

Equities

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China Insurance: 1Q12 Sector Statistics

Life Growth Stabilizing; P&C Loss Ratio Deteriorating

■ Industry Overview

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- **1Q12: life better than P&C** — The CIRC just published the 1Q12 insurance sector statistics. Life premium growth showed signs of stabilization but P&C loss ratio saw noticeable deterioration. We reiterate our view that life insurance growth should turn incrementally better in 2012, whereas P&C cycle is peaking and starts to see modest pressure. We continue to prefer life over P&C. Ping An and NCI remain our top picks.
- **Stabilizing life premium growth in 1Q12** — Life premiums grew 1.4% yoy in 1Q12, versus negative growth in 4Q11 and 3Q11. NCI posted the strongest growth of 16% yoy, while China Life lagged peers with -7% growth. Meanwhile, P&C premium growth for the sector was 15% in 1Q12.
- **Deterioration in P&C loss in 1Q12** — P&C claims paid increased 33% yoy in 1Q12, much higher than the 15% P&C premium growth. P&C loss ratio jumped to 44.0% in 1Q12, up 6.1ppt yoy. While the sector loss ratio is based on gross premiums and are not directly comparable with those based on GAAP financials, we believe the yoy pickup in sector loss ratio points to deterioration of P&C underwriting profitability.
- **Incrementally better life outlook** — We believe life premium growth is likely to incrementally improve from here given: (1) An easier base for comparison should start to emerge in mid-2012. (2) Macro policy easing should support liquidity and improve demand for savings-type life insurance products. (3) Investment returns of banks' wealth management products have been softening of late, which should reduce competitive pressure on life insurance products. (4) Potential pension reform would benefit life insurers.
- **P&C cycle peaking** — We believe the P&C cycle is peaking and may start to modestly deteriorate in 2012: (a) Regulatory focus is gradually shifting to consumer protection. (b) The revised auto insurance standardized terms entail higher liability cover. (c) The auto insurance pricing reform will likely lead to a modest reduction in pricing. (d) There are signs of pricing/commission rate competition in certain cities of late. (e) The opening of CTPL to foreign players will create more competition in the longer term.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 1. Deterioration in P&C loss in 1Q12 (Rmb mn)

	1Q11	1Q12	YoY change
Gross premiums			
Human life	348,422	353,432	1.4%
P&C	113,293	130,050	14.8%
Claims			
Human life	55,101	59,936	8.8%
P&C	42,939	57,261	33.4%
Claims ratio			
Human life	15.8%	17.0%	1.1%
P&C	37.9%	44.0%	6.1%

Source: CIRC, Citi Investment Research and Analysis

Ping An Insurance

(2318.HK; HK\$67.15; 1)

Valuation

We derive our HK\$75 target price using a sum-of-the-parts (SOTP) valuation approach incorporating: (1) A three-stage growth model to project NBV (discount rate of 13.0%, first-stage growth of 18%, second-stage growth of 6.0% and terminal growth of 4.0%); (2) Price/Book approach to value P&C insurance (2.0x) and banking (1.0x); (3) 1x book value for Corporate and Others; and (4) 10% holding company discount given its banking and investment businesses are at their early stages of expansion, and it remains to be seen whether execution will be successful. Our target price implies a Price/EV multiple of 1.9x. We believe Chinese life insurers deserve a valuation premium over European peers given the stronger growth, higher margin, more protected pricing, and better market positions of the Chinese life insurers.

Risks

The key downside risks that could prevent the shares from reaching our target price include: 1) sharp A-share market corrections, 2) draconian macro policy tightening in China, 3) earnings-destructive changes in insurance accounting, 4) setbacks in major equity stake investments (e.g. Fortis in 2008), and 5) earnings/NBV disappointment. Key upside risks include: 1) sharp A-share rally, 2) stronger-than-expected cross-selling synergies from its proposed stake investment in SZDB, and 3) better-than-expected earnings/NBV delivery.

New China Life

(1336.HK; HK\$36.80; 1)

Valuation

We derive our target price by using an Appraisal Value approach, which combines the embedded value (EV) with new business value (NBV). In turn, we use a three-stage growth model to project NBV. Key assumptions include a discount rate of 13.7%, first-stage growth of 22%, second-stage growth of 6.6% and terminal growth of 4.0%. Our target price is HK\$41, implying a Price/EV multiple of 2.2x. We believe

Chinese life insurers deserve a valuation premium over European peers given the stronger growth, higher margins, more protected pricing, better market positions of the Chinese life insurers.

Risks

Key downside risks include sharp A-share market correction, draconian macro policy tightening in China, earnings-destructive changes in insurance accounting, and earnings/NBV disappointment. The main upside risks include sharp A-share rally, faster-than-expected liberalization of investment channels, faster-than-expected pension reform, any better-than-expected earnings/NBV delivery. Any of these risks could cause the shares to deviate from our target price.

