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SWS RESEARCH

Financials | Company In-depth Research

Bringing China to the World

14 January 2019

买入
首次覆盖

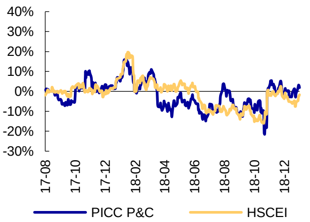
马太效应

中国财险 (02328:HK)

Market Data: 11 January 2019

Closing Price (HK$)	8.06
Price Target (HK$)	10.08
HSCEI	10,455
HSCCI	4,275
52-week High/Low (HK$)	17.40/7.31
Market Cap (US$m)	22,867
Market Cap (HK$m)	179,280
Shares Outstanding (m)	22,242
Exchange Rate (Rmb-HK$)	1.14

Price Performance Chart:



Source: Wind

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Financial summary and valuation

	2016	2017	2018E	2019E	2020E
Revenue (Rmbm)	311,160	350,314	395,155	450,367	518,093
YoY (%)	10.46	12.58	12.80	13.97	15.04
Net profit (Rmbm)	18,020	19,807	18,497	23,200	27,786
YoY (%)	(17.52)	9.92	(6.61)	25.42	19.77
EPS (Rmb)	0.81	0.89	0.83	1.04	1.25
Diluted EPS (Rmb)	0.81	0.89	0.83	1.04	1.25
ROE (%)	15.79	15.69	12.88	14.21	15.14
Dividend yield (%)	2.90	3.18	2.97	3.72	4.45
PE (x)	8.75	7.96	8.53	6.80	5.68
PB (x)	0.88	0.79	1.02	0.91	0.81

Note: Diluted EPS is calculated as if all outstanding convertible securities, such as convertible preferred shares, convertible debentures, stock options and warrants, were exercised.

人保财险是中国最大的财产险公司，提供包括汽车保险，意外伤害保险和责任保险等产品。我们认为公司将继续实现承保利润和稳定的投资回报，车险和非车险业务的市场份额进一步增长将有效的推动收入增长。我们预测 18E 的每股收益为 0.83 元（同比下降 6.7%），19E 的每股收益为 1.04 元（同比增长 25.3%），20E 的每股收益为 1.25 元（同比增长 20.2%）。由于我们的目标价 10.08 港元（1.14 倍 19E PB）距离现价还有 25%的上行空间，我们首次覆盖给予买入评级。

规模效益。人保财险具有显着的规模经济效益。2018 年上半年，其承保费用率达到 32.3%（同比增长 0.2 个百分点），而其管理费用率仅为 2.4%（同比持平）。此外，由于直接销售渠道占比行业领先（2018 年上半年达到直接承保保费总额的 27.6%），公司受益于较低的佣金费用。我们预测 18E 的综合成本率为 97.6%，19E 为 97.5%，20E 为 97.0%（过去五年平均为 97%）。由于公司较其 15 个最大竞争对手的成本优势约为 5%，我们预计在车险保费日益市场化的进程下，人保财险的市场份额将进一步增长。可抵税的佣金率上限比例提高可以缓解佣金率上升对所得税费用的负面影响。

非车险增速。中国的财产险市场比其他大多数国家更倾向于车险业务。自 2010 年以来，车险保费占财产险总保费的 72%以上。我们预计人保财险的车险保费增长将在 2018-2020 年同比减速至约 10%，而我们对其他非车险业务的增长前景保持乐观，主要来自于消费者保险意识的增长和政府的政策支持。我们认为非车险业务将成为公司新的盈利推动因素，2018 - 2020 年非车险总保费收入同比增长 20%以上，占 2020 年总保费的 35%（对比 2017 年的占比 29%）。

首次覆盖，买入评级。由于其较低的费用率，人保财险可以抵消增长的赔付率，同时在中国竞争日益激烈的财产险市场中享有优势。加上稳定的投资回报，该公司仍然是全球最便宜的财产险股票之一（0.91x 19E PB），我们预测 2019 年股本回报率（ROE）为 14%，股息收益率为 3%。由于可抵税的佣金率上限提高的预期，我们预计人保财险的盈利在 18 年 4 季度增加。我们注意到该公司有足够的准备金来应对可能出现的负面承保业绩，而投资可能会带来积极的盈利影响。我们认为公司目前的估值水平提供了足够的安全边际，同时我们对公司基本面改善前景持乐观态度。我们通过 DDM 模型得出目标价 10.08 港元，相当于 1.14 倍 19E PB。我们的目标价距离现价还有 25%的上行空间，我们首次覆盖给予买入评级。

PICC Property & Casualty (PICC P&C) is China's largest property and casualty insurance company, offering a wide range of non-life insurance products, including auto insurance, accidental injury insurance, and liability insurance. We expect the firm to continue to deliver underwriting profit and stable investment returns, with top-line growth driven by further market share gains in both the auto and non-auto segments, amid a positive regulatory environment. We forecast EPS of Rmb0.83 in 18E (-6.7% YoY), Rmb1.04 in 19E (+25.3% YoY), and Rmb1.25 in 20E (+20.2% YoY). With 25% upside to our target price of HK$10.08 (1.14x 19E PB), we initiate coverage with a BUY rating.

Scale effect. PICC P&C enjoys significant economies of scale. In 1H18, its underwriting expense ratio reached 32.3% (+0.2ppts YoY), while its administrative expense ratio only amounted to 2.4% (flat YoY). Moreover, the firm benefits from lower commission fees thanks to direct sales (27.6% of total direct written premiums in 1H18). We forecast combined ratios of 97.6% in 18E, 97.5% in 19E, and 97.0% in 20E (vs 97% on average over the past five years). With a cost advantage of c.5% over its 15 largest competitors, we expect PICC P&C's market share to further grow, amid an increasingly liberalised auto insurance market. We also expect the negative impact of higher commission ratios on income tax expenses to be relieved under the expectation of tax-deductible commission ratio cap to be lifted above 15%.

Non-auto to take the lead. China's property and casualty insurance market is more skewed towards auto insurance than in most other countries. Auto premiums accounted for over 72% of total insurance premiums since 2010. We expect PICC P&C's auto premium growth to decelerate to c.10% YoY in 2018-20E, while we are positive on the growth prospects of other insurance segments, underpinned by rising insurance awareness and government support. We believe non-auto insurance will become the company's new earnings driver, with non-auto gross written premiums (GWP) to grow 20%-plus YoY in 2018-20E, accounted for 35% of total GWP in 20E (vs 29% in 17A).

