GWP in 2016. However, the fee rate paid to the Alibaba group reduced from 30.9% in 2015 to 24.4% in 2016, while fee rate paid to the Ctrip Group declined from 87.5% in 2015 to 69.2% in 2016. The declining trend in fee rate indicates increasing bargaining power of ZA against its major partners.

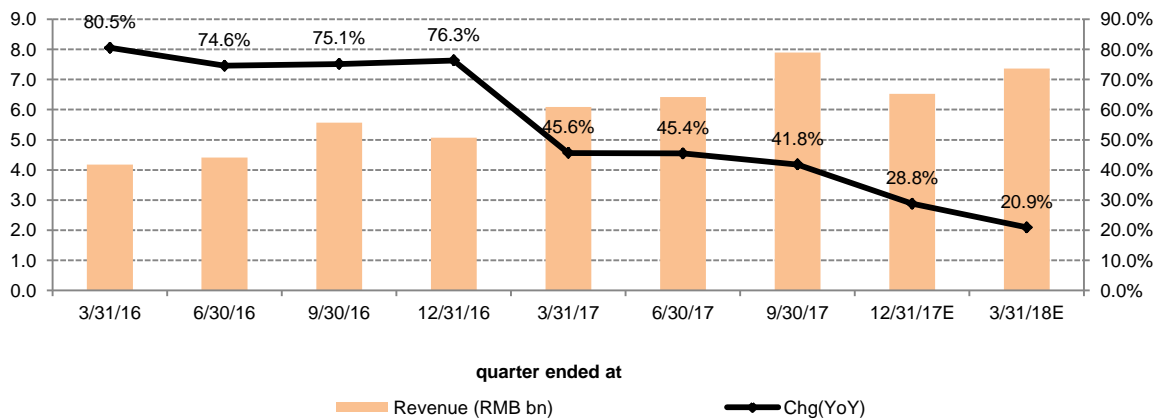
3. Its insurance business generates a large volume of policies (e.g. sold over 200mn policies within a week in Double 11 Shopping Festival in Nov 2016) with low GWP; in another words, GWP per customer is low (avg. GWP RMB9.9/customer in 2016, +35.6%YoY). In 2016, ZA's served 348.4 mn customers in its five major ecosystems. Its peer Ping An had 36.88 mn P&C insurance customers and 49.56 mn life insurance customers in 2016. The established insurance business model that relies on the traditional agency forces incline to forgo these small-ticket transactions. Online platform operators, including ZA, employ FinTech that enables efficient handling of a large volume of small insurance policies, hence filling the supply gap.

4. ZA and its ecosystem partners, which are mainly ecommerce platform operators such as Alibaba Group and Ctrip Group, are engaged in a mutually beneficial way. High fee rate offered by ZA to its ecosystem partners alone would not guarantee customer flow unless customers of its ecosystem partners have a strong demand for insurance products. In e-commerce, asymmetric information between buyers and sellers is one of the largest obstacles of business development. Tailor-made insurance products offered by ZA such as cargo insurance, shipping return insurance, product broken

insurance, and credit insurance will help mitigate potential financial losses of buyers and sellers in the ecommerce platform. Insurance products offered by ZA will facilitate business growth of its ecosystem partners.

Exhibit 10: Alibaba (BABA US)'s quarterly revenue


Remarks: Bloomberg's market consensus of Alibaba's revenue growth is 52%YoY and 36%YoY for FY03/18E and FY03/19E respectively
 Source(s): Bloomberg, ABCI Securities

Exhibit 11: Ctrip (CTRP US)'s quarterly revenue


Remarks: Bloomberg's market consensus of Ctrip's revenue growth is 39.2%YoY and 28.5%YoY for FY12/17E and FY12/18E
 Source(s): Bloomberg, ABCI Securities

Exhibit 12: GWP derived from major ecosystems (ranked by 1H17 revenue mix)

Ecosystem	FY16 (RMBmn)	Prop	1H17 (RMBmn)	Prop	2014-16 GWP CAGR	1H17 GWP Chg(YoY)
Lifestyle consumption	1,620.4	47.5%	909.1	36.5%	48.8%	39.0%
Travel	1,081.6	31.7%	705.7	28.3%	394.3%	49.8%
Health	235.9	6.9%	437.5	17.6%	14545.1%	898.9%
Consumer finance	318.1	9.3%	256.4	10.3%	485.6%	113.8%
Others	148.3	4.4%	179.1	7.2%	324.2%	184.7%
Auto	3.7	0.1%	4.1	0.2%	Notes*	1637.3%
Total	3,408.0	100.0%	2,491.9	100.0%	107.2%	84.3%

