

COMPANY NOTE

Company Update

Hong Kong | Financials | Insurance

1 June 2015

Jefferies

PICC Property and Casualty Co. (2328 HK) Auto Insurance Reform Updates – Expect Smooth Transition

Key Takeaway

The trial program for commercial auto insurance reform was launched recently. In this report, we recap and analyze the key elements of the reform, and believe that the transition is likely to be smooth. In addition, underwriting performance of mid-sized P&C insurers in 2014 was recorded at only 103%, showing limited capacity for aggressive competition. Hence, we reiterate our positive view on PICC P&C.

Auto-insurance deregulation recap: The trial program for auto deregulation was launched recently in six provinces (Hei Long Jiang, Shan Dong, Guang Xi, Chong Qing, Shan Xi, Qing Dao), covering about 15% of the market in terms of premium income. To recap, some of the key changes in the reform include:

1) Insurance terms - Original: Standardized liability terms. **Post reform:** A main liability framework will be provided by the Insurance Association; insurers will be allowed to add on innovative coverage, subject to CIRC approvals. **Implications:** The mainstream strategy undertaken, so far, is simply to use the association framework. We expect innovative terms to be introduced only gradually, with proper risk control.

2) The Pricing Mechanism - Original: Base price is provided by the regulators; insurers can charge a 30% discount/premium to the base price (additional 15% discount allowed for telemarketing). **Post reform:** Regulators now provide only expected loss guidance; insurers can then set their own expense loading to get to the base price. On top of No Claims Discount (0.6x-2.0x), additional discounts/premiums can be charged according to distribution/underwriting factors (15% each). **Implications:** All inclusive, range of discount/premium move from 0.7x-1.3x (excluding telemarketing) to 0.43x-2.65x, which allows for more pricing differentiation (note: NCD is automatically calculated, so differentiation is from distribution and underwriting). From our discussions with insurers, it appears that aggressive discounts are unlikely to be offered.

Expect smooth transition: We expect transition of auto-insurance pricing reform to be smooth, especially for large insurers (even though consolidations among smaller players could happen over time); given **1)** Relatively tight regulator control and gradual roll-out; **2)** Limited capacity to compete for smaller insurers; **3)** Rising profit focus among large insurers.

Valuation/Risks

Our PT implies 2.5x 15E P/B (vs 5-year historical average of 2.2x). Maintain BUY. **Risks:** deterioration of A-shares; irrational competition triggered by deregulation.

RMB	Prev.	2013A	Prev.	2014A	Prev.	2015E	Prev.	2016E
Combined Ratio	--	96.7%	--	96.5%	--	96.4%	--	96.4%
ROE	--	20.5%	--	21.1%	--	18.2%	--	17.9%
BV/Share	--	4.23	--	5.78	--	6.84	--	7.80
EPS								
FY Dec	--	0.82	--	1.06	--	1.15	--	1.31
FY P/E		17.3x		13.4x		12.4x		10.8x

BUY

Price target HK\$21.50
Price HK\$17.78

Bloomberg: 2328 HK
Reuters: 2328.HK

Financial Summary

Book Value (MM):	Rmb85,775.0
Book Value/Share:	Rmb5.78
Net Debt (MM):	Rmb22,449

Market Data

52 Week Range:	HK\$20.15 - HK\$10.70
Total Entprs. Value (MM):	HK\$269,962.8
Market Cap. (MM):	HK\$241,879.1
Shares Out. (MM):	13,604.0
Float (MM):	4,599.5
Avg. Daily Vol.:	29,900,820

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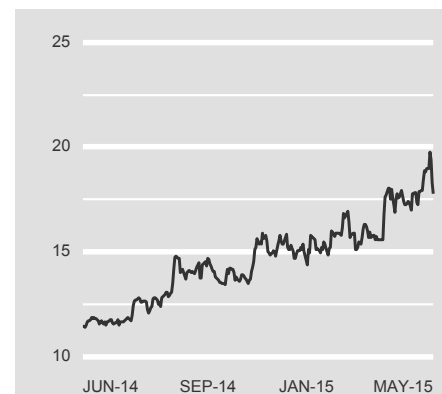
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Price Performance



Auto insurance deregulation updates

After a long period of discussions, trial program for auto insurance deregulation was launched recently in six provinces (Hei Long Jiang, Shan Dong, Guang Xi, Chong Qing, Shan Xi, Qing Dao), covering about 15% of the market in terms of premium income.