Initiate with a BUY. Thanks to a lower expense ratio, PICC P&C has been able to offset its deteriorating loss ratio, while enjoying a sharp edge in China's increasingly competitive insurance market. Coupled with stable investment returns, the company remains one of the cheapest property and casualty insurance stocks worldwide (0.91x 19E PB), with a return on equity (ROE) of 14% and a dividend yield of 3% in 19E. We expect PICC P&C's earnings to increase in 4Q18, as new regulation helps improve its commission ratio. We note the firm has sufficient reserves to smooth out negative underwriting results, while investments may trigger a positive earnings surprise. We believe the current valuation level provides enough safety margin, while we are positive on the insurer's fundamentals improvement prospects. Using a dividend discount model (DDM), we derive a target price of HK$10.08, representing 1.14x 19E PB. With 25% upside, we initiate coverage of the company with a BUY recommendation.

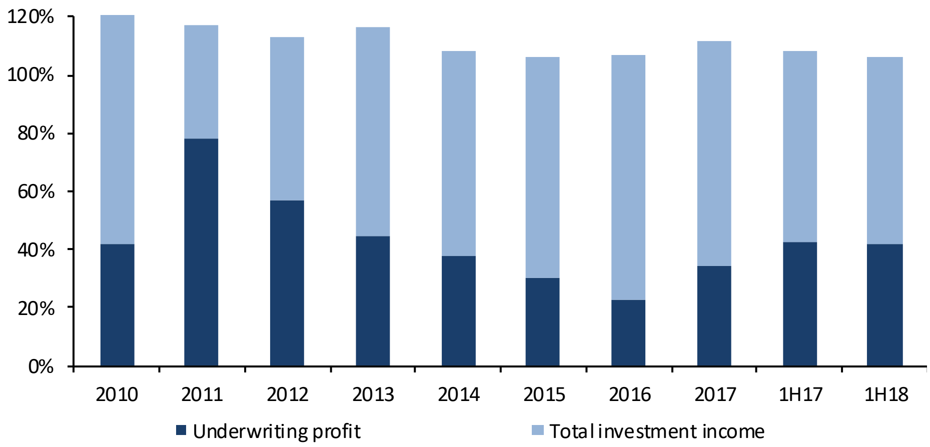
A P&C insurance leader

Property and casualty (P&C) insurance companies' profit is driven by both underwriting profit, on the liability side, and investment income, on the asset side. Due to the short-term nature of P&C insurance policies (usually shorter than a year), the time difference between premium collection and claim payments is relatively short. If claims and expenses are controlled within a reasonable range (resulting in a combined ratio of less than 100%), then the insurer can make underwriting profit. On the asset side, insurers can make investment income by investing collected premiums. The profit formula for P&C insurers can be summarised as follows:

P&C profit = Underwriting profit + Investment income = Net premium earned x (1 - Combined ratio) + Investment assets x Investment yield

We note leading P&C insurers in growth markets usually enjoy stable underwriting performance and stable income with a relatively conservative balance sheet (usually achieving higher ROE and stable dividend yields). As a leading P&C insurance company, PICC P&C has always outperformed its peers in terms of combined ratio, while posting stable underwriting profitability and investment returns. We expect the firm to continue to deliver underwriting profit and stable investment returns, with top-line growth driven by further market share gains in both the auto and non-auto segments, amid a positive regulatory environment. Thanks to a lower expense ratio, PICC P&C has been able to offset its deteriorating loss ratio, while enjoying a strong edge in China's increasingly competitive insurance market. We thus expect the firm's combined ratio to remain stable in the future. We also expect investment returns to be driven by longer asset duration, underpinned by Huaxia Bank's (600015:CH – Not rated) growing income. PICC P&C remains one of the cheapest P&C insurance stocks worldwide (0.91x 19E PB), with an ROE of 14% in 19E a dividend yield of 3%. We believe the stock is currently trading at an undervalued PB multiple.

Fig 1: Underwriting profit and total investment income as a percentage of profit before tax

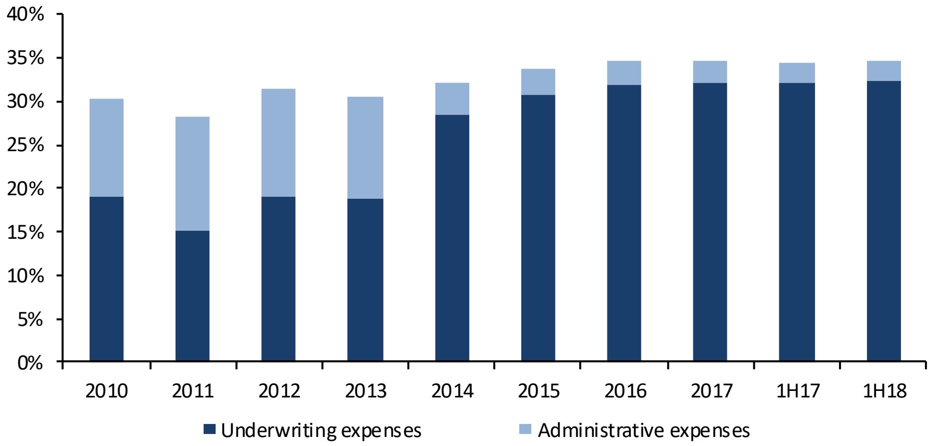


Source: Company data, SWS Research

Scale effect

PICC P&C's underwriting profit margin benefits from a significant scale effect, reaching 4.1% in 1H18 (around 3-4% in recent years). The firm's combined ratio amounted to 95.9% in 1H18 (+0.4ppts YoY), with a loss ratio of 61.2% (+0.3ppts YoY) and an expense ratio of 34.7% (+0.1ppt YoY). Meanwhile, the company's underwriting expense ratio reached 32.3% in 1H18 (+0.2ppts YoY). Thanks to its strong cost management capability, the firm's administrative expense ratio only totalled 2.4% in 1H18 (flat YoY).