*Notes: Ecosystem not entered in 2014

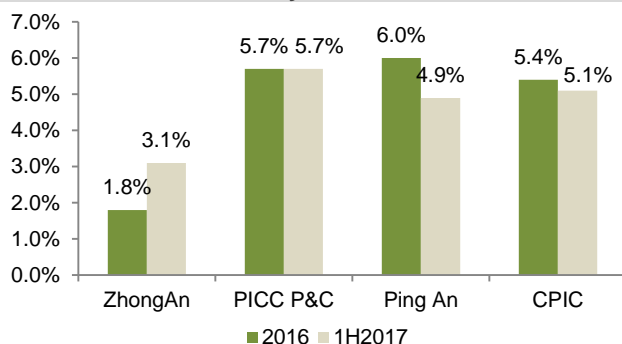
Source(s): the Company, ABCI Securities

Exhibit 13: GWP breakdown by insurance types or by insurance products

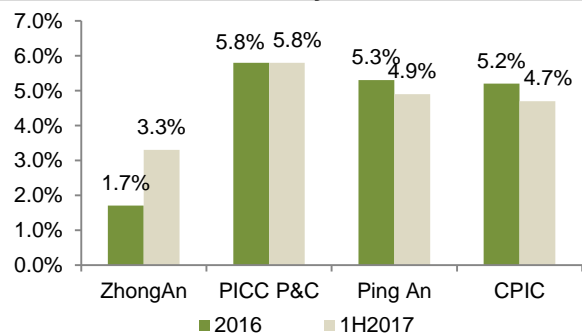
	FY16 (RMBmn)	Mix	1H17 (RMBmn)	Mix	2014-16 GWP CAGR	1H17 GWP Chg(YoY)
By types:						
P&C insurance	2,220.8	65.2%	1,436.7	57.7%	72.1%	57.5%
ST life insurance	1,187.2	34.8%	1,055.2	42.3%	417.1%	140.1%
Total	3,408.0	100.0%	2,491.9	100.0%	107.2%	84.3%
By products:						
Accident insurance	982.2	28.8%	724.8	29.1%	370.4%	77.7%
Health insurance	205.0	6.0%	330.3	13.3%	12458.0%	943.2%
Bond insurance	517.6	15.2%	322.7	12.9%	118.0%	51.2%
Liability insurance	185.1	5.4%	199.9	8.0%	240.2%	139.9%
Credit insurance	102.8	3.0%	138.5	5.6%	406.8%	399.3%
Cargo insurance	59.3	1.7%	40.9	1.6%		
Household property insurance	15.5	0.5%	28.5	1.1%	84.3%	809.1%
Others	1,340.5	39.3%	706.2	28.3%	47.5%	24.1%
<i>of which, shipping return</i>	1,193.6	35.0%	N/A	N/A	35.0%	N/A
Total	3,408.0	100.0%	2,491.9	100.0%	107.2%	84.3%

Source(s): the Company, ABCI Securities

Performance of investment assets has room to improve. We estimate net investment assets of ZA will increase to RMB 19.0 bn at end-2017E from RMB 7.8 bn at end-2016 after raising ~RMB 11.3 bn of net proceeds from new shares issued in Sep-Oct. ZA's investment yield (on net or gross basis) was relatively low compared to major P&C insurers. Hence, we believe its investment performance should have room for growth for ZA to improve its investment performance.

