JPM-pp1

Asia Pacific Equity Research

20 March 2015

# Ping An Insurance Group - H (2318 HK)

**Overweight**

Price: HK$88.50
19 Mar 2015
Price Target: HK$130.00
PT End Date: 30 Jun 2015

## 2H14 first cut: Strong fundamental re-rating, muted trust AUM growth, and 10-for-10 bonus share issue proposal

The company delivered **strong 2H14 results, enough to drive near-term price momentum**. (1) Better-than-expected fundamental re-rating for insurance operations (Life: 2H NBV growth: +26% y/y, FY14 P&C combined ratio: 95%), (2) muted trust AUM growth (+9% h/h) with enhanced risk management discussion under G-SIIs context, (3) proposal for a **10-for-10 bonus share issue** to the existing shareholders with Rmb0.50/share of the final dividend are key takeaways from 2H results. Despite strong evidence on customer migration trend and fast business development on the internet finance (i.e., Lufax, Wanliton, Ping An Pay, etc.), we do not factor those positives in due to little earnings/value contribution outlook similar to Ping An Trust. We maintain our forecasts pending further review following the analyst briefing. Nonetheless, the company's outstanding fundamental re-rating, its better risk management recognition status, and surprising capital deployment plan suggest strong share price upside potential at the current share price level we believe.

- **Strong 2H14 results.** The company delivered strong 2H results on many fundamental metrics. (1) **Life**: With further increase on the agency headcount (total: 363,000 persons, +14% y/y), the contribution of the protection-type products (i.e., accident & health, traditional) increased to +41% of total new business in 2014 (vs. 23% in 2012) driving record FY14 NBV growth (~22B, +21% y/y). As expected, however, the NBV margin in the bancassurance declined to ~3.6% (-3.4%p y/y). (2) **Non-life**: Thanks to strong premium growth (+24% y/y) and underwriting margin improvement (combined ratio: 95.3%, -2%p y/y), net profit on Ping An P&C increased by +50%y/y. (3) **Trust**: compared to 1H14 (+26% h/h), overall Trust AUM growth has largely muted (~Rmb 399B, +9% h/h) with more disclosure regarding underlying assets/ risk management process. (4) **Capital**: Due to equity capital raising (HK$ 36.8B in Dec-14) and strong earnings, the group solvency ratio improved to 205% (+31%p y/y). Thus, we do not think its slight miss on FY14 NP consensus (actual ~ Rmb39B, **+40% y/y** vs. consensus/JPMe: ~41B) as a negative point. (Ping An Bank 4Q14 result: link)

- **Enhanced risk management discussion under G-SIIs designation.** Following the regulatory follow-up, for the first time, its annual report incorporates many discussion related to the risk management procedure as one of G-SIIs. According to the annual report, the company established and submitted its Systematic Risk Management Plan (SRMP), Recovery and Resolution Plan (RRP), and Liquidity Risk Management Plan (LRMP) to CIRC following the request by FSB and IAIS in 2014. To comply with better risk management guidance under the global standard, we believe the company will consider de-leveraging its non-insurance/banking business (i.e., Ping An Trust/ Lufax etc.) in the near term (For details on the regulatory timetable for G-SIIs: link)

- **Surprising capital deployment plan.** Coupled with Rmb0.5/share for the final dividend, the company proposed a **10-for-10 bonus share issue** to existing shareholders, releasing capital reserve (equivalent to Rmb~9.14B) for shareholder approval at the AGM. In addition, the company officially announced its mid-term shareholders' return plan (2015-17) under separate disclosure. The company noted ~15%-30% of the annual profit distribution as the cash dividend. Our initial impression is that the company seems to have an optimistic outlook on its future earnings growth as well as the balance sheet condition under C-ROSS/G-SIIs. However, considering its strong insurance premium growth (or capital consumption) outlook and chronic risk concern on non-insurance business (higher asset risk charge), we would like to see more clarity on this capital management plan.

