

FIG
Insurance
Equity – China

Neutral (V)

Target price HKD	18.4
Share price HKD	15.7
Potential return (%)	17

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

Performance	1M	3M	12M
Absolute (%)	-5.3	2.5	54.0
Relative ^A (%)	-4.0	-2.3	37.4

Index ^A	Hang Seng Index
RIC	2328.HK
Bloomberg	2328 HK
Market cap (USDm)	30,100
Market cap (HKDm)	233,401
Free float (%)	37

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

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PICC P&C (2328 HK)

N(V): Strong FY14 but is Agricultural profit sustainable?

- ▶ **Net income and book value were 9% and 2% above consensus, respectively; only dividend disappointed**
- ▶ **We question whether high profitability of government-sponsored Agricultural insurance is truly sustainable?**
- ▶ **Reiterate N(V) on PICC P&C but increase TP by 7% to HKD18.4 (was HKD17.2) which offers a 17% potential return**

What we liked: (1) Net profit was 9% above consensus, having risen 43% y-o-y and more spectacularly 150% in 2H. Beat was attributable to higher-than-expected investment income with combined ratio missing estimates. The RMB6bn increase in pre-tax profit was attributable to better underwriting (22%), lower impairments (14%) and realized gains (10%). (2) All business lines achieved <100% combined ratio including property, where the combined ratio fell 13.8%pts to 97.9% in a cat-light year. Agricultural insurance was a standout performer, accounting for just 7% of premium but an impressive 28% of pre-tax profit (excluding corporate). We believe the government may not take too kindly to PICC P&C posting such spectacular underwriting results (83.3% combined ratio) in a business where premiums are heavily subsidised by government – watch this space. (3) Shareholders funds were 2% above consensus. (4) Reserve ratio was relatively strong at 41%.

What we disliked: (1) Combined ratio was 0.5%pts worse than consensus but better than our estimate. The 96.5% combined ratio actually improved by 0.2%pts y-o-y with improvement in loss ratio (-1.8%pts) offsetting deterioration in expense ratio (+1.6%pts). (2) Dividend per share of RMB0.27 was 16% below consensus, with PICC P&C pay-out ratio falling back to 25% versus 61% in FY13 and 26% in FY12. (3) Solvency ratio of 239% was below our estimate of 248%.

Reiterate Neutral (V) rating and increase TP to HKD18.4 (from HKD17.2) which offers a 17% potential return. The 7% increase in TP was driven by mark-to-market impact and the better-than-expected FY14 results; we increase our 2015/16/17e EPS by 7%/6%/10%.

Exhibit 1: GPW & PBT mix and combined ratios by business lines

%	GPW mix		PBT mix*		Combined ratio		% YoY
	FY13	FY14	FY13	FY14	FY13	FY14	
Motor	73%	73%	52%	52%	97.8%	97.7%	-0.1%
Property	6%	5%	-15%	2%	111.7%	97.9%	-13.8%
Cargo	2%	1%	14%	3%	67.2%	90.7%	23.5%
Liability	4%	4%	12%	6%	88.7%	93.6%	4.9%
Injury and Health	4%	6%	5%	1%	96.0%	99.5%	3.5%
Agriculture	7%	7%	23%	28%	88.7%	83.3%	-5.4%
Others	4%	4%	10%	7%	86.6%	90.1%	3.5%
Overall	100%	100%	100%	100%	96.7%	96.5%	-0.2%

Source: Company data, HSBC; * PBT = Profit before tax excluding 'Corporate'

Financials & valuation

Key financial data (RMB mn)				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
Gross written premiums	253,037	269,764	308,773	353,714
Net earned premiums	211,169	225,162	257,798	295,395
Total pre-tax profit	19,441	20,823	24,167	29,605
NPAT	15,115	16,216	18,880	23,212
Shareholders equity of PICC P&C	85,770	104,713	122,217	143,159

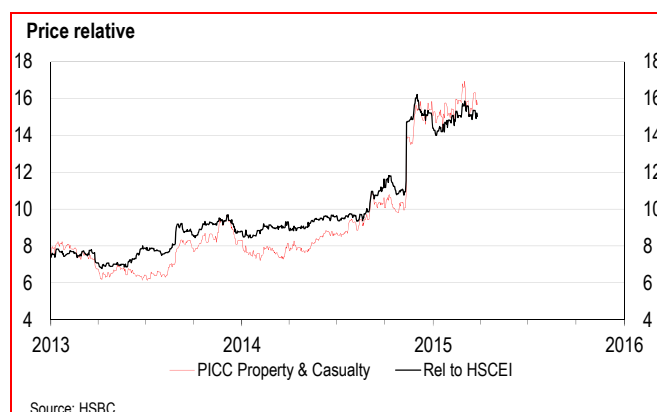
Operational metrics				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
GPW growth	13%	7%	14%	15%
NPE growth	16%	7%	14%	15%
Premium retention ratio	88%	88%	88%	88%
NPAT growth	43%	7%	16%	23%
Loss ratio	64.4%	65.4%	65.2%	65.0%
Expense ratio	32.1%	31.9%	31.9%	31.3%
Combined ratio	96.5%	97.2%	97.0%	96.3%
Solvency ratio	239%	261%	261%	270%
Reserve ratio	40.9%	44.4%	41.3%	41.3%
Dividend payout ratio	25%	25%	25%	25%