Appendix A-1

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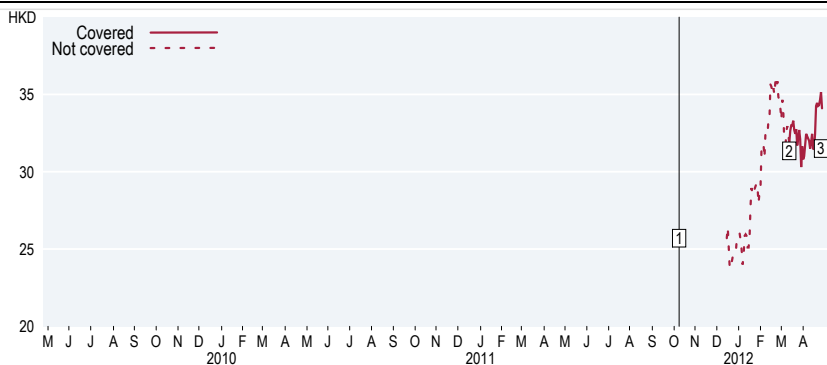
New China Life (1336.HK)

Ratings and Target Price History

Fundamental Research

Analyst: Darwin Lam, CFA

Covered since March 13 2012



	Date	Rating	Target Price	Closing Price
1	8-Oct-11	Stock rating system changed		

* Indicates change

	Date	Rating	Target Price	Closing Price
2	13-Mar-12	*1	*38.00	31.85

	Date	Rating	Target Price	Closing Price
3	26-Apr-12	1	*41.00	35.15

Rating/target price changes above reflect Eastern Standard Time

New China Life (1336.HK)

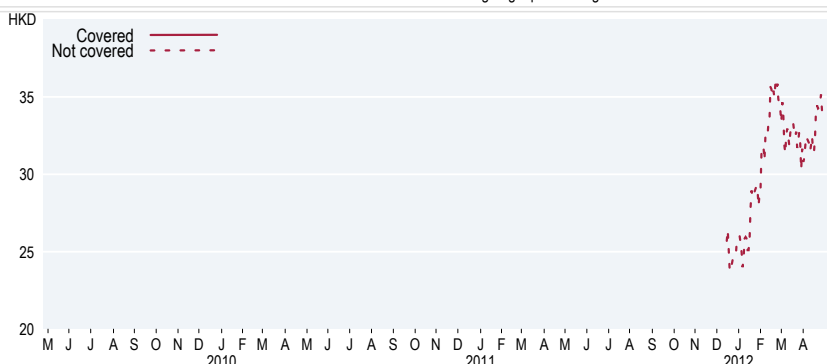
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Darwin Lam, CFA

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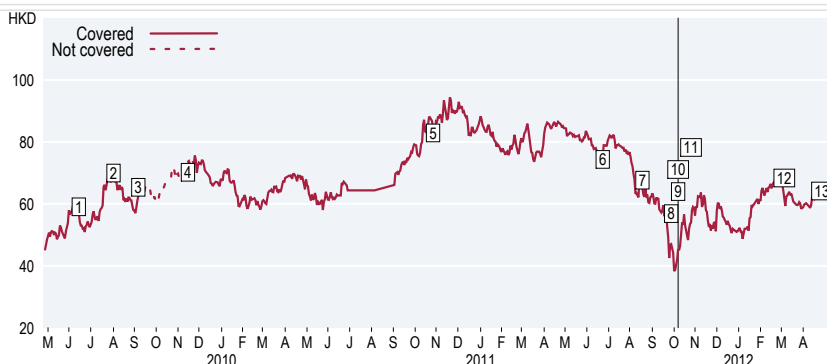
Ping An Insurance (2318.HK)

Ratings and Target Price History

Fundamental Research

Analyst: Darwin Lam, CFA

Covered since November 16 2009



	Date	Rating	Target Price	Closing Price
1	14-Jun-09	*2M	*66.00	59.05
2	3-Aug-09	*1L	*80.00	69.20
3	7-Sep-09	Coverage terminated		
4	16-Nov-09	1L	*85.00	73.60
5	27-Oct-10	1L	*98.00	84.15

* Indicates change

	Date	Rating	Target Price	Closing Price
6	23-Jun-11	1L	*90.00	75.70
7	18-Aug-11	1L	*83.00	65.05
8	28-Sep-11	1L	*75.00	47.00
9	7-Oct-11	Stock rating system changed		
10	7-Oct-11	*1	75.00	45.40

	Date	Rating	Target Price	Closing Price
11	26-Oct-11	1	*70.00	53.95
12	6-Mar-12	1	*73.00	61.80
13	27-Apr-12	1	*75.00	63.80

Rating/target price changes above reflect Eastern Standard Time

Ping An Insurance (2318.HK)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Darwin Lam, CFA

Covered since November 16 2009



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