- **Price target, valuation and risks.** We maintain our forecasts pending the analyst briefing. **Key downside risks:** asset quality concerns at its banking and trust operations, weaker-than-expected demand for protection-type products, and larger-than-expected deterioration in non-life underwriting cycle.

Table **1: Ping An Group: 2H14 earnings results**

Rmb in millions, %

| | 1H14 | 2H14E | H/H Chg | Y/Y Chg | 2H14E | Vs. est. | 2013 | 2014E | Y/Y Chg | 2014E | Vs. est. |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Gross written premiums** | **179,395** | **147,028** | -18% | 18% | **141,115** | 4% | **269,051** | **326,423** | 21% | **320,510** | 2% |
| Reinsurance prem. ceded | -13,875 | **-10,785** | -22% | -7% | **-4,361** | n.m. | -21,034 | -24,660 | 17% | -18,236 | 35% |
| **Net written premiums** | **165,520** | **136,243** | -18% | 21% | **136,754** | 0% | **248,017** | **301,763** | 22% | **302,274** | 0% |
| Chg. in unearned prem. res. | -6,156 | **-6,828** | 11% | 78% | **-10,437** | -35% | -7,818 | -12,984 | 66% | -16,593 | -22% |
| **Net earned premiums** | **159,364** | **129,415** | -19% | 19% | **126,317** | 2% | **240,199** | **288,779** | 20% | **285,681** | 1% |
| Net claims incurred | -124,009 | **-104,317** | -16% | 16% | **-99,035** | 5% | -198,002 | -228,326 | 15% | -223,044 | 2% |
| Total expenses | -59,690 | **-69,853** | 17% | 28% | **-55,593** | 26% | -100,559 | -129,543 | 29% | -115,283 | 12% |
| **Underwriting performance** | **-24,335** | **-44,755** | 84% | 26% | **-28,310** | 58% | **-58,362** | **-69,090** | 18% | **-52,645** | 31% |
| Investment income | 27,387 | **44,151** | 61% | 57% | **43,163** | 2% | 55,583 | 71,538 | 29% | 70,550 | 1% |
| **Net attributable profit** | **21,362** | **17,917** | -16% | 75% | **19,271** | -7% | **28,154** | **39,279** | 40% | **40,633** | -3% |

Source: Company reports and J.P. Morgan estimates.

Table **2: Ping An Group: 2H14 EV/ NBV results**

Rmb in millions, %

| | 1H14 | 2H14 | H/H Chg | Y/Y Chg | 2H14E | Vs. est. | 2013 | 2014 | Y/Y Chg | 2014E | Vs. est. |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Group EV | 364,376 | 458,812 | 26% | 39% | 474,050 | -3% | 329,653 | 458,812 | 39% | 474,050 | -3% |
| Life EV | 222,681 | 284,682 | 28% | 40% | 284,682 | 0% | 203,038 | 264,223 | 30% | 284,682 | -7% |
| NBV | 11,792 | 10,174 | -14% | 26% | 9,781 | 4% | 18,163 | 21,966 | 21% | 21,573 | 2% |
| First-year premiums | 44,293 | 27,910 | -37% | 16% | 27,255 | 2% | 59,035 | 72,203 | 22% | 71,548 | 1% |
| New business margin | 26.6% | 36.5% | | | 35.9% | +0.6% | 30.8% | 30.4% | | 30.2% | |

Source: Company reports and J.P. Morgan estimates.

Figure 1: China life insurers: NBV margin trend
%

Source: Company reports and J.P. Morgan estimates.
Note: NBV margin = NBV/ FYP

Figure 2: Ping An P&C: Combined ratio trend
%

Source: Company reports.

Figure 3: Ping An Group: Group solvency movement

Source: Company reports.

Figure 4: Ping An Group: Life product Mix (New Business)

Source: Company reports.