According to CIRC, 20 insurers have already obtained approvals for licenses under the new regulation, including:

Table 1: P&C insurers approved under post-deregulation framework

PICC P&C	Ping An P&C	CPIC P&C
Taiping P&C	China Life P&C	Sunshine Properties
Huatai Insurance	AXA Tianping	Samsung P&C
Generali Properties	Zking P&C	Liberty Mutual
Bohai P&C	China Continent P&C	Beibuwan Properties
Yong An P&C	China United P&C	Chang An Liabilities Insurance
Jintai P&C	Fu De P&C	

Source: CIRC

To recap, we have summarized some of the key changes of the reform in the remainder of the report.

Insurance terms

Original: Insurance companies are required to follow one of the three standardized liability terms approved by CIRC, namely Term A/B/C (Term A led by PICC P&C; Term B led by Ping An; Term C led by CPIC). Note that there is no significant difference between the three systems.

Post reform: A main liability framework will be provided by the Insurance Association, and insurers will be allowed to add on innovative coverage, subject to CIRC approvals. Post reform, auto insurers could enjoy several choices of liability terms, including:

- 1) Liability frameworks set by Insurance Association of China;
- 2) Individually developed innovative liability terms approved by CIRC; or
- 3) A combination of association framework and innovative liability terms.

Implications: According to local media, the mainstream strategy undertaken, so far, is to use association frameworks. We expect innovative terms to be gradually introduced.

Pricing mechanism

Original: Price = base price x NCD x other adjustment factors

Base price is provided by the regulators, and do not allow for any differentiations for different car types or potential cost of parts. The insurers are then able to charge using the below two factors:

- No claim discount (0.7x-1.3x);
- Other factors;

Combining the two factors, namely, [NCD x other adjustment factors], a 30% cap is applied (e.g. 0.7x-1.3x).

For telemarketing distributions, an additional 15% discount is allowed, in addition to the 0.7x-1.3x discount/premium charged.

Post reform, base price is expected to be stable comparing to the original system

Post reform: Price = base price x NCD x distribution x underwriting; where

Base price = pure risk premium / (1-loading)

Regulators now provide only expected loss guidance, namely, 'pure risk premium', which takes into account different expected costs of car brands. For example, car brands with higher part-repairs/whole ratio could result in higher pure risk premium.

Overall, pure risk premium is drafted to be equivalent to 65% of base price before deregulation. At the same time, insurers could set own expense loading to reach base price. Sector average loading is expected to be around 35%. As a result, value of base price post reform (i.e. [pure risk premium/(1-loading)]) is expected to be similar compared to the original system.

In terms of NCD factor, it will be automatically calculated and set by Association, ranging 0.6x-2.0x, compared to 0.7x-1.3x previously, to enhance matches between risk profiles and premium rates.

Table 1: NCD factor values before and after the reform

Claims record	NCD before deregulation	NCD post deregulation
No claims in past 3 years	0.70	0.60
No claims in past 2 years	0.80	0.70
No claims in last year	0.90	0.85
New underwriting	1.00	1.00
One claims last year	1.00	1.00
Two claims last year	1.00	1.25
Three claims last year	1.10	1.50
Four claims last year	1.20	1.75
Five or more claims last year	1.30	2.00

Source: Jefferies, Insurance Association of China

On top of NCD factor, additional discounts/premiums can be charged according to:

- Distribution factors (up to 0.85x-1.15x);
- Underwriting factors (up to 0.85x-1.15x).

Both factors offer meaningful instruments for insurers to differentiate in terms of pricing, in our view.

Implications: All inclusive, range of discount/premium move from 0.7x-1.3x (excluding telemarketing) to 0.43x -2.65x.

Table 3: Pricing discounts under original and new system

	Original	New
NCD	0.7x-1.3x	0.6x-2.0x
Distribution		0.85x-1.15x
Underwriting		0.85x-1.15x
Range before telemarketing	0.7x-1.3x	0.43x-2.65x
Telemarketing	0.85x	

Source: CIRC

Note: 0.43=0.6x0.85x0.85; 2.65 = 2.0x1.15x1.15

From our discussions with insurers, it appears that aggressive discounts are unlikely to be offered; the key priority is to ensure smooth transition and maintain profitability.

Expect smooth transition

We expect transition of auto insurance deregulation to be smooth, especially for large insurers, given:

- Relatively tight regulator control and gradual rollout;
- Limited capacity to compete for smaller insurers;
- Rising profit focus among large insurers.