Fig 2: Underwriting and administrative expenses as a percentage of earned premiums



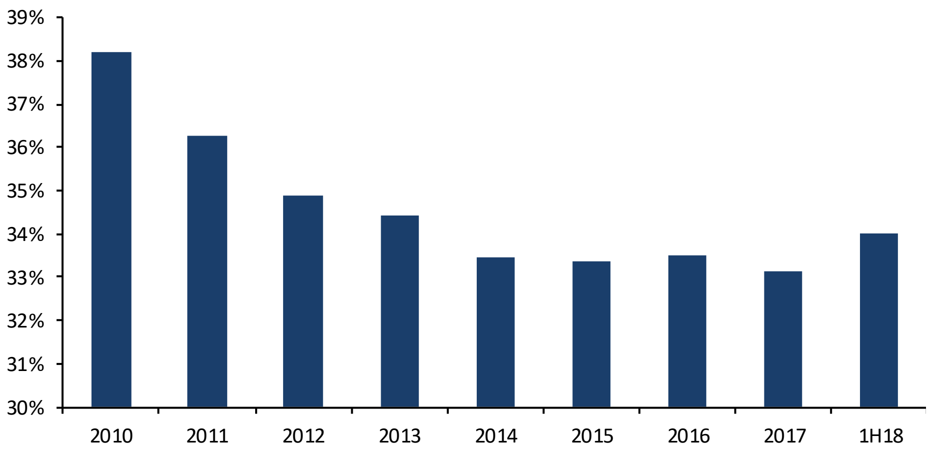
Source: Company data, SWS Research

Given the homogeneity of P&C insurance products, market players have increasingly focused on prices and services. Given the current liberalisation of auto insurance rates, prices are now close to their break-even level. As a result, major players are competing on costs, giving large listed insurers a significant edge given their scale. We expect leading P&C insurance companies to gain market share, increase their ROE, and improve their cost ratios, amid China's auto insurance liberalisation reforms.

Non-auto to take the lead

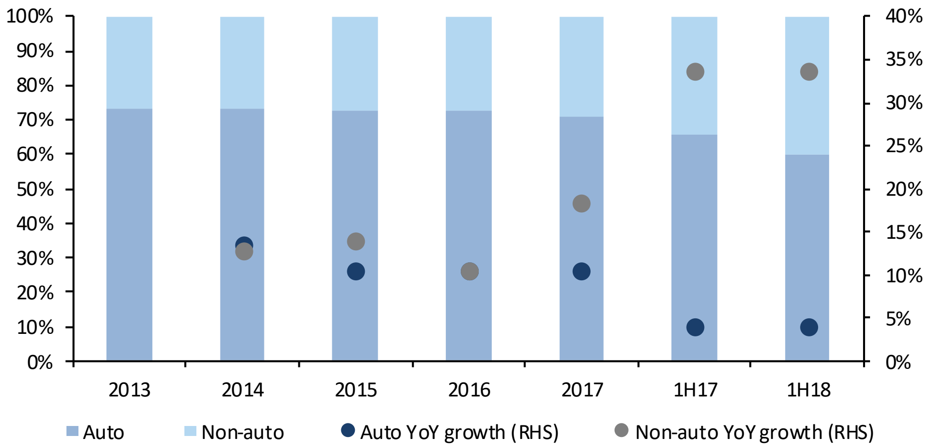
In 1H18, PICC P&C achieved total premium income of Rmb204.8bn, with a market share of 34.0% (+0.9ppts from end-2017), ranking first in the P&C insurance industry. We note all segments posted YoY premium growth in 1H18: +3.9% YoY for auto insurance premiums and +33.6% YoY for non-auto insurance premiums. Meanwhile, the proportion of non-auto insurance premiums in the firm's total insurance premiums increased 5.9ppts to 40.3%.

Fig 3: PICC P&C's market share



Source: Wind, SWS Research

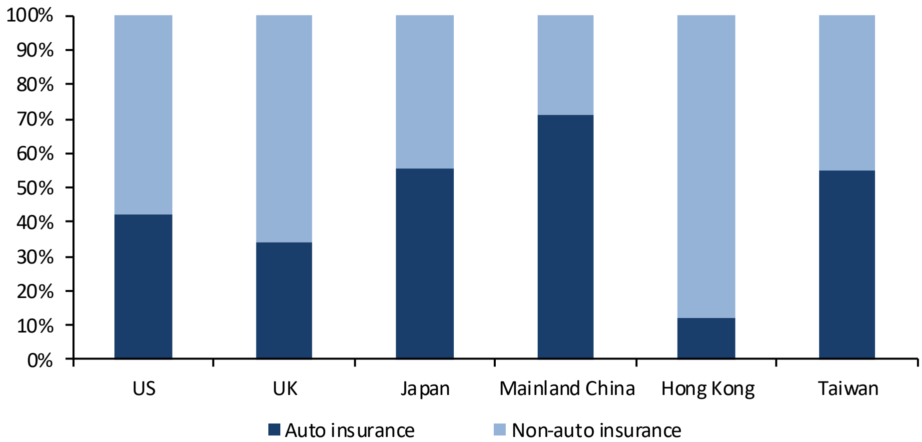
Fig 4: Auto and non-auto insurance premium breakdown



Source: Company data, SWS Research

China's P&C insurance market is more skewed towards auto insurance than in other countries. We are positive on the growth prospects of non-auto insurance segments, underpinned by rising insurance awareness and government support.

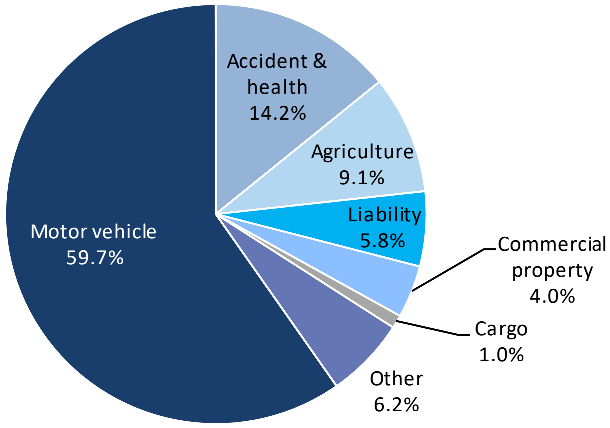
Fig 5: P&C insurance premium breakdown



Source: CEIC, Wind, SWS Research

We believe non-auto insurance will become the company's new earnings driver, with non-auto GWP to grow 20%-plus YoY in 2018-20E. We expect accident & health, agriculture, liability, and credit & guarantee to be the fastest growing non-auto segments for PICC P&C in 2018-20E. We forecast the proportion of non-auto insurance in the firm's total GWP to increase from 29% in 17A to 35% in 20E.