Exhibit 14: Net investment yield


Source(s): Companies, ABCI Securities

Exhibit 15: Total investment yield


Source(s): Companies, ABCI Securities

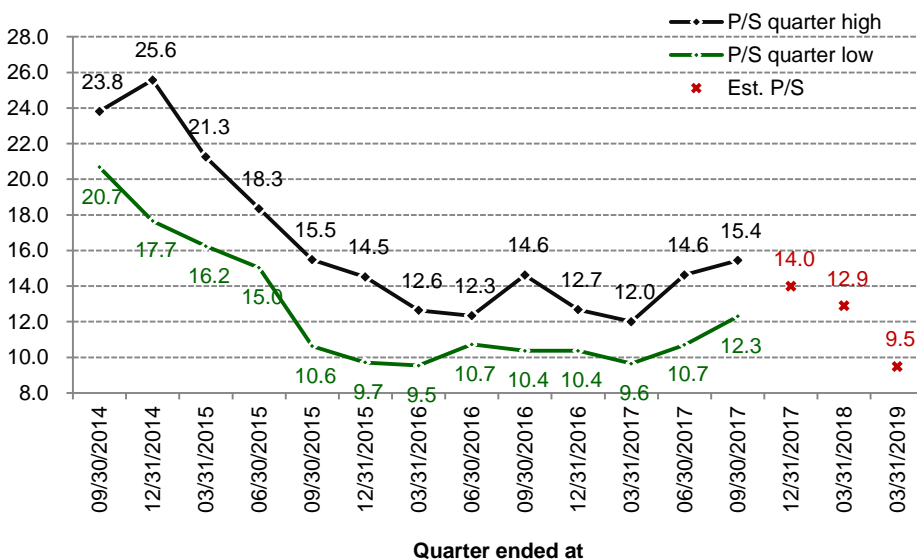


Valuation

We have incorporated the following factors in our assessment of ZA's equity value.

1. Market valuation of Alibaba (BABA US; US\$183.21), a major ecosystem partner of ZA. BABA was trading at 12.3x-15.4x trailing P/S in 3Q17. BABA is currently trading at 12.9x fwd.FY3/31/2018E P/S and 9.5x fwd.FY3/31/2019E P/S (based on Bloomberg's market forecasts).
2. Sustainability of ZA's business. Its payment to ecosystem partners is mainly a variable cost subject to GWP income. Since its P&C insurance contracts are short-term in nature, its potential liabilities in these contracts would also be of the same duration. After its IPO, we estimate its financial resources to be RMB 19 bn and assume an annual cash burn rate of ~RMB600-700 mn (excl. settlement of insurance claims and payment to ecosystem partners). In our view, ZA should have sufficient working capital for its business.
3. We believe ZA is able to evolve from the second stage of development in the ecosystem to the third stage within the next few years.
4. ZA has no dividend record; its accumulated loss at end-June was RMB 226mn.
5. We forecast its GWP and total income to grow by 74% YoY and 59% YoY in FY17E, but it would record a net loss of RMB 604mn.
6. We apply P/S comparative approach to derive the Group's equity value. Based on our analysis, the fair value range would be 12-15x FY18E P/S, representing RMB 68-85/share (or HK\$ 80-100). We set TP at HK\$90, which is the mid-point of our valuation range.

Exhibit 16: Alibaba (BABA US): Price/Revenue Band



Market is expecting BABA to achieve 52.7%YoY and 35.8%YoY revenue growth for FY3/18E and FY3/19E. (FY end of BABA is on Mar 31).

Remarks: Rolling 12-month revenue
Source(s): Bloomberg, ABCI Securities



Risk Factors

1. ZA is relying heavily on ecosystem partners for customer flow and will be affected if these partners divert these customers to its competitors.
 - a) Cathay Insurance, a 51%-owned subsidiary of Ant Financial (ZA's major shareholder and ecosystem partner), is providing P&C insurance products via online channels. If Ant Financial diverts the customer flow to Cathay Insurance, ZA will be adversely affected.
 - b) Trust Mutual Life, a 34%-owned associate of Ant Financial, is providing health and accident insurance products. ZA and Trust Mutual Life are competing in the health and accident insurance market.
 - c) Tencent, the second largest shareholder of ZA with a 10.21% stake, is holding a 15% stake in Hetai Life Insurance. ZA and Hetai Life are competing in the health and accident insurance market.
2. ZA was operating at a combined ratio over 100% in its P&C insurance business in FY14-1H17. Its insurance underwriting business was operating at loss.
3. Online-only P&C license prohibits ZA from selling its insurance products offline.
4. Other P&C insurers are penetrating into the online P&C insurance market.
5. The effectiveness of ZA's FinTech relies on its ecosystem partners to supply raw data for assessment.
6. Investment assets will increase significantly after the IPO. We estimate these assets to account for over 96% of total assets or 108% of total equity. A 10% increase/decrease in assets value will enhance/reduce equity value by 10.8%.
7. ZA has no dividend track record and recorded an accumulated net loss in the balance sheet at end-June 2017. We believe dividend distribution is highly unlikely in the short-term.
8. We predict ZA to record a net loss in FY17E, and we expect its combined ratio to maintain at above 100% in FY18E. Nonetheless, a turnaround may occur in FY18E due to the increase in investment income. The actual outcome may deviate from our assumptions or expectations.
9. High frequency of customer complaints to the CIRC suggests corporate governance has room to improve. According to survey issued by the CIRC, ZA was ranked 9th in the number of complaints on contract disputes, 10th in claims disputes, and 20th in suspected illegal actions for 9M17. ZA also had the second highest number of complaints per RMB 100mn of premium in 9M17.



