

# AIA Group

## 1H15 expected to surprise positively on HK/China

### Upgrading to Buy, HK market performance expected to be strong

AIA's share price has underperformed HSI, HSCEI and HSCEI financials index by 6-11% in 2Q where the average P/EV gap between AIA and its Chinese peers has narrowed down from over 50% to around 20% over the past nine months. We believe that AIA's strong franchise, superior management and powerful free cashflow surplus generation would help the stock maintain a strong P/EV premium vs its Chinese peers for as long as AIA continues to deliver strong VoNB growth. We are upgrading AIA to a Buy where we expect strong H115 result to be a positive stock re-rating catalyst.

### Upgrading our FY15 VoNB growth forecast to 29%/40% for HK/China

Despite changes on investment immigration policy announced by the HK government, new premium sales driven by strong fundflows into HK is expected to positively surprise the market for 1H15. We expect AIA Hong Kong to report strong ANP growth in H115 and we have upgraded our FY15E AIA HK VoNB forecast from 18% to 29%. Strong HK/China markets (representing 44% of total FY14 VoNB) is expected to remain a key driver for AIA's VoNB growth into FY16. We also revised up our FY15E NPAT by 7%.

### Slower US rate rising cycle and strong Asian markets helps investment results

AIA had seen some impact of slower bancassurance growth in some ASEAN markets during FY14 where fundflows were affected by changing global rate environments. With US Fed's more delayed rate rise policy direction and YTD strong Asian equities markets, these impacts are not expected to affect 1H15 result as much. Together with strong active agency growth during 2H14, AIA is expected to hold up its position well despite increasing competition in Malaysia and Indonesia from peers.

### Valuation: Buy rating with new PT of HK\$57.50

We raise our price target by 7% to HK\$57.50 as we forecast stronger VoNB supported by HK/China market and higher EV profit supported by investment income. Our DCF-based price target is equivalent to 2.1x 2015E implied P/EV (previously 2.0x) and 20.6x 2015E NBV (previously 19.1x).

## Equities

Hong Kong  
Insurance, Full-Line

**12-month rating** **Buy**  
Prior: Neutral

**12m price target** **HK\$57.50**  
Prior: HK\$53.75

**Price** **HK\$50.50**

**RIC:** 1299.HK **BBG:** 1299 HK

### Trading data and key metrics

**52-wk range** HK\$53.75-38.30

**Market cap.** HK\$608bn/US\$78.5bn

**Shares o/s** 12,044m (ORD)

**Free float** 100%

**Avg. daily volume ('000)** 27,549

**Avg. daily value (m)** HK\$1,410.4

**Common s/h equity (11/15E)** US\$34.0bn

**P/BV (11/15E)** 2.5x

### EPS (UBS, diluted) (US\$)

	From	To	% ch	Cons.
<b>11/15E</b>	0.34	0.37	7.17	0.32
<b>11/16E</b>	0.37	0.38	1.60	0.35
<b>11/17E</b>	0.40	0.40	0.32	0.40

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Highlights (US\$)	11/12	11/13	11/14	11/15E	11/16E	11/17E	11/18E	11/19E
EPS (local GAAP, diluted)	0.25	0.24	0.29	0.37	0.38	0.40	0.44	0.39
EPS (UBS, diluted)	0.25	0.24	0.29	0.37	0.38	0.40	0.44	0.39
Emb value EPS (UBS)	0.29	0.17	0.20	0.43	0.48	0.50	0.53	0.55
Emb value per share (UBS)	2.62	2.82	3.09	3.50	3.93	4.12	4.33	4.55
DPS (US\$)	0.05	0.05	0.06	0.09	0.09	0.09	0.10	0.11
TNAV per share (UBS)	2.20	1.95	2.39	2.66	2.95	3.25	3.59	3.94
Profitability/valuation	11/12	11/13	11/14	11/15E	11/16E	11/17E	11/18E	11/19E
P/E (local GAAP, diluted) x	13.9	18.8	17.8	17.7	17.2	16.2	14.9	16.5
P/Emb value EPS (UBS) x	12.1	25.7	25.4	15.1	13.6	13.0	12.4	11.8
P/EV per share (UBS) x	1.3	1.6	1.7	1.9	1.7	1.6	1.5	1.4
RoEV (UBS) %	11.9	6.3	6.8	13.1	12.9	12.5	12.5	12.5
Return on TNAV (UBS) %	12.7	11.3	13.3	14.6	13.6	13.0	12.8	10.5
Net dividend yield %	1.4	1.2	1.3	1.3	1.4	1.5	1.6	1.7