Fig 6: PICC P&C's insurance premium breakdown in 1H18

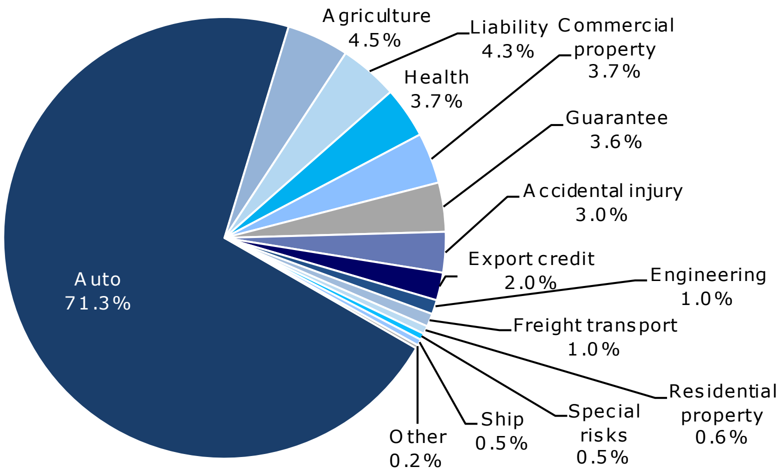


Source: Company data, SWS Research

Auto premiums to maintain stable growth

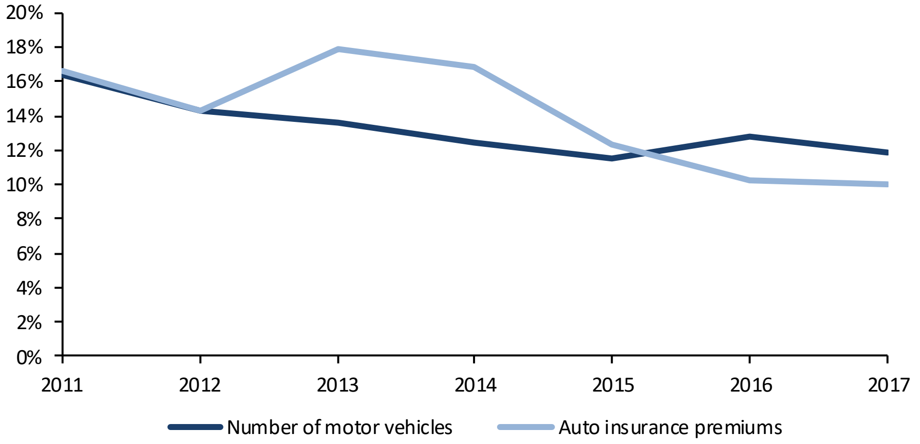
China's P&C insurance market is mainly driven by auto insurance, which has accounted for over 72% of the total market since 2010. Auto premiums totalled Rmb752.1bn in 2017 (+10% YoY). We anticipate continuous growth in the total number of motor vehicles, which reached 217m in 2017 (+12% YoY), thus supporting auto premium growth, despite the negative impact from falling premium rates amid China's auto insurance liberalisation reforms. As such, we forecast slowing auto premium growth in 2018-20E (+c.10% YoY).

Fig 7: China's P&C insurance premium breakdown in 2017



Source: Wind, SWS Research

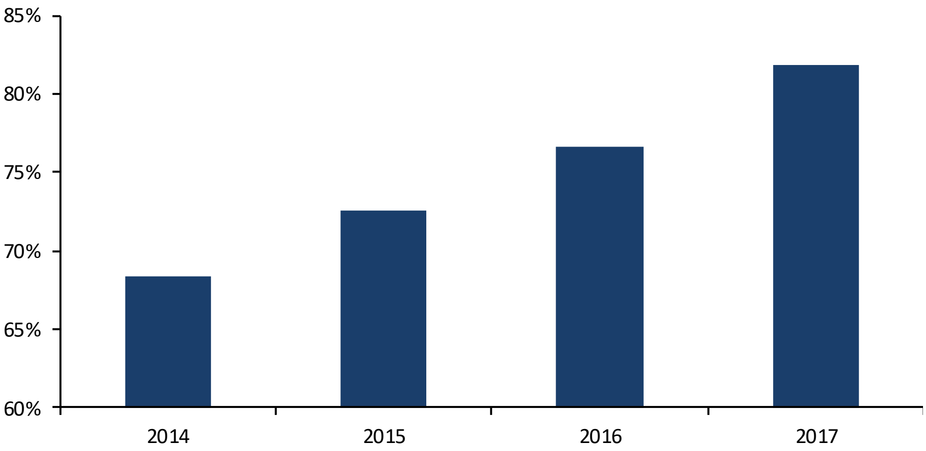
Fig 8: China's motor vehicle and auto premium YoY growth rates



Source: Wind, SWS Research

We believe the increasing auto insurance coverage will offset the falling premium rates caused by the auto insurance liberalisation reforms. According to statistics compiled by China Insurance Information Technology Corporation (CIITC), the insurance coverage adequacy ratio increased from 68.4% in 2014 to 81.9% in 2017. As per government regulation, owners of motor vehicles must take out liability insurance offering basic coverage for road traffic accidents (including loss of life and damage to third-party property). Meanwhile, insurees may purchase additional motor vehicle liability insurance to supplement the basic coverage.

Fig 9: China's insurance coverage adequacy ratio



Source: CIITC, SWS Research

Auto insurance liberalisation

We expect China's P&C insurance industry to enter an earnings recovery cycle. We note the industry's premium growth has rebounded significantly since early 2018, with 1H18 YoY growth of 12.1%. Meanwhile, regulators have increased control on the P&C insurance market. We believe stricter market supervision will curb costs for P&C insurers, especially in the auto insurance segment, and expect the combined ratio of quality insurers to improve. We believe the market is overly pessimistic about the P&C insurance sector, mainly due to uncertainties related to China's auto insurance liberalisation reforms.

We believe competition will intensify, premium adequacy ratios decline, and loss ratios increase during the initial stage of the reforms. Longer-term, we expect the industry to become increasingly concentrated. As a leading player, we expect PICC P&C to maintain stable underwriting profit margin and gain market share. Furthermore, we see earnings as likely to increase due to lower income tax, as the firm's commission rate falls below 15% or through a higher tax-deductible commission ratio (which may be increased to more than 15%). As such, we expect PICC P&C to be one of the major beneficiaries of China's auto insurance liberalisation reforms.

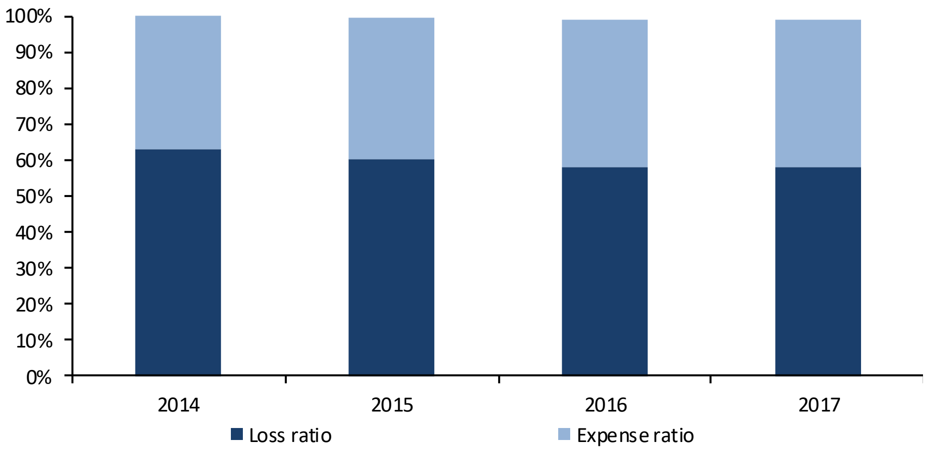
Fig 10: China's auto insurance liberalisation reforms