Financial statements

Exhibit 17: Consolidated income statement summary (2014A-2019E)

FY ended Dec 31 (RMB mn)	2014	2015	2016	2017E	2018E	2019E
Gross written premiums	794.1	2,283.0	3,408.0	5,935.5	8,980.4	13,170.9
Less: Premiums ceded to reinsurers	(7.3)	(10.4)	(39.6)	(178.1)	(179.6)	(263.4)
Net written premiums	786.8	2,272.6	3,368.4	5,757.4	8,800.8	12,907.5
Less: Net change in unearned premium reserves	(74.6)	(351.1)	(143.0)	(1,036.3)	(1,584.1)	(2,323.4)
Net premiums earned	712.2	1,921.5	3,225.4	4,721.1	7,216.6	10,584.2
Net investment income	80.1	520.7	98.6	287.1	467.6	492.6
Net fair value gains through P&L	9.9	40.6	41.8	302.0	579.4	610.3
Other operating income	15.4	26.6	46.8	100.0	100.0	100.0
Total income	817.5	2,509.3	3,412.7	5,410.1	8,363.7	11,787.1
Net claims incurred	(522.9)	(1,316.3)	(1,355.3)	(2,456.6)	(3,639.5)	(5,201.5)
Handling charges and commissions	(16.2)	(100.6)	(287.1)	(575.7)	(704.1)	(903.5)
Finance costs	(5.7)	(3.1)	(0.2)	(2.0)	0.0	0.0
Other operating and admin expenses	(236.2)	(1,029.8)	(1,757.1)	(2,999.3)	(3,816.1)	(5,053.8)
Total benefits, claims & expenses	(781.0)	(2,449.8)	(3,399.7)	(6,033.6)	(8,159.7)	(11,158.8)
Pre-tax profit	36.6	59.6	13.0	(623.5)	203.9	628.3
Income tax expense	0.4	(15.3)	(3.6)	20.0	(51.0)	(157.1)
Net profit for the year	37.0	44.3	9.4	(603.5)	153.0	471.2
Basic sales per share (RMB)	0.818	2.162	2.751	4.167	5.690	8.019
Pro forma FD sales/share (RMB)	0.818	2.023	2.751	3.681	5.690	8.019
Basic EPS (RMB)	0.037	0.038	0.008	(0.465)	0.104	0.321
Pro forma FD EPS (RMB)	0.037	0.036	0.008	(0.411)	0.104	0.321
Weighted avg. no. of shares (mn shares)	1,000.0	1,160.4	1,240.6	1,298.4	1,469.8	1,469.8
Issued shares at end of period (mn shares)	1,000.0	1,240.6	1,240.6	1,469.8	1,469.8	1,469.8
ROAA	2.7%	0.9%	0.1%	-4.1%	0.8%	2.3%
ROAE	3.7%	1.1%	0.1%	-5.0%	0.9%	2.6%

Source(s): the Company, ABCI Securities estimates

Exhibit 18: Consolidated balance sheet summary (2014A-2019E)

As of Dec 31 (RMB mn)	2014	2015	2016	2017F	2018F	2019F
Investment assets:						
Cash	141.7	1,374.8	1,140.0	2,472.3	2,548.9	2,685.0
Fixed income investments	451.4	3,317.0	3,175.3	7,607.2	7,842.8	8,261.7
Equity & investment funds	148.2	1,806.3	1,937.0	3,803.6	3,921.4	4,130.8
Other investments	408.3	1,207.9	1,585.0	5,134.9	5,293.9	5,576.6
Total investment assets, net	1,149.6	7,706.0	7,837.3	19,018.0	19,607.1	20,654.1
Add: Securities sold under agreements to repurchase	140.0	1.6	2.7	-	-	-
Gross investment assets	1,289.6	7,707.6	7,840.0	19,018.0	19,607.1	20,654.1
Non-investment assets	79.8	361.6	1,492.2	750.0	800.0	800.0
of which, cash in WC	-	0.1	13.3	-	-	-
Total assets	1,369.5	8,069.1	9,332.2	19,768.0	20,407.1	21,454.1
Total equity	1,020.6	6,898.3	6,859.0	17,524.3	18,220.1	18,538.3
Total liabilities	348.9	1,170.8	2,473.3	2,243.8	2,187.0	2,915.8
Issued shares at end of period (mn shares)	1,000.0	1,240.6	1,240.6	1,469.8	1,469.8	1,469.8
NBV (RMB/share)	1.021	5.560	5.529	11.923	12.396	12.613
Assets/equity (x)	1.34	1.17	1.36	1.13	1.12	1.16