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of HK\$50.50 on 18 Jun 2015 16:56 HKT

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# Investment Thesis

## AIA Group

### Investment case

AIA recorded strong growth in the number of active new agents in FY14 (up 14% YoY). The number of active new agents rose 42% for AIA China, while growing double-digit in Malaysia/Singapore/Hong Kong. In our view, the FY14 results have not fully reflected these upgrades in distribution. AIA has also built a strong foundation for the AIA-Citi alliance in 2014 to support ANP growth in the next two years. In 2015, stronger than expected HK/China markets are expected to drive home strong VoNB results. We continue to believe that AIA can deliver sustainable ROEV growth of 13-14% with its strong franchise and management. The strong core EV profit should help AIA maintain a P/EV premium vs Chinese peers. With recent share price weakness, we view the H115 result a potential stock price re-rating catalyst and upgraded AIA to Buy from Neutral. Our DCF-based price target implies 2.1x FY15E P/EV (previously 2.0x) and 20.6x FY15E VoNB (previously 19.1x).

### Upside scenario

In our upside scenario, we assume FY15/FY16/FY17 RoEV of 15.0%/14.7%/14.3% compared to our base case assumptions of 13.3%/13.0%/12.7%. This assumes an even stronger RoEV expansion due to better-than-expected results with increasing contributions from higher-margin markets such as Hong Kong, China and Singapore. In this case, we would estimate a valuation of HK\$61.27 per share.

### Downside scenario

In our downside scenario, we assume FY15/FY16/FY17 RoEV of 13%/11%/10%, with a more volatile ASEAN market. In this case, we would estimate a valuation of HK\$51.42 per share.

### Upcoming catalysts

We believe the potential catalysts include: 1) continued VoNB growth in FY15; 2) further capital management improvements (which could provide an additional re-rating catalyst); and 3) further details on the AIA-Citi partnership.

12-month rating

Buy

12m price target

HK\$57.50

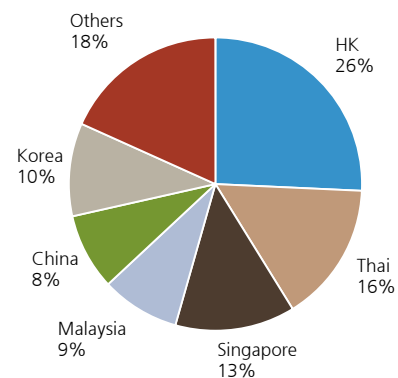
### Business description

AIA Group and its subsidiaries is the largest independent publicly listed pan-Asian life insurance group. It operates in 17 markets in Asia with wholly-owned branches and subsidiaries in Australia, Brunei, China, Hong Kong, Indonesia, Korea, Macau, Malaysia, New Zealand, the Philippines, Singapore, Taiwan, Thailand, Vietnam, and a 97%-owned subsidiary in Sri Lanka, a 26%-owned joint venture in India and a representative office in Myanmar.

### Industry outlook

Rising global yields could pose as a challenge to the asset liability management of life insurers in the region, especially those with exposure to the ASEAN markets. Overall, we still expect robust growth opportunities for AIA, with strong economic growth and rising demand for protection insurance products in the region.