	Detail	Factors (intervals)	Outcome
First round: 02/2015-06/2017	Pricing factor interval set with increased pricing autonomy	UW = [0.85, 1.15]	Insurers' rates decreased, expense ratios increased, and loss ratios declined
		Dist = [0.85, 1.15]	
		NCD = [0.6, 2.0]	
Second round: 06/2017-02/2018	Further relaxation of pricing factors	Shenzhen: UW = [0.70, 1.25], Dist = [0.70, 1.25]	Further increased insurers' pricing autonomy
	Comprehensive supervision of combined ratios, expense ratios, and outstanding claim reserves	Henan: UW = [0.80, 1.15], Dist = [0.75, 1.15]	
		8 provinces*: UW = [0.75, 1.15], Dist = [0.75, 1.15]	
		Others: UW = [0.85, 1.15], Dist = [0.75, 1.15]	
		NCD = [0.6, 2.0]	
Third round: since 03/2018	Increased pricing autonomy, lower limit on the floating coefficient of expense ratios	Sichuan: UW = [0.65, 1.15], Dist = [0.65, 1.15]	Further increased insurers' pricing autonomy with structural improvement
		5 provinces**: UW = [0.70, 1.15], Dist = [0.70, 1.15]	
		Xinjiang: UW = [0.75, 1.15], Dist = [0.75, 1.15]	
		Guangxi, Shaanxi, Qinghai: full liberalisation	
		NCD = [0.6, 2.0]	

Source: SBIRC, SWS Research
Note: UW = underwriting factor, Dist = distribution factor, NCD = no-claim discount factor
* Tianjin, Hebei, Fujian, Guangxi, Sichuan, Qinghai, Qingdao, and Xiamen
** Shanxi, Fujian, Shandong, Henan, and Xiamen

China's auto insurance liberalisation reforms started in 2015, allowing prices to be more in line with market mechanisms. During the first round of reform, a pricing factor interval was set with increased pricing autonomy for insurance companies, based on the following formula: "premium = benchmark premium x rate adjustment factor = benchmark pure risk premium / (1 - surcharge rate) x underwriting factor x distribution factor x no-claim discount factor x traffic violation factor". In this formula, the benchmark pure risk premium, NCD factor, and traffic violation factor are set by the China Insurance Regulatory Commission (CIRC), while the surcharge rate normally stands at 35%. Insurance companies are allowed to choose individual underwriting and distribution factors. Therefore, we calculate the theoretical upper limit for the rate adjustment factor as 2.6450 (2 x 1.15 x 1.15) and the theoretical lower limit as 0.4335 (0.6 x 0.85 x 0.85). We note insurance companies' prices came close to the lower limit, while insurers experienced increased expense ratios and decreased loss ratios, in contrast with the reform's original goal. A second round of reform, aiming to further liberalise the pricing factor with a focus on the comprehensive regulation of combined ratios, expense ratios, and outstanding loss reserves, was implemented in June 2017. We note that, during the first two rounds of pricing reforms, PICC P&C's combined ratio declined steadily, with the loss ratio decreasing in 2014-16 before climbing back in 2017, while the expense ratio experienced the opposite trend. Therefore, after two rounds of reform, the regulator's objective is on track to be achieved.

Fig 11: PICC P&C's loss ratio and expense ratio



Source: Company data, SWS Research

The third round of reform started in March 2018, with increased pricing autonomy and a lower limit on the floating coefficient of expense ratios. In July 2017, the CIRC issued Circular No. 174, strengthening control on the sales expense of insurance products, which could lead to higher income tax. In June 2018, the China Banking and Insurance Regulatory Commission (CBIRC) released Circular No. 57, requiring P&C insurers to submit their planned commission ratio, including commission fees, service fees, promotion fees, remuneration, and bonuses. Prior to this, insurance companies only had to submit their combined ratio, expense ratio, and unresolved claims reserve ratio. As a result, PICC P&C, Ping An P&C, CPIC P&C, and China Life P&C rolled out a self-discipline agreement setting caps on auto insurance commission fees.

Fig 12: P&C insurers' self-discipline agreement

Ranking by market share	Company	Upper limit of auto insurance commission fees	
		New vehicle	Old vehicle
1	PICC P&C	25%	20%
2	Ping An P&C	25%	20%
3	CPIC P&C	25%	20%
4	China Life P&C	26%	21%
5-9	-	27%	22%
10 onwards	-	30%	25-28%

Source: SBIRC, SWS Research

Fig 13: P&C insurers' expense ratio after the second round of reform

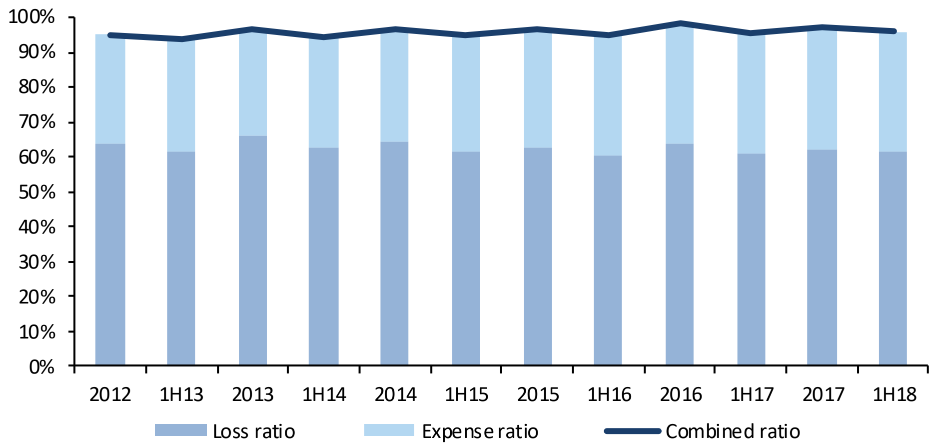
Scale (GWP)	Top-2	Rmb15-100bn	Rmb5-15bn	Rmb1-5bn	Below Rmb1bn	New entrants
Number of companies	2	7	5	20	25	7
Auto premium YoY growth	14.2%	9.0%	6.3%	4.4%	3.0%	33.3%
Expense ratio	37.4%	38.7%	43.0%	47.8%	52.4%	88.4%

