

**FIG**  
**Insurance**  
 Equity – China

## Neutral (V)

Target price HKD	4.60
Share price HKD	3.92
Potential return (%)	17

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	-2.2	10.4	20.2
Relative <sup>A</sup> (%)	-0.9	5.3	7.2

Index <sup>A</sup>	Hang Seng Index
RIC	1339.HK
Bloomberg	1339 HK
Market cap (USDm)	21,446
Market cap (HKDm)	166,302
Free float (%)	19

Note: (V) = volatile (please see disclosure appendix)

**29 March 2015**

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 Disclosure appendix, and  
 with the Disclaimer, which  
 forms part of it

# PICC Group (1339 HK)

Downgrade to N(V): Life & Health business needs a plan

- ▶ **Life & Health NBV were significantly below our expectations; massive opaque business reorientation is causing significant pain with no end in sight**
- ▶ **Better-than-expected earnings and book value largely attributed to separately listed PICC P&C**
- ▶ **Too much uncertainty; downgrade to N(V) from OW(V); cut TP by 10% to HKD4.60 (was HKD5.1) which implies a 17% potential return**

**Downgrade PICC Group to N(V) and cut TP to HKD4.6 (was HKD5.1) which implies a 17% potential return. The extremely disappointing and volatile Life & Health NBV results shattered our confidence that things were gradually improving for this high-risk stock.** Life and Health NBV results were significantly below our expectations and befitting of units undergoing massive (and opaque) business restructuring. There were huge changes in business mix, opaque negative assumption changes, collapse in margins and persistency. In 2H 14, Life NBV fell 33% and Health NBV was negative. We believe management needs to lay out a clear plan for Life & Health business and begin executing. The 10% TP cut is driven by a fall in valuation for PICC Life (1.91x to 1.37x EV) and PICC Health (1.27x to 0.57x EV), partially offset by higher value for PICC P&C (2.35x to 2.38x BV).

**What we disliked:** (1) Life NBV was 14% below consensus, having fallen 10% y-o-y (1H:6%, 2H: -33%) driven by a 6% APE growth and 6.7%pts fall in margin. We suspect some of margin collapse was due to unquantifiable assumption changes. There were dramatic shifts in business mix; traditional accounted for 77% of GPW (FY13:12%) (2) 13-mth policy persistency fell to 50.8% which is strangely below the 25-month ratio. (3) Health still not broken even, and recorded a 43% decline in NBV (no consensus available) having posted an implied negative NBV of RMB128m in 2H. (4) Group solvency ratio of 182% was 15%pts worse than expected. (5) Disclosure gaps persist; no Non-Standard Assets exposure and no Group EV. Life & Health does not show what would happen to EV and NBV if calculated using the FY13 assumption set; hence, it is difficult to ascertain what the underlying NBV growth was.

**What we liked:** (1) Net income was 17% above consensus with 9%pts of beat pertaining to better-than-expected results from PICC P&C – see separate results note. (2) Book value was 3% above consensus. (3) Life EV was 8% above consensus, rising 29% y-o-y despite 5%pts worth of negative assumption changes. We assume PICC Life changed mortality/ claim ratio/ lapse rates/ expenses/ commissions given that its base case 10% risk discount rate and 5.75% investment return assumptions were unchanged.

## Financials & valuation

P&L summary (RMBm)				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
Non-life	21,309	22,691	26,035	31,473
Life	2,335	2,811	3,374	4,096
Health	(388)	1,902	2,669	3,607
AMC	572	984	1,160	1,361
Other	(408)	(300)	(200)	(100)
Pre-tax profit	23,420	28,087	33,038	40,438
Tax	(4,705)	(5,643)	(6,637)	(8,124)
Minority interest	(5,606)	(6,632)	(7,708)	(9,363)
Net profit to shareholders	13,109	15,813	18,693	22,951

Operational metrics (RMBm)				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
Life NBV (11% RDR)	3,338	3,396	3,743	4,101
Life NBV growth	-12%	2%	10%	10%
Life FYP growth	6%	5%	7%	7%
Life NBV/ FYP margin	34.6%	33.4%	34.4%	35.2%
Life RoEV	24.8%	13.5%	12.6%	12.7%
Health NBV (11% RDR)	258	292	330	372
Health NBV growth	-44%	13%	13%	13%
Health FYP growth	211%	12%	13%	13%
Health NBV/ FYP margin	22.8%	23.0%	23.0%	23.0%
Health RoEV	16.5%	6.0%	6.8%	7.7%
P&C GPW growth	15.7%	6.6%	14.5%	14.5%
Reported P&C COR	96.5%	97.2%	97.0%	96.3%
Net investment yield (Group)	4.7%	5.2%	5.2%	5.1%

Embedded value (RMBm)				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
Life ANW	30,560	32,674	34,344	36,057
VIF before cost of capital	18,177	22,920	28,583	35,280
Cost of capital	(2,308)	(2,910)	(3,629)	(4,480)
VIF post	15,869	20,010	24,954	30,800
Life EV (11% RDR)	46,429	52,684	59,297	66,857