In 2014, we notice that underwriting results for middle-sized P&C insurers were already in loss territory. Average combined ratio of middle-sized insurers was recorded at around 103% for both 2013 and 2014, indicating limited capacity of aggressive strategies for smaller market participants.

Table 2: Business fundamentals of China Top20 P&C insurers

Rank	Corporate names (CH)	Corporate names (ENG)	Premium (RMB'mn)	Mkt share	2013 COR	2014 COR	2013 expense ratio	2014 expense ratio	2013 claims ratio	2014 claims ratio
1	人保股份	PICC P&C	252,419	33.5%	96.7%	96.5%	30.5%	32.2%	66.2%	64.3%
2	平安财	Ping An P&C	142,857	19.0%	97.3%	95.3%	36.8%	37.6%	60.5%	57.7%
3	太保财	China Pacific Property	92,837	12.4%	99.5%	103.8%	33.5%	35.7%	66.0%	68.1%
4	国寿财产	China Life P&C	40,397	5.4%	102.6%	101.0%	38.3%	39.4%	64.3%	61.6%
5	中华联合	China United Property	34,865	4.7%	99.4%	98.2%	35.8%	36.6%	63.6%	61.6%
6	大地财产	China Continent P&C	22,358	3.0%	103.6%	100.4%	39.0%	41.4%	64.6%	59.0%
7	阳光财产	Sunshine P&C	21,173	2.9%	105.2%	101.4%	43.0%	43.8%	62.2%	57.6%
8	出口信用	Export and Credit Ins.	18,118	2.5%						
9	太平保险	Taiping General	13,270	1.8%	99.8%	99.8%	47.0%	45.4%	52.8%	54.4%
10	天安	Tianan Insurance	11,153	1.5%	103.1%	114.4%	43.9%	53.2%	59.2%	61.2%
11	华安	Sinosafe Insurance	7,616	1.0%	104.7%	103.9%	48.4%	51.9%	56.3%	52.0%
12	永安	Yongan Insurance	6,994	1.0%	107.7%	100.5%	42.6%	41.6%	65.2%	58.9%
13	安盛天平	AXA Tianping	6,617	0.9%	105.9%	106.4%	46.2%	52.0%	59.7%	54.4%
14	英大财产	Yingda Taihe P&C	6,512	0.9%	99.5%	101.6%	42.2%	41.2%	57.3%	60.4%
15	华泰	Huatai Insurance	6,372	0.9%	100.3%	100.4%	38.6%	47.3%	61.6%	53.1%
16	永诚	Alltrust Insurance	5,844	0.8%	111.8%	107.8%	49.8%	48.0%	62.0%	59.8%
17	中银保险	BOC Insurance	5,325	0.7%	95.1%	96.9%	42.9%	38.1%	52.2%	58.8%
18	安邦	Anbang Insurance	5,135	0.7%						
19	都邦	Dubon Insurance	3,576	0.5%	98.1%	104.6%	44.8%	49.9%	53.2%	54.7%
20	信达财险	Cinda P&C	3,512	0.5%	109.5%	111.4%	50.7%	54.7%	58.7%	56.7%
Mid-size (Avg)			218,838	29.8%	103.1%	103.3%	43.6%	45.6%	59.5%	57.6%

Source: Jefferies, company data

Note: An Bang P&C experienced large interest expense in 2014, leading to abnormally high expense ratios for 2013 and 2014. As a result, we exclude the company's combined ratio data from the table.