Source: Insurance Yearbook 2017, SWS Research

Commission rates to decline

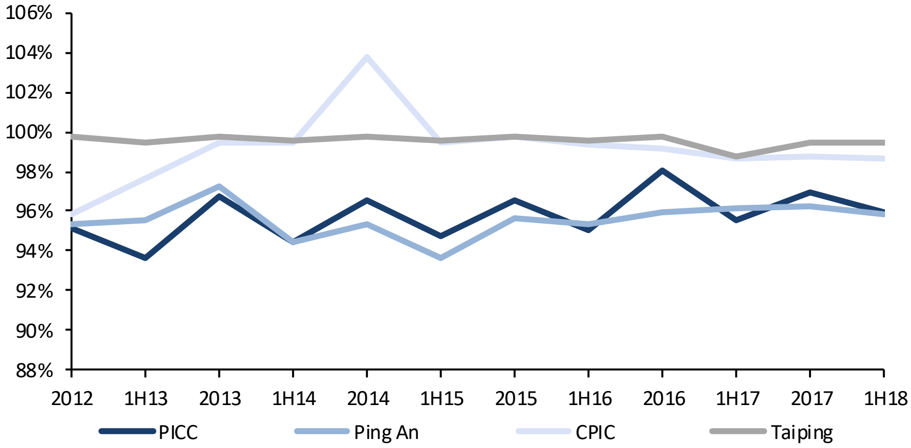
As a leading P&C insurance company, PICC P&C has always outperformed its peers in terms of combined ratio, while enjoying significant economies of scale amid China's increasingly competitive insurance market. Thanks to a lower expense ratio, the firm has been able to offset its deteriorating loss ratio. We forecast combined ratios of 97.6% in 18E, 97.5% in 19E, and 97.0% in 20E (vs 97% on average over the past five years).

Fig 14: PICC P&C's combined ratio



Source: Company data, SWS Research

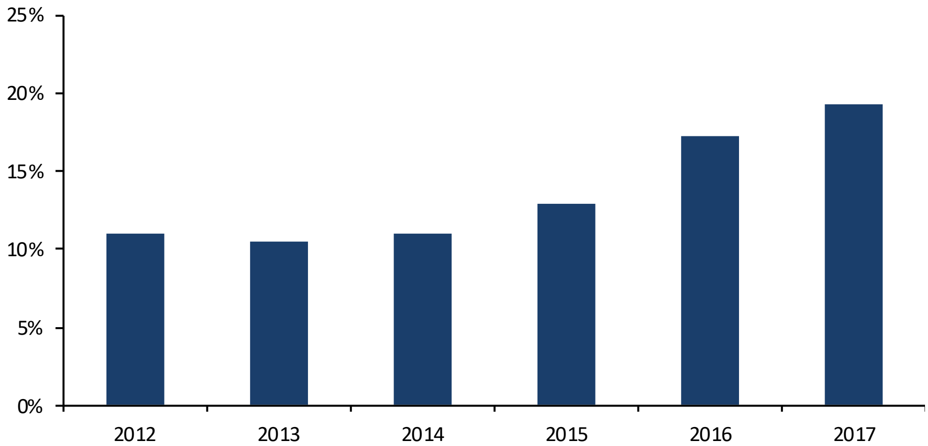
Fig 15: P&C insurers' combined ratio



Source: Company data, SWS Research

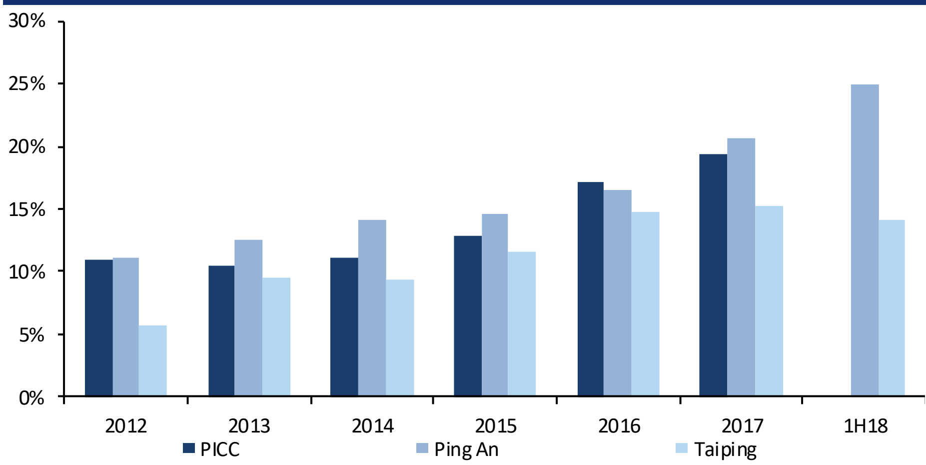
PICC P&C's commission ratio climbed from 11% in 2014 (before the auto insurance liberalisation reform started) to 19% in 2017 (end of the second round of reform), as competition increased between insurance companies. This had a negative impact on income tax expenses, due to a 15% cap on tax-deductible commission ratios for P&C insurance products as regulated by the Ministry of Finance. As a result, P&C insurers reported higher tax rates in 2017 and 1H18. PICC P&C's tax rate reached 37.3% in 9M18. We note the firm is actively lobbying the government to lift the tax-deductible commission ratio cap above 15%. We see this as a positive factor for future earnings growth.