### Issuer information

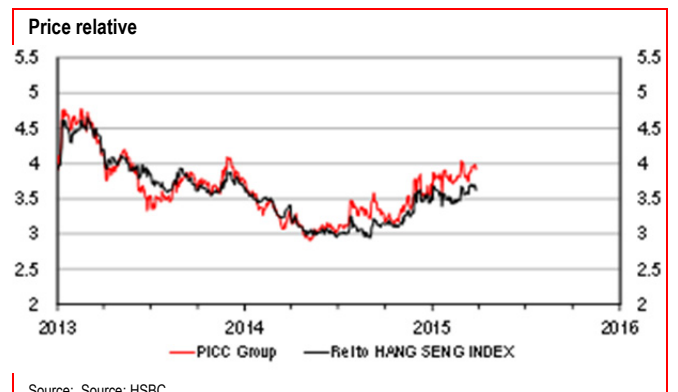
Market cap (HKDm)	166,302
Market cap (USDm)	21,446
Free float	19

Group valuation metrics				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
P/EV Group	N/A	N/A	N/A	N/A
- Group RoEV	N/A	N/A	N/A	N/A
P/ Tangible NAV	1.4x	1.2x	1.0x	0.9x
- RoTNAV	16.9%	16.3%	16.1%	16.8%
P/ book value	1.4x	1.2x	1.0x	0.9x
- RoE	16.0%	15.5%	15.5%	16.2%
P/E	10.2x	8.4x	7.1x	5.8x
Dividend yield	0.3%	0.3%	0.4%	0.4%

Per share data (HKD)				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV group	N/A	N/A	N/A	N/A
- growth	N/A	N/A	N/A	N/A
TNAV	2.59	3.13	3.69	4.37
- growth	31%	21%	18%	18%
EPS	0.39	0.46	0.55	0.67
- growth	62%	20%	18%	23%
DPS	0.01	0.01	0.01	0.02
- payout ratio	3%	3%	3%	3%

Issuer information	New	Old	Change
2015e EPS (RMB)	0.37	0.31	20.9%
2016e EPS (RMB)	0.44	0.37	19.3%
2017e EPS (RMB)			
2015e BVPS (RMB)	2.62	2.72	-3.6%
2016e BVPS (RMB)	3.07	3.12	-1.7%
2017e BVPS (RMB)			
2015e NBV (RMBm)	3,396	4,516	-24.8%
2016e NBV (RMBm)	3,743	5,106	-26.7%
2017e NBV (RMBm)			
2015e Life EV (RMBm)	52,684	52,926	-0.5%
2016e Life EV (RMBm)	59,297	61,595	-3.7%
2017e Life EV (RMBm)			
Cost of Equity	10.8%	10.8%	0.0%
Target price	4.60	5.10	-9.8%

Source: Company data, HSBC estimates



Note: price at close of 27 March 2015

Exhibit 1: Key summary

RMBmn unless otherwise	FY12	FY13	FY14	Change FY14/13	vs. HSBC Beat/ Miss, %	vs. Consensus Beat/ Miss, %	Change % 1H14	YoY 2H14
Net profit share's	6,832	8,121	13,109	61%	18%	17%	-12%	1022%
EPS (RMB)	0.20	0.19	0.31	63%	18%	19%	-12%	1161%
Dividend per share (RMB)	0.00	0.01	0.01	14%	-10%	5%	NA	14%
<b>Life</b>								
APE	8,060	9,114	9,654	6%			48%	-37%
New RP as % FYP	4.8%	4.2%	4.5%	0.4%			-1.2%	4.8%
NBV (10% RDR)	4,031	4,070	3,668	-10%	-17%	-14%	6%	-33%
- Individual	NA	1,407	1,554	10%			0%	26%
- Bancassurance	NA	2,219	1,592	-28%			8%	-75%
- Group	NA	445	462	4%			14%	-29%
NBV/ APE margin (10% RDR)	50.0%	44.7%	38.0%	-6.7%			-14.9%	2.0%
<b>Health</b>								
APE	419	364	1,134	211%			473%	-33%
NBV (10% RDR)	738	481	276	-43%	-56%		17%	-193%
NBV/ APE margin(10%)	176%	132%	24%	-107.8%			-156%	-175%
P&C combined ratio	95.1%	96.7%	96.5%	-0.2%	-0.9%	0.5%	0.7%	-1.3%
Total investment yield, %	4.2%	5.2%	6.0%	0.8%			-0.1%	
Persistency 13 month: Life	91.9%	81.0%	50.8%	-30.2%			-25.4%	
Persistency 25 month: Life	91.3%	86.3%	75.9%	-10.4%			-11.1%	
RMBmn unless otherwise	FY12	FY13	FY14	Change FY14/13	vs. HSBC Beat/ Miss, %	vs. Consensus Beat/ Miss, %	Change % 1H14	HoH 2H14
Total shareholders' funds	65,374	71,575	92,581	29%	-10%	3%	12%	15%
EV: Life (10% RDR)	30,906	36,863	47,414	29%	1%	8%	11%	16%
EV: Health (10% RDR)	4,569	2,491	4,463	79%	-2%		83%	-2%
EV risk discount rate assumption	10%	10%	10%	Unchanged			Unchanged	Unchanged
EV investment return assumption	5.75%	5.75%	5.75%	Unchanged			Unchanged	Unchanged
Solvency ratio: Group	152%	148%	182%	34%	-15%		6%	28%
Solvency ratio: Life	130%	202%	301%	99%	101%		19%	80%
Solvency ratio: Health	162%	116%	187%	71%	119%		51%	20%
Solvency ratio: P&C	175%	180%	239%	59%	-8%		1%	58%
No. life agents	N/A	N/A	94,648	N/A			NA	1%