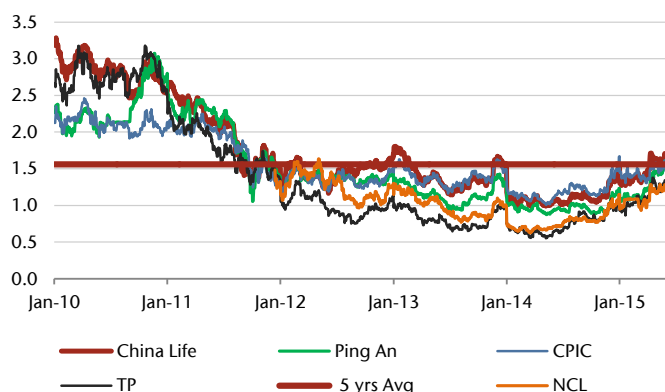
Valuation

Chart 1: China insurance valuation

Ticker	Price (HK\$)	P/EV			NBVM			P/E			P/B			Ratings	
		2014	2015E	2016E	2014	2015E	2016E	2014	2015E	2016E	2014	2015E	2016E		
2628 HK	China Life - H	37.25	1.85 x	1.59 x	1.41 x	16.7 x	12.1 x	8.5 x	26.2 x	22.5 x	19.6 x	2.97 x	2.67 x	2.40 x	HOLD
2318 HK	Ping An - H	114.10	1.77 x	1.50 x	1.30 x	16.1 x	10.3 x	6.1 x	19.5 x	16.6 x	13.4 x	2.81 x	2.32 x	1.98 x	BUY
2601 HK	CPIC - H	39.95	1.69 x	1.47 x	1.29 x	13.6 x	8.9 x	5.4 x	26.3 x	18.6 x	16.3 x	2.48 x	2.25 x	2.05 x	BUY
1336 HK	NCL - H	49.50	1.45 x	1.20 x	1.03 x	7.8 x	3.6 x	0.5 x	19.3 x	15.8 x	12.7 x	2.56 x	2.18 x	1.85 x	BUY
966 HK	CTIH	31.60	1.57 x	1.32 x	1.14 x	11.0 x	5.8 x	2.6 x	21.7 x	21.6 x	18.7 x	2.41 x	2.15 x	1.91 x	BUY
1339 HK	PICC Group	5.50	1.78 x	1.51 x	1.32 x	n/a	n/a	n/a	14.3 x	12.0 x	10.3 x	2.02 x	1.70 x	1.44 x	HOLD
Average			1.69 x	1.43 x	1.25 x	13.1 x	8.2 x	4.6 x	21.2 x	17.9 x	15.2 x	2.54 x	2.21 x	1.94 x	
2328 HK	PICC P&C	17.78							13.4 x	12.4 x	10.9 x	2.46 x	2.08 x	1.83 x	BUY
	*Implied PICC Life & Health		0.85 x	0.75 x	0.66 x	-2.3 x	-4.3 x	-6.0 x				1.14 x	0.99 x	0.82 x	
1299 HK	AIA	51.05	2.16 x	1.94 x	1.73 x	23.6 x	17.9 x	13.1 x	24.7 x	21.6 x	20.2 x	2.69 x	2.45 x	2.24 x	BUY

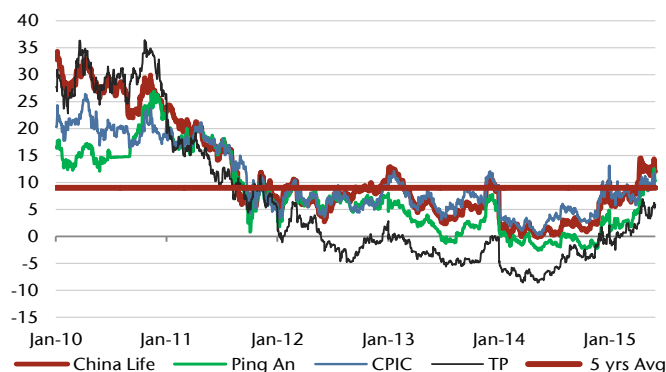
Source: Jefferies estimates, company data

