

## New China Life Insurance - H (1336 HK)

**Neutral**

Price: HK\$44.65

27 Feb 2015

Price Target: HK\$42.00

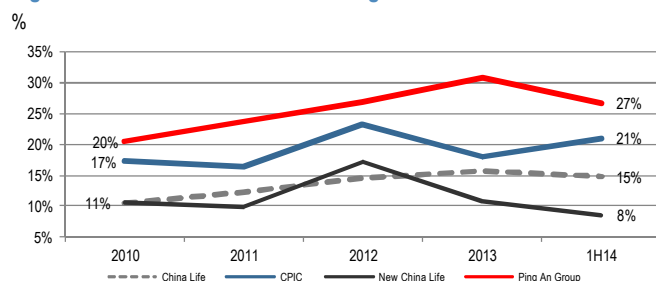
PT End Date: 30 Jun 2015

Strategic cooperation with internet company ended without gain

New China Life has just disclosed that the company's trial to cooperate with a strategic investor in the internet industry has terminated without any result. Despite relatively weak fundamental/ business performance compared to major life insurers, the company has been the best performer during 2014 within H-share listed Chinese insurers. Thus we do not rule out the possibility that there might have been some positive market expectation built up on the strategic cooperation potential with the internet company including ownership structure changes. Although the sector has outperformed the market by 2-10% during New China Life's suspension period, given that the company has shown the best YTD performance (+14%) coupled with the termination disclosure on the cooperation discussion, we expect **a short-term negative share price reaction** to the news. The company's H-share listed stock will resume trading on 2 March-15.

- **Trading suspended since 19 January, 2015.** Due to the business cooperation effort with a strategic investor in the leading position in the internet industry (i.e., significant matter), the trading on this company has been suspended for more than a month. During the suspension period, H-share listed major insurers have outperformed the market by 2-10% on the back of: 1) strong January premium, 2) more evidence on reform agenda (i.e., release on the C-ROSS framework, life pricing liberalization outlook, healthcare market acceleration etc.), and 3) market unwind on insurers' asset quality concern following the government's easing cycle. That said, our initial thought is that the **disclosure today would work as a short-term 'negative' share price catalyst** as we do not rule out the positive market expectation built up on the strategic cooperation potential with the internet company to some extent. We highlight that, despite its relatively poor operational trend, the company was the best performer in 2014 (+51%) and also the best YTD performer (+14%).
- **Major fundamental challenge ahead with asset quality concern mitigation outlook.** Following the monetary easing trend in China, market concern on the company's large size asset allocation to non-standard assets (i.e., ~18% of AUM as of Jun-14) would likely to be mitigated to some extent. However, its overall fundamental outlook looks quite challenged for this year, we believe. First, we expect sizable reserve top-up for the next couple of quarters following lowered long-term bond yield trend. Based on our observation as of 3Q14, compared to peers, overall liability reserving size looks relatively small ([New China Life Insurance Company Ltd - H: 3Q14 results – Strong bottom line, but asset allocation and fast liability reserve growth are our key concerns](#), October 26, 2014) Second, due to high business dependency on the bancassurance channel, its premium growth for 2014/1M15 was only equally +6% y/y. Considering its higher surrender ratio (-1.9%, as of Sep-14) (or asset-liability cash flow mis-matching), despite the healthcare insurance market acceleration, we expect that the company's major business focus is likely to remain the bancassurance channel selling the savings-type policies. Third, given its earnings model is largely based on the investment spread margin (= investment return- funding cost), the pricing liberalisation on life policies (or higher funding cost) and potential deposit rate cut (or lower investment return) would work as earnings/ NBV compression factor, we believe. Finally, following gradual introduction of the C-ROSS framework, despite lowered interest rate environment, we do not expect its further asset allocation changes into the risky asset.

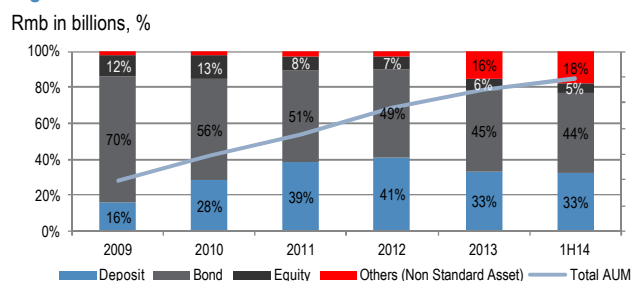
Figure 1: China life insurers: NBV margin trend



Source: Company data. J.P. Morgan estimates.