Fig 16: PICC P&C's commission ratio



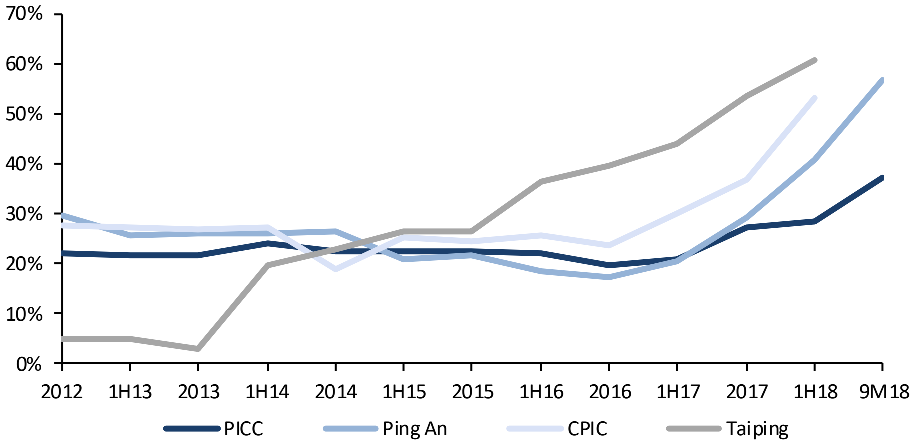
Source: Company data, SWS Research

Fig 17: P&C insurers' commission ratio



Source: Company data, SWS Research

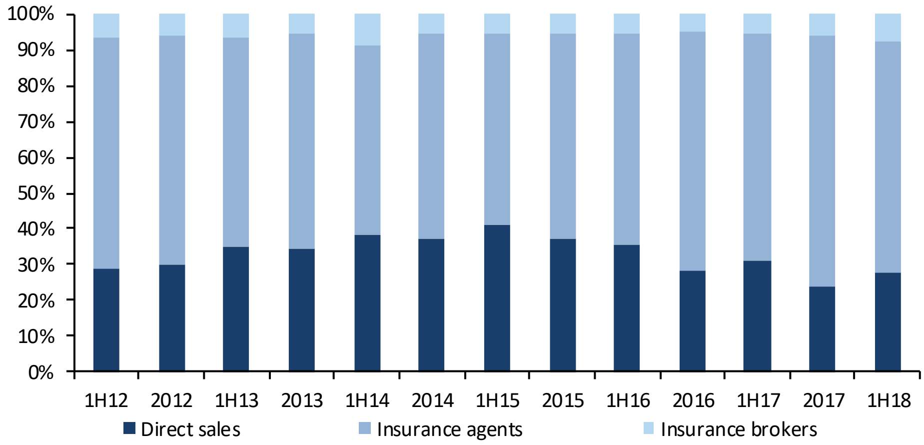
Fig 18: P&C insurers' tax rate



Source: Company data, SWS Research

PICC P&C is looking to optimise its distribution mix by increasing its market share in the agent sales channel, including individual agents and car dealers, for which the company enjoys lower commissions compared with peers due to scale advantages. The proportion of direct sales in the firm's direct written premiums decreased from 37% in 2015 to 24% in 2017 as the company no longer enjoyed its 15% price discount on telephone and online sales platforms. Nevertheless, with direct sales representing 28% of direct written premiums as of 1H18, PICC P&C remains the market leader on the back of its comprehensive range of customer services. We expect the price advantage of direct sales to increase as premiums decline due to China's auto insurance reforms. Moreover, we note the firm's higher proportion of direct sales helps it reduce its total commission fees. Commission rates vary greatly from one insurance product to another. We note PICC P&C benefits from a historical advantage in terms of the agricultural insurance with low commission rates.

Fig 19: PICC P&C's direct written premium breakdown

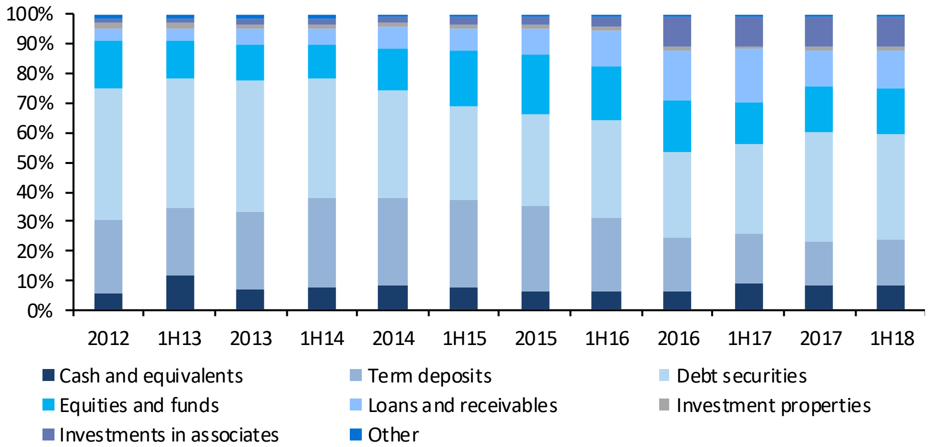


Source: Company data, SWS Research

Stable investment returns

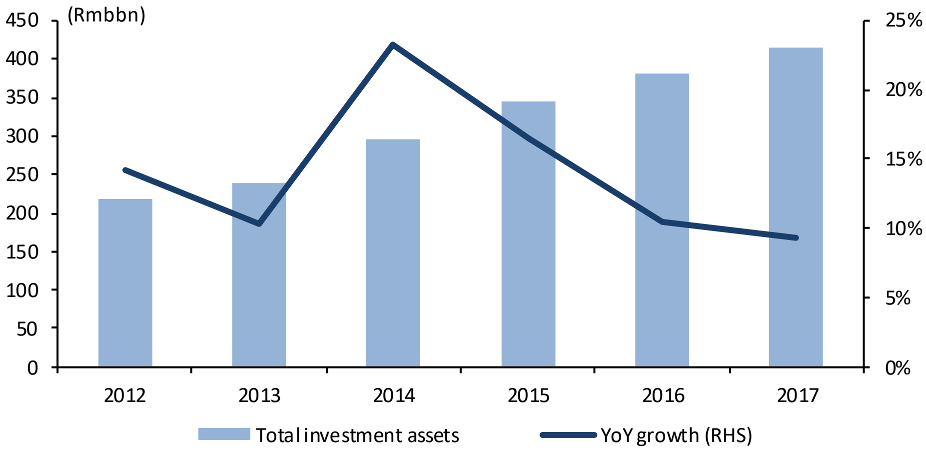
PICC P&C's total investment assets increased at a Cagr of 14% to Rmb415.5bn between 2012 and 2017. The firm's asset allocation has been relatively stable with c.70% of assets invested in fixed income and c.15% invested in equities. The proportion of investments in associate companies rose from 1.2% in 2012 to 10.4% in 1H18, thanks to the firm's acquisition of a 19.99% stake in Huaxia Bank in 2016. We note the stake in Huaxia Bank can generate over 20% of the firm's total investment income. As such, we forecast a total investment yield of 5% and net investment yield of 4% for the company over the next three years.