Chart 2: H-shares P/EV 5 years



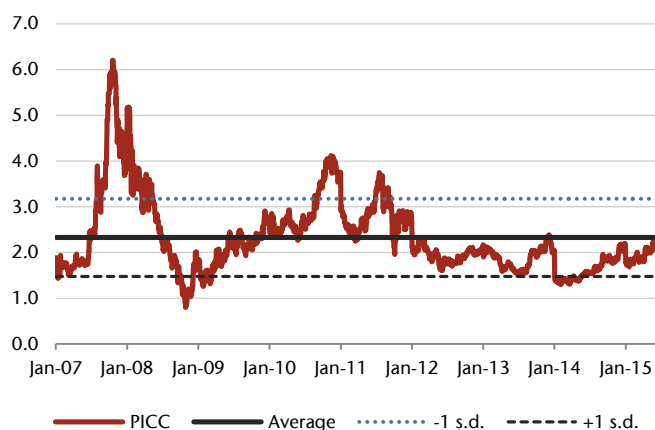
Source: Bloomberg; Jefferies Estimates

Chart 3: H-shares NBVM 5 years



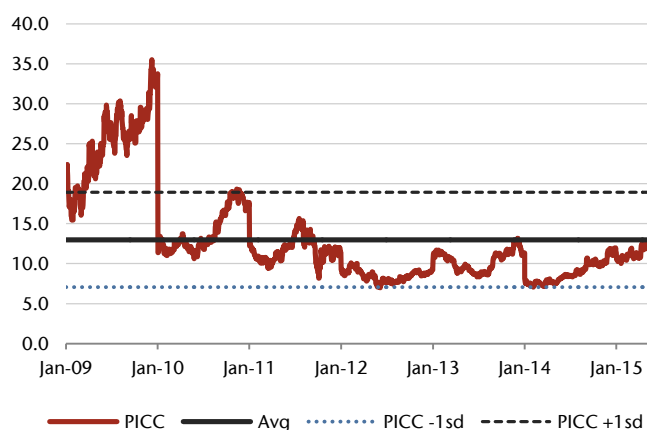
Source: Bloomberg; Jefferies estimates

Chart 4: PICC P&C historical P/B



Source: Bloomberg; Jefferies Estimates

Chart 5: PICC P&C historical P/E



Source: Bloomberg; Jefferies estimates

Company Description

PICC P&C is the leading P&C insurer in China, with market share of 36.3% in 2011 based on gross premiums.

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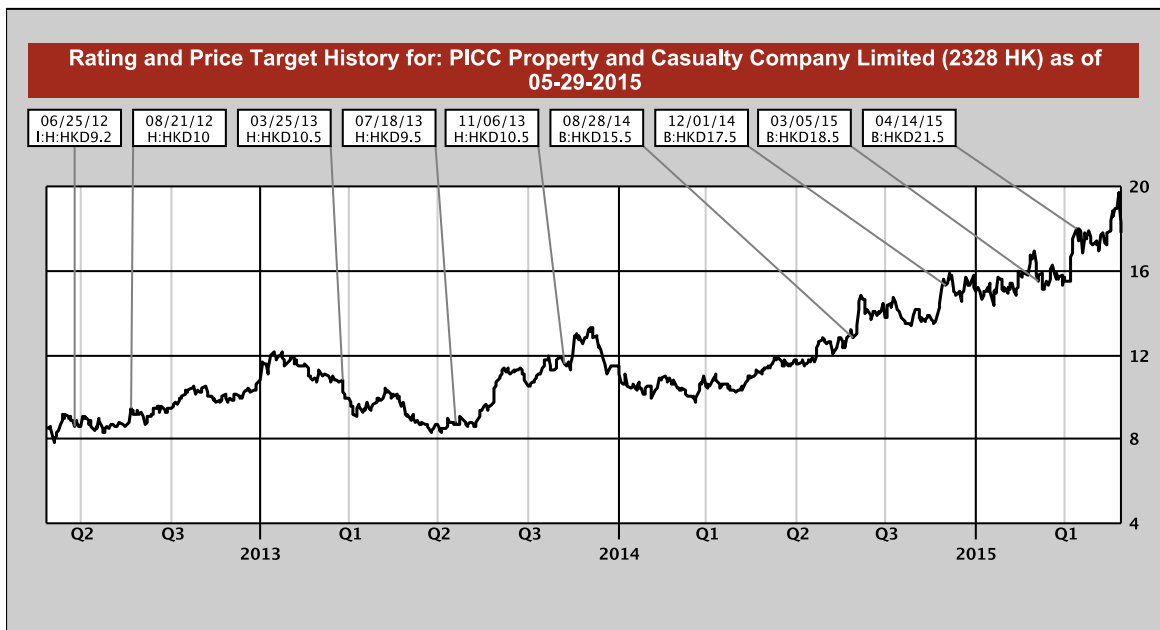
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- AIA Group Limited (1299 HK: HK\$51.05, BUY)
- China Life Insurance Company Limited (2628 HK: HK\$37.25, HOLD)
- China Pacific Insurance (Group) Co., Ltd. (2601 HK: HK\$39.95, BUY)
- China Taiping Insurance Holdings Company Limited (966 HK: HK\$31.60, BUY)
- New China Life Insurance Company Ltd. (1336 HK: HK\$49.50, BUY)
- PICC Group (1339 HK: HK\$5.50, HOLD)
- PICC Property and Casualty Company Limited (2328 HK: HK\$17.78, BUY)
- Ping An Insurance (Group) Company of China, Ltd. (2318 HK: HK\$114.10, BUY)



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			Count	Percent
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