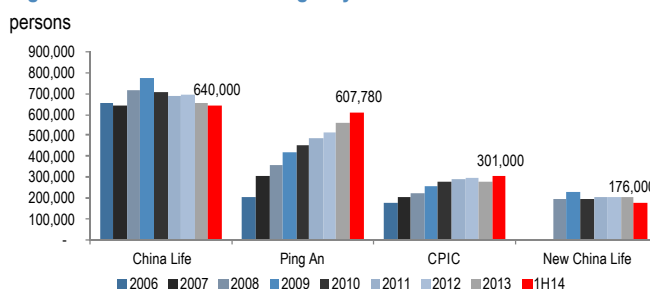
Note: NBV margin = NBV/ First Year Premium (FYP)

Figure 3: New China Life: Asset Allocation trend



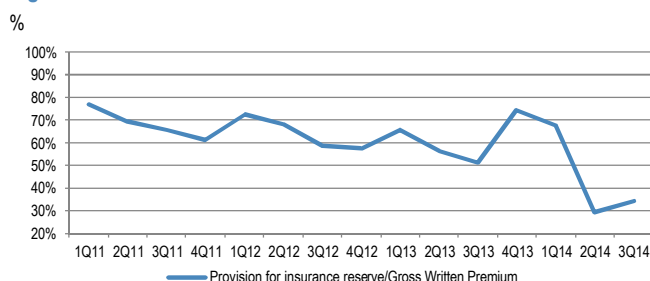
Source: Company data. J.P. Morgan estimates.

Figure 2: China life insurers: Agency headcount trend



Source: Company data.

Figure 4: New China Life: Provision for insurance reserve/ GWPs



Source: Company data

## Investment Thesis

Despite its earnings recovery in 2013 on the back of it recovering from a large impairment loss, its insurance operation showed little evidence of fundamental improvement in that year. We think its relatively small balance sheet will remain a key disadvantage during this period of strong industry growth. However, a strong A-share market recovery and further monetary easing from the government should work as upside catalysts.

## Valuation

Our New China Life-H PT (Jun-15) of HK\$42 is derived from a multi-stage NBV growth model, which yields an implied P/EV of 1.4x and implied NBM of 7x.

Embedded value (31 December, 2014)	27.97
Expected return on EV	2.45
New business value (2014)	1.77
Experience variance	(0.91)
Market value adjustments	(0.04)
Capital movement	(0.25)
Embedded value (31 December, 2015)	30.98
Goodwill	12.47
New business value (2015)	1.77
New business multiple (x)	7.1x
Fair Value (Dec-15)	43.5
Price Target (Jun-15)	42.0

Source: J.P. Morgan estimates.

## Risks to Rating and Price Target

Upside risks to our rating and price target include: 1) sooner-than-expected restructuring results; 2) a stronger-than-expected rally in A-share markets; and 3) rapid branch network expansion, driving premium growth.

Downside risks to our rating and price target include: 1) a weaker-than-expected A-share market movement; 2) a flattening China long-term bond yield driving reserve provisioning top-up; and 3) a faster-than-expected asset quality deterioration cycle.

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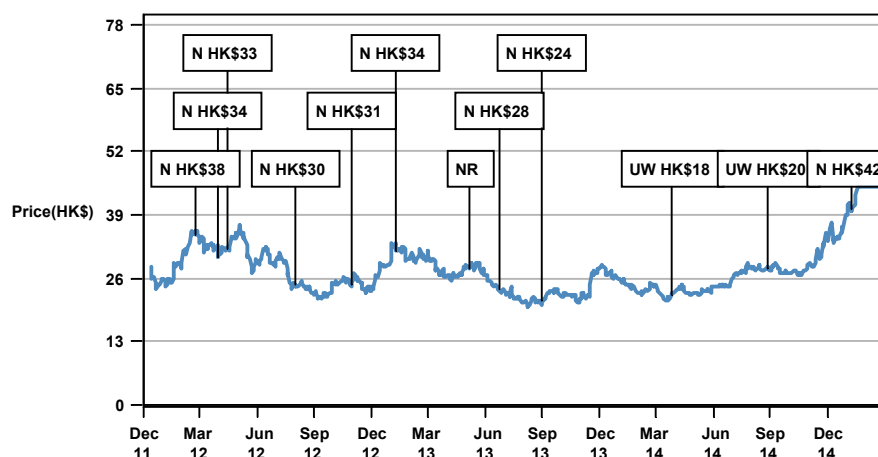
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New China Life Insurance - H (1336.HK, 1336 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.  
Break in coverage May 07, 2013 - Jun 22, 2013.

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