Source(s): the Company, ABCI Securities estimates



Exhibit 19: Consolidated cash flow statement summary (2014A-2019E)

FY ended Dec 31 (RMB mn)	2014	2015	2016	2017F	2018F	2019F
Operating activities:						
Net cash flow from operating activities	119.6	300.5	853.4	1,352.5	2,509.1	3,536.1
Investing activities:						
PPE	(22.1)	(39.7)	(183.6)	(150.0)	(200.0)	(200.0)
Investments, net	(178.6)	(5,053.6)	(1,225.1)	(9,848.4)	(512.5)	(910.9)
Investment incomes & others	57.6	430.9	52.9	400.0	460.0	500.0
Net cash flow from investing activities	(143.1)	(4,662.4)	(1,355.9)	(9,598.4)	(252.5)	(610.9)
Financing activities:						
New issues	0.0	5,775.0	0.0	11,280	0.0	0.0
Transaction cost	0.0	(38.5)	0.0	0.0	0.0	0.0
Securities sold under repurchase agreements, net	134.3	(141.5)	280.9	(280.0)	0.0	0.0
Net cash flow from financing activities	134.3	5,595.0	280.9	11,000.4	0.0	0.0
Net change in cash	110.8	1,233.2	(221.7)	2,754.5	2,256.6	2,925.2
Basic net operating cash flow (RMB/share)	0.120	0.259	0.688	1.042	1.707	2.406
Price/OCF (x) (px HK\$75.95)	-	-	93.9	62.0	37.8	26.8

Source(s): the Company, ABCI Securities estimates

Exhibit 20: Shareholding Structure

	Cost (RMB/share)	Shares holding (mn shares)	Stakes
Un-listed shares:			
Founding shareholders (Oct 9, 2013):			
Ant Financial	1.0	199.0	13.54%
Tencent Computer System	1.0	150.0	10.21%
Ping An Insurance	1.0	150.0	10.21%
Shenzhen Jia De Xin Investment Ltd	1.0	140.0	9.53%
Unifront Holding Ltd	1.0	90.0	6.12%
Cnhooray Internet Technology Co Ltd (100%owned by Sinolink (1168 HK))	1.0	81.0	5.51%
Shanghai Yuanqiang Investment Co Ltd	1.0	50.0	3.40%
Shenzhen Rixun Internet Co Ltd	1.0	30.0	2.04%
Shanghai Haoguan Investment Management Partnership (acquired in 7/2016)*		28.6	1.94%
Shanghai Qianguo Investment Management Partnership (acquired in 7/2016)*		31.4	2.14%
Qindgao Huilijun Trading Co Ltd (acquired in 4/2017)*		50.0	3.40%
Sub-total (unlisted shares)		1,000.0	68.04%
Listed H-shares:			
Pre-IPO investors (Jun 7, 2015) (1 yr lock up under China's company law since listing):			
Morgan Stanley Asia Securities Products LLC	24.00	30.73	2.09%
CICC Securities (HK) Limited (owned by CICC (3908 HK))	24.00	31.25	2.13%
CDH Avatar, L.P.	24.00	62.00	4.22%
Keywise ZA Investment	24.00	61.19	4.16%
Equine Forces Limited Partnership	24.00	55.46	3.77%
Sub-total of pre-IPO investors		240.63	16.37%
Global offering in Sep-Oct 2017:			
Softbank Group (cornerstone investor), 6-mth lock-up	59.70	71.91	4.89%
Other public H-share shareholders (free float)		157.28	10.70%
Sub-total of global offering		229.19	15.59%
Sub-total listed H shares		469.81	31.96%
Gross total		1469.81	100.00%

Note*: acquired from other founding shareholders at un-disclosed costs.

Source(s): the Company, ABCI Securities

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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

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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