Valuation change			
HKD unless otherwise stated	New	Old	Change
Avg ROE 2015 -17e	17.3%	17.6%	-0.3%
Sustainable growth	5%	5%	0.0%
Cost of equity	10.8%	10.8%	0.0%
Implied multiple (x)	2.1x	2.2x	-2.3%
BV p/s	8.8	8.0	9.5%
Fair value end 2015e	18.7	17.5	7.0%
12M Fair Value 2015e	19.2	17.9	7.6%
Dividend	0.3	0.4	-22.6%
Valuation discount	0%	0%	0.0%
H target price - HKD	18.4	17.2	7.0%

Group valuation metrics				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
P/EV Group	2.2x	1.8x	1.5x	1.3x
- Group RoEV	60%	27%	21%	21%
P/ Tangible NAV	2.2x	1.8x	1.5x	1.3x
- RoTNAV	21%	17%	17%	17%
P/ book value	2.2x	1.8x	1.5x	1.3x
- RoE	23%	18%	17%	17%
P/E	11.9x	11.5x	9.9x	8.1x
Dividend yield	2%	2%	3%	3%

Per share data (HKD)				
Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV group	7.23	8.81	10.28	12.04
- growth	37%	22%	17%	17%
TNAV	7.23	8.81	10.28	12.04
- growth	37%	22%	17%	17%
Book value	7.23	8.81	10.28	12.04
- growth	37%	22%	17%	17%
EPS	1.33	1.36	1.59	1.95
- growth	34%	3%	16%	23%
DPS	0.34	0.35	0.40	0.50
- payout ratio	25%	25%	25%	25%

Issuer information	
Market cap (HKD mn)	233,401
Market cap (USD mn)	30,100
Free Float	37%



Note: price at close of 27 March 2015

Exhibit 2: Actual vs. Expected, FY14

RMBmn unless otherwise	FY12	FY13	FY14	Change FY14/FY13	vs. Consensus Beat/ Miss, %	1H14 YoY Change	2H14 YoY Change
Gross premium written	193,487	223,525	253,037	13%		14%	12%
Net premiums earned	155,304	182,546	211,169	16%		14%	17%
Net claims incurred	(98,722)	(120,902)	(135,947)	12%		16%	10%
Acquisition costs	(29,505)	(34,437)	(41,803)	21%		13%	30%
General & admin costs	(19,496)	(21,247)	(26,128)	23%		14%	32%
Underwriting profit	7,581	5,960	7,291	22%		-1%	416%
Investment income	8,387	9,939	12,141	22%		21%	23%
Net realised and unrealised losses	(913)	(342)	1,319	-486%		-297%	-411%
- Realised gains	(19)	871	1,458	67%		-107%	1063%
- Unrealised gains/(losses)	340	(19)	239	-1674%		-1433%	-1785%
- Impairment losses	(1,350)	(1,344)	(502)	-63%		-18%	-99%
- Fair value gains	116	150	64	-57%		-79%	-12%
Investment expenses	(182)	(208)	(243)	17%		13%	20%
Interest expenses policyholder deposits	(5)	(1)	0	-100%		NA	-100%
Exchange gains	(13)	(142)	9	-106%		-673%	-59%
Sundry income	194	401	425	6%		53%	-7%
Sundry expenses	(137)	(185)	(177)	-4%		0%	-7%
Finance costs	(1,629)	(2,060)	(1,631)	-21%		-5%	-35%
Share of profits of associates	66	77	307	299%		32%	-1340%
Pre-tax profit	13,349	13,439	19,441	45%		5%	149%
Tax	(2,944)	(2,881)	(4,326)	50%		17%	145%
Net income	10,405	10,558	15,115	43%	9%	2%	150%
EPS	0.81	0.76	1.06	39%	5%	-2%	177%
DPS	0.21	0.46	0.27	-42%	-16%	-100%	22%
Payout ratio	26%	61%	25%	-35%		-41%	-70%
Tax rate	22%	21%	22%	0.81%		2%	0%
Reserve ratio	45.5%	42.0%	40.9%	-1.0%			
Loss ratio overall	63.6%	66.2%	64.4%	-1.8%		0.9%	-8.2%
Expense ratio overall	31.5%	30.5%	32.1%	1.6%		-0.1%	2.9%
Combined ratio overall	95.1%	96.7%	96.5%	-0.2%	0.5%	0.8%	-5.3%
- Motor	96.2%	97.8%	97.7%	-0.1%		-1.1%	-1.9%
- Property	98.5%	111.7%	97.9%	-13.8%		5.9%	-56.4%
- Cargo	76.5%	67.2%	90.7%	23.5%		29.5%	11.5%
- Liability	91.9%	88.7%	93.6%	4.9%		2.3%	0.4%
- Injury and Health	95.6%	96.0%	99.5%	3.5%		3.5%	1.6%
- Agriculture	N/A	88.7%	83.3%	-5.4%		11.6%	11.6%
- Others	87.6%	86.6%	90.1%	3.5%		0.9%	-15.8%
NEP growth	17%	18%	16%	-2%			
Retention ratio	80%	82%	83%	1.8%		0%	4%
Net investment yield, %	4.1%	4.4%	4.5%	0.2%		0.4%	0.2%
Total investment yield, %	3.6%	4.2%	5.0%	0.8%		-0.2%	1.9%
RMBmn unless otherwise	FY12	FY13	FY14	FY14/FY13	vs. Consensus Beat/ Miss, %	1H14 HoH Change	2H14 HoH Change
Solvency ratio	175%	180%	239%	59%		1%	58%
Shareholders funds	45,450	57,499	85,770	49%	2%	11%	34%