### ANP by region as of FY14



Source: Company data

### ANP by region (FY13-17E)

US\$ mn	FY13	FY14	FY15E	FY16E	FY17E
HK	781	952	1,285	1,478	1,655
Thai	565	572	642	733	827
Singapore	400	489	546	583	630
Malaysia	319	320	368	405	445
China	249	311	453	566	679
Korea	338	380	437	472	505
Others	689	676	682	757	810
<b>Group</b>	<b>3,341</b>	<b>3,700</b>	<b>4,413</b>	<b>4,994</b>	<b>5,552</b>

Source: Company data, UBS estimates.

## Upgrading to Buy, 1H15 to surprise positively

Figure 1: VoNB forecasts in FY15

VoNB (US\$m)	New	Old	% change	% of total Group VoNB
Hong Kong	797	730	9%	35%
China	362	320	13%	16%
Group	2,283	2,169	5%	100%
VoNB YoY growth (%)	New	Old	% change	
Hong Kong	29%	18%	11%	
China	40%	24%	16%	
Group	24%	18%	6%	

Source: UBS estimates

**AIA has a lot of room still to deliver agency business improvements:** We view AIA's strong active agency growth in 2014 to drive home a strong result for FY15. In particular, AIA China, increased their active new agents by 42% during 2014. Active new agents also grew by double-digit in Malaysia, Singapore and HK in 2014. In our view, the FY14 results have not fully reflected these distribution upgrades and we expect AIA to report double-digit active agency growth across the group for 1H15.

**HK/China expected to be a key growth driver for 2015:** Our on the ground discussions with selective HK life insurance agency directors, company managements and industry bodies such as HKFI (HK Federation of Insurers) have led us to believe that new premium sales contribution by Mandarin speakers in HK during 1H15 can contribute up to 30-50% of a majority of HK life insurance agents, where average ticket size could be as much as 100% higher than HK locals.

Despite changes on investment immigration policy announced by the HK government, new premium sales driven by strong fundflows into HK is expected to positively surprise the market for 1H15. We have upgraded our FY15E AIA HK VoNB forecast from 18% to 29%. We also revised up our FY15 NPAT by 7%. Our FY15 NPAT forecast is 17% above consensus.

Figure 2: UBS versus consensus

NPAT (US\$m)	FY15E	FY16E	FY17E
UBS forecasts	4,420	4,559	4,829
Bloomberg consensus	3,774	4,286	4,822
UBS vs consensus %	17%	6%	0%

Source: Bloomberg, UBS estimates. Data as of 18 June 2015.

**More delayed US rate rising cycle helpful:** AIA had seen some impact of slower bancassurance growth in some ASEAN markets during FY14 where fundflows were affected by the changing global rate environments. With US Fed's more delayed rate rise policy direction and YTD strong Asian equities markets, these impacts are not expected to affect 1H15 result as much.

In our view, step-up efforts by AIA's major regional peers such as Prudential Asia and Manulife in Indonesian and Malaysian markets had somewhat intensified the overall competitive environment during 2013-14. On the other hand, provided

overall macro environment remains stable, AIA's strong active agency growth and major distribution efficiency improvement efforts deployed in markets such as Indonesia during 2014 will help the company to hold up its position well in the lucrative ASEAN region.

**Recent stock price weakness a good opportunity:** AIA's share price has underperformed HSI, HSCEI and HSCEI financials index by 6-11% in 2Q where the average P/EV gap between AIA and its Chinese peers has narrowed down from over 50% to around 20% over the past nine months. We believe that AIA's strong franchise, superior management and powerful free cashflow surplus generation would help the stock maintain a strong P/EV premium vs its Chinese peers for as long as AIA continues to deliver strong VoNB growth. We are upgrading AIA to a Buy where we expect strong H115 result to be a positive stock re-rating catalyst.