Source: Company data, Bloomberg, HSBC estimates; \* PICC Group discloses its NBV and EV results under a 10% risk discount rate assumption but we adjust this to 11% in valuation

## Valuation and risks

We value PICC Group using a sum-of-the-parts valuation methodology whereby we appraise Life at 1.37x FY15e EV, P&C at 2.38x FY15e BV, Health at 0.57x FY15e EV and Asset Management at 14x FY15e earnings. The business valuations are based on a Gordon Growth model using a 10.8% cost of equity and 5% sustainable growth. We then apply a 10% 'financial disclosure discount', a 15% 'conglomerate discount' and a 13% asset risk discount to derive our HKD4.6 target price. Under our research model, the Neutral band for volatile China stocks runs from 10ppt below and above a 9% China hurdle rate. Our TP implies a potential return within the Neutral band; we thus downgrade the stock to N(V). Downside risks: the remaining focus on low-margin single-premium products and shareholder exposure to trust assets. Upside risks: Management volume-to-value migration being more than expected and better-than-expected equity market performance.

Exhibit 2: PICC Group: SOTP valuation changes

RMBmn unless stated	P&C	Life	Health	AM	Other	Group	Asset risk	DPS	Discount	PT
<b>Implied multiple (x)</b>	<b>P/ BV</b>	<b>P/ EV</b>	<b>P/ EV</b>	<b>P/ E</b>						
Old	2.35x	1.91x	1.27x	13.6x						
New	2.38x	1.37x	0.57x	21.2x						
Change	0.03x	-0.55x	-0.70x	7.62x						
<b>12M valuation per share (HKD)</b>										
Old	4.72	2.13	0.16	0.21	0.42	7.64	(0.90)	0.01	25%	5.10
New	5.16	1.54	0.07	0.20	0.04	7.02	(0.90)	0.01	25%	4.60
Change	0.44	(0.59)	(0.09)	(0.01)	(0.38)	(0.63)	0.00	(0.00)	0%	-10%

Source: HSBC estimates

# Disclosure appendix

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Upside/Downside is the percentage difference between the target price and the share price.

### **Prior to this date, HSBC's rating structure was applied on the following basis:**

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## Rating distribution for long-term investment opportunities

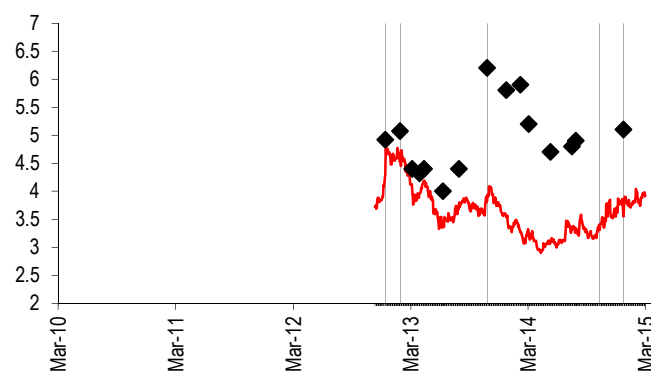
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## Share price and rating changes for long-term investment opportunities

PICC Group (1339.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight (V)	09 January 2013
Overweight (V)	Neutral (V)	24 February 2013
Neutral (V)	Overweight (V)	21 November 2013
Overweight (V)	Restricted	04 November 2014
Restricted	Overweight (V)	19 January 2015
Target Price	Value	Date
Price 1	4.92	09 January 2013
Price 2	5.07	24 February 2013
Price 3	4.40	02 April 2013
Price 4	4.32	25 April 2013
Price 5	4.40	09 May 2013
Price 6	4.00	07 July 2013
Price 7	4.40	26 August 2013
Price 8	6.20	21 November 2013
Price 9	5.80	20 January 2014
Price 10	5.90	05 March 2014
Price 11	5.20	31 March 2014
Price 12	4.70	06 June 2014
Price 13	4.80	12 August 2014
Price 14	4.90	24 August 2014
Price 15	Restricted	04 November 2014
Price 16	5.10	19 January 2015

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
PICC GROUP	1339.HK	3.92	27-Mar-2015	1, 4, 5, 11

Source: HSBC

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