### Investment Thesis

Following the strong start in the high-margin protection-type insurance market in China (mostly healthcare insurance), we think Ping An's agency-based business model will drive a sector-leading fundamental re-rating of the stock. The shares do not currently price in the insurance business transition resulting from the full-scale healthcare insurance market opening in China in our view. For major share price drivers, we highlight: 1) non-insurance related business reshuffling potential as the only global systematically important insurers (G-SII) in Asia, 2) a gradual decrease in group earnings contribution from the bank (i.e., <30%), and 3) its strong earnings re-rating from the insurance operation from structural insurance market development in China.

### Valuation

Our Jun-15 PT of HK$130 (SOTP-based) is derived from 14.1x NBM for life, 2.0x P/BV for non-life and 0.6x P/BV for the bank, and applies an appraisal value approach for the life insurance business, a P/BV approach for the non-life insurance and banking businesses, a P/E approach for the securities business and a 20% discount to holding company capital.

SOTP valuation

| | HK$ | Methodology |
|---|---|---|
| Life operation | 105.53 | |
| Embedded value | 48.00 | Embedded value movement analysis |
| Goodwill | 57.54 | Implied P/EV of 2.2x & new business multiple of 14.1x |
| Non-life operation | 15.14 | ROE of 20.4%, CoE of 11.5% and 2.0x blended P/BV |
| Banking operation | 7.54 | Factored Rmb7.70 per Ping An Bank share |
| Securities operation | 0.88 | Based on 6.0x P/E |
| Holding company | 5.91 | 20% discount to capital at holding company level |
| **Share price equivalent (Dec-15)** | **135.02** | **Sum-of-the-parts** |
| **Price target (Jun-15)** | **130.00** | |

Source: J.P. Morgan estimates.

### Risks to Rating and Price Target

Downside risks to our rating and price target include: 1) asset quality concerns at the banking and trust operations; 2) weaker-than-expected household demand for protection-type products, resulting in poor NBV growth; and 3) a larger-than-expected deterioration in the non-life underwriting cycle.

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| Date | Rating | Share Price (HK$) | Price Target (HK $) |
|---|---|---|---|
| 05-Jan-07 | N | 43.65 | 35.00 |
| 12-Apr-07 | OW | 40.30 | 50.20 |
| 17-Jul-07 | OW | 61.40 | 70.10 |
| 25-Oct-07 | N | 108.50 | 91.10 |
| 17-Mar-08 | N | 53.20 | 73.50 |
| 15-Aug-08 | OW | 48.30 | 61.90 |
| 16-Oct-08 | OW | 38.30 | 54.20 |
| 16-Jan-09 | OW | 35.20 | 50.70 |
| 09-Apr-09 | N | 48.65 | 50.40 |
| 07-Jul-09 | N | 57.60 | 61.60 |
| 15-Aug-09 | N | 65.00 | 64.00 |
| 16-Nov-09 | N | 73.60 | 81.00 |
| 14-Apr-10 | N | 69.65 | -- |
| 18-Jun-10 | OW | 62.70 | 82.00 |
| 02-Sep-10 | OW | 66.10 | 86.00 |
| 28-Oct-10 | OW | 86.75 | 105.00 |
| 07-Mar-11 | OW | 83.20 | 101.00 |
| 07-Jul-11 | OW | 81.95 | 97.00 |
| 23-Sep-11 | OW | 52.55 | 80.00 |
| 26-Oct-11 | OW | 53.95 | 84.00 |
| 09-Jan-12 | OW | 48.70 | 72.00 |
| 02-Aug-12 | OW | 61.05 | 68.00 |
| 02-Sep-12 | OW | 56.00 | 65.00 |
| 30-Oct-12 | OW | 61.20 | 70.00 |
| 09-Jan-13 | OW | 68.15 | 76.00 |
| 07-May-13 | NR | 62.50 | -- |
| 22-Jun-13 | OW | 53.60 | 77.00 |
| 30-Aug-13 | OW | 53.85 | 78.00 |
| 27-Oct-13 | OW | 57.05 | 84.00 |
| 14-Mar-14 | OW | 61.10 | 88.00 |
| 27-Aug-14 | OW | 65.25 | 100.00 |
| 08-Jan-15 | OW | 80.45 | 130.00 |

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