Source: Company data, HSBC estimates

Valuation and risks

We drive our HKD18.4 target price based on a Gordon Growth model, assuming an average FY15-17e ROE of 2.13%, a risk discount rate of 10.8% and 5% long-term growth. Under our research model, the Neutral band for volatile China stocks runs from 10ppt below to 10ppt above a 9% China hurdle rate. Our target price of HKD18.4 implies a potential return of 17%, within the Neutral band; we therefore reiterate our Neutral (V) rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Key upside risks: (i) better-than-expected combined ratio; (ii) economies of scale benefit. Key downside risks: (i) commercial auto reform promotes intensification in competition; (ii) large losses in agricultural insurance due to enforced price cuts and adverse weather.

Disclosure appendix

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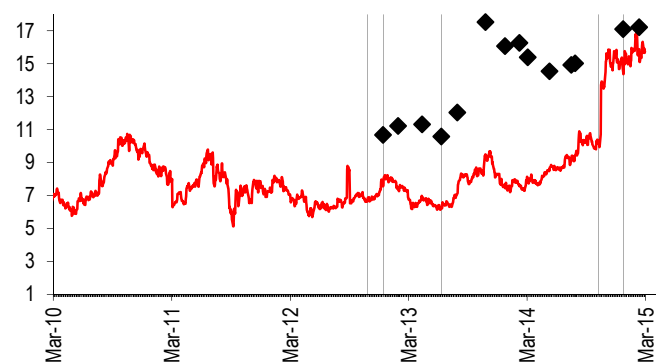
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Hold	39%	(28% of these provided with Investment Banking Services)
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For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

PICC Property & Casualty (2328.HK) Share Price performance HKD Vs HSBC

rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Neutral (V)	Restricted	20 November 2012
Restricted	Neutral (V)	09 January 2013
Neutral (V)	Overweight (V)	07 July 2013
Overweight (V)	Restricted	04 November 2014
Restricted	Neutral (V)	19 January 2015
Target Price	Value	Date
Price 1	Restricted	20 November 2012
Price 2	10.67	09 January 2013
Price 3	11.22	24 February 2013
Price 4	11.31	09 May 2013
Price 5	10.58	07 July 2013
Price 6	12.03	26 August 2013
Price 7	17.51	21 November 2013
Price 8	16.07	20 January 2014
Price 9	16.26	05 March 2014
Price 10	15.39	31 March 2014
Price 11	14.53	06 June 2014
Price 12	14.91	12 August 2014
Price 13	15.01	24 August 2014
Price 14	Restricted	04 November 2014
Price 15	17.10	19 January 2015
Price 16	17.20	09 March 2015

Source: HSBC

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Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
PICC PROPERTY & CASUALTY COMP	2328.HK	15.74	27-Mar-2015	1, 2, 4, 5, 6, 11

Source: HSBC

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