## Summary of forecast revisions

- We revise up FY15/FY16/FY17E annualized new premium (ANP) growth for Hong Kong market by 17% driven by strong investment demands from mainland China customers. We thus upgrade FY15 AIA HK VoNB forecast from 18% to 29%.
- Given strong agency force growth and improving productivity in AIA China and Malaysia, we upgrade these two markets' VoNB forecast from 24%/25% to 40%/30% in FY15, respectively.
- We also adjust our currency impact assumptions on the regional market to reflect the US dollar's strength YTD.
- As a result, our FY15/FY16/FY17 NPAT estimates rose by 7.2%/1.6%/0.3%.

**Figure 3: Summary of forecast revisions**

<b>NPAT</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
New	4,420	4,559	4,829
Old	4,124	4,483	4,806
% change	7%	2%	0%
<b>EPS in HK\$</b>			
	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
New	2.85	2.94	3.12
Old	2.66	2.89	3.10
% change	7%	2%	0%
<b>DPS/sh in HK\$</b>			
	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
New	0.67	0.69	0.73
Old	0.63	0.68	0.73
% change	7%	2%	0%
<b>VoNB</b>			
	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
New	2,283	2,637	2,967
Old	2,169	2,465	2,772
% change	5%	7%	7%
<b>VoNB growth</b>			
	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
New	24%	16%	12%
Old	18%	14%	12%
% change	6%	2%	0%
<b>Operating PAT</b>			
	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
New	3,458	3,714	3,985
Old	3,475	3,731	3,975
% change	-1%	0%	0%

Source: UBS estimates

**Figure 4: Forecast revisions on ANP and VoNB by region**

<b>VoNB by market</b> <b>(US\$mn)</b>	<b>Now</b>				<b>Before</b>			
	<b>ANP</b>		<b>VONB</b>		<b>ANP</b>		<b>VONB</b>	
	<b>2015E</b>	<b>2016E</b>	<b>2015E</b>	<b>2016E</b>	<b>2015E</b>	<b>2016E</b>	<b>2015E</b>	<b>2016E</b>
Hong Kong	1,285	1,478	797	931	1,123	1,292	730	814
Thailand	642	733	417	476	632	725	411	471
Singapore	546	583	339	362	546	583	339	362
Malaysia	368	405	210	235	352	387	201	225
China	453	566	362	436	400	500	320	385
Korea	437	472	87	104	437	463	87	102
Others	682	757	241	282	692	768	244	286
<b>Total (pre adj.)</b>	<b>4,413</b>	<b>4,994</b>	<b>2,453</b>	<b>2,825</b>	<b>4,183</b>	<b>4,718</b>	<b>2,332</b>	<b>2,644</b>
Adj. on reserving / capital			-50	-50			-50	-50
Unallocated expenses			-119	-138			-114	-129
<b>Total (post adj.)</b>	<b>4,413</b>	<b>4,994</b>	<b>2,283</b>	<b>2,637</b>	<b>4,183</b>	<b>4,718</b>	<b>2,169</b>	<b>2,465</b>

Source: UBS estimates

## Valuation

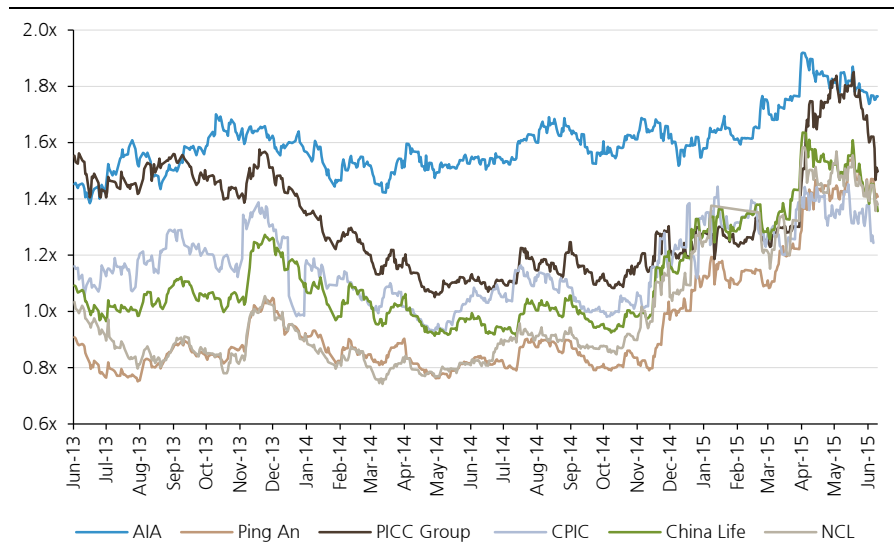
We increase our price target from HK\$53.75 to HK\$57.50 as we forecast stronger NBV supported by HK/China market and higher EV profit supported by investment income. Our DCF-based price target is equivalent to 2.1x 2015E implied P/EV (previously 2.0x) and 20.6x 2015E NBV (previously 19.1x).

**Figure 5: PT derivation**

DCF using EV Op Profits	2015E	2016E	2017E
EV Operating Profits	5,197	5,735	6,251
<b>COE</b>	<b>11.0%</b>		
<b>Terminal Growth</b>	<b>4.0%</b>		
PV of 3 year EV Op Profits*	5,197	5,167	6,251
PV of Terminal Value @11%			72,477
Valuation @11% COE/Discount Rate			89,092
Weighted Number of Shares			12,009
Valuation per share US\$			7.42
<b>Valuation per share HK\$</b>			<b>57.50</b>

Source: UBS estimates

**Figure 6: AIA's 12-month forward target P/EV vs Chinese peers**



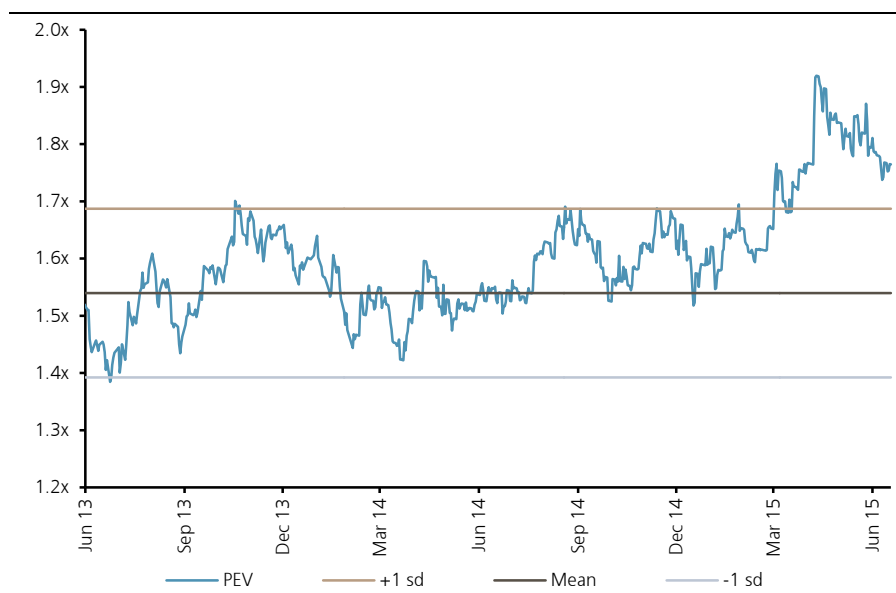
Source: Company data, UBS estimates. Data as of 18 June 2015.

**Figure 7: Company current price valuation**

Company	Rating	Target price (LC)	Price (LC)	Upside %	Market cap US\$m	CP implied P/EV (x) 15E	PT implied P/EV (x) 15E
China Life	Neutral	39.00	33.95	15%	123,772	1.45	1.67
Ping An	Buy	127.50	110.20	16%	129,917	1.51	1.75
CPIC	Neutral	43.50	38.15	14%	44,591	1.35	1.54
PICC Group	Neutral	5.27	4.70	12%	25,718	1.58	1.77
NCI	Neutral	51.00	47.60	7%	26,152	1.49	1.59
AIA	Buy	57.50	50.50	14%	78,450	1.86	2.12
China Life - A	Buy	47.31	33.43	42%	152,214	1.81	2.57
Ping An - A	Buy	110.43	84.00	31%	123,680	1.46	1.92
CPIC - A	Buy	48.45	30.97	56%	45,210	1.39	2.17

Source: UBS estimates. Data as of 18 June 2015.

**Figure 8: 12-month forward target P/EV**



Source: Company data, UBS estimates. Data as of 18 June 2015.

### Forecast returns

Forecast price appreciation	+13.9%
Forecast dividend yield	1.3%
Forecast stock return	+15.2%
Market return assumption	6.5%
Forecast excess return	+8.7%

## Statement of Risk

As a large life insurance company operating in 15 markets around Asia, AIA Group (AIA) is subject to market, regulatory and operational risks. For example, with around 80% of its investment portfolio invested in cash and bonds, its returns are sensitive to prevailing interest rates in the economies in which it operates. The group's main reporting currency is US dollar, which also leaves its results sensitive to fluctuations in the currencies of the group's main markets (including Hong Kong and Singapore). One of the primary methodologies used to value the company relies on the group's published embedded value and value of new business numbers. These are subject to many different assumptions and can be adversely impacted by unfavourable outcomes in terms of mortality, morbidity, investment returns, and expenses.



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12-Month Rating	Definition	Coverage <sup>1</sup>	IB Services <sup>2</sup>
<b>Buy</b>	FSR is > 6% above the MRA.	45%	37%
<b>Neutral</b>	FSR is between -6% and 6% of the MRA.	43%	33%
<b>Sell</b>	FSR is > 6% below the MRA.	12%	20%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
<b>Buy</b>	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
<b>Sell</b>	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 March 2015.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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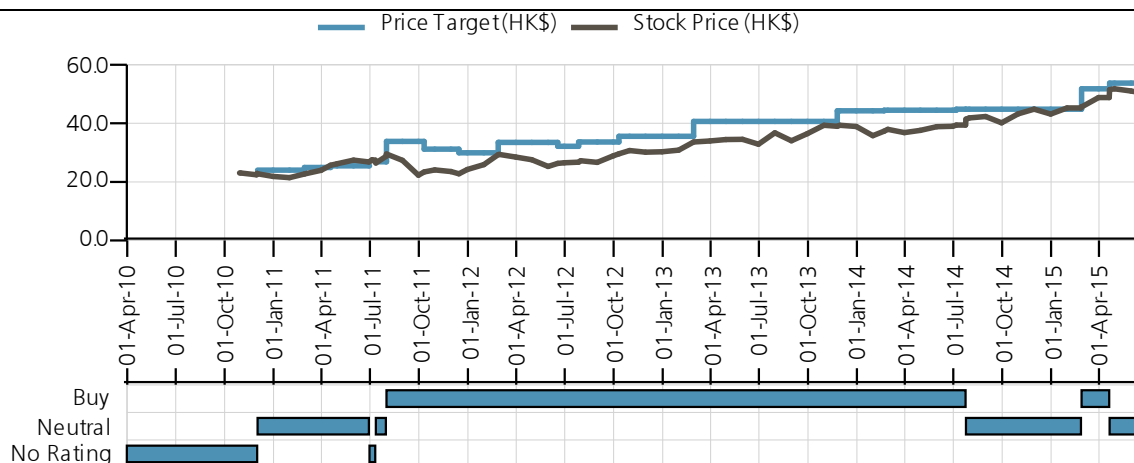
Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>AIA Group</b> <sup>16</sup>	1299.HK	Buy	N/A	HK\$50.50	17 Jun 2015

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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### AIA Group (HK\$)



Source: UBS; as of 17 Jun 2015

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