Fig 20: PICC P&C's investment assets



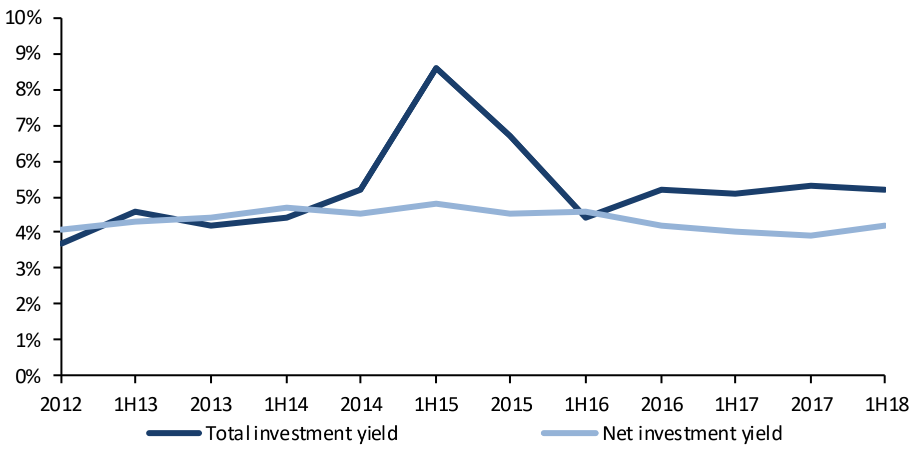
Source: Company data, SWS Research

Fig 21: PICC P&C's total investment assets



Source: Company data, SWS Research

Fig 22: PICC P&C's investment yield



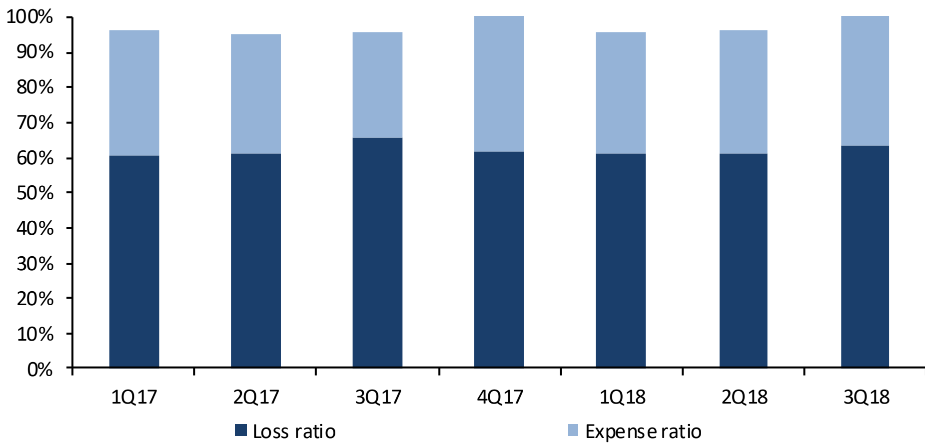
Source: Company data, SWS Research

Financial analysis

PICC P&C's net profit declined 25.5% YoY to Rmb13.2bn in 9M18, due to soaring commission expenses and higher income tax expenses. The firm's commission ratio reached 23.4% in 9M18, higher than in 9M17 (18.1%), but lower than in 1H18 (25.7%). Its combined ratio arrived at 97.5% in 9M18, with a loss ratio of 61.9% and an expense ratio of 35.6%. Meanwhile, higher commission expenses resulted in a higher tax rate of 37.3% (vs 28.3% in 1H18). However, we note investment income grew 20.7% YoY in 9M18, which helped offset the firm's underwriting loss.

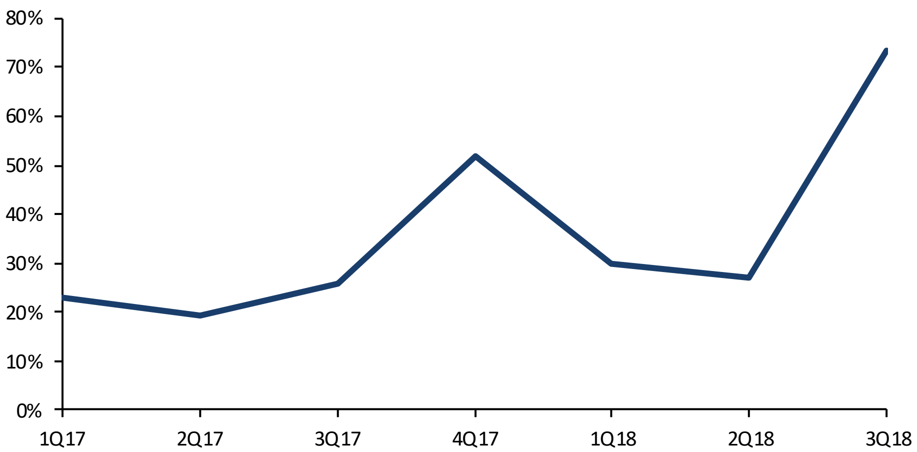
The surge in commissions was mainly due to regulators' focus on the "consistency between regulatory filings and implementation" in the auto insurance market since August 2018, in order to prevent insurers from hiding additional commissions through misclassified expense items. Looking forward, we expect PICC P&C's earnings to improve in 4Q18, as we believe the company booked a one-off commission in 3Q18 before the new regulation took effect, which should result in an improved commission ratio. We note the firm has sufficient reserves to smooth out negative underwriting results, while investments may trigger a positive earnings surprise. Furthermore, we believe tax authorities are likely to ease the tax burden on insurance companies in the future.

Fig 23: PICC P&C's quarterly combined ratio



Source: Company data, SWS Research

Fig 24: PICC P&C's quarterly tax rate



Source: Company data, SWS Research

Earnings forecasts

We forecast GWP growth of 12.8% YoY in 18E, 14.0% YoY in 19E, and 15.0% YoY in 20E. Due to slowing auto sales, auto premium income growth decelerated to 10.5% YoY on average since 2015. We thus expect auto GWP growth to reach 10.0% YoY in 18E, 10.5% YoY in 19E, and 10.8% YoY in

20E. Meanwhile, we expect non-auto GWP growth to arrive at 19.7% YoY in 18E, 21.8% YoY in 19E, and 23.7% YoY in 20E.

Fig 25: PICC P&C's GWP forecasts

(Rmbm)	2016	2017	2018E	2019E	2020E
GWP	311,160	350,314	395,155	450,367	518,093
Auto	225,640	249,232	274,155	302,941	335,659
Non-auto	85,520	101,082	121,000	147,425	182,434
YoY growth	10.5%	12.6%	12.8%	14.0%	15.0%
Auto	10.5%	10.5%	10.0%	10.5%	10.8%
Non-auto	10.4%	18.2%	19.7%	21.8%	23.7%

Source: Company data, SWS Research

We forecast combined ratios of 97.6% in 18E, 97.5% in 19E, and 97.0% in 20E, with loss ratios of 62.9%, 63.6%, and 64.3%, and expense ratios of 34.8%, 33.9%, and 32.7%, respectively. We believe the firm's expense ratio will deteriorate in 2018 due to the surging commission ratio, although we expect it to improve in 4Q18 on the back of regulatory control.

Fig 26: PICC P&C's combined ratio forecasts

	2016	2017	2018E	2019E	2020E
Loss ratio	63.6%	62.3%	62.9%	63.6%	64.3%
Expense ratio	34.6%	34.7%	34.8%	33.9%	32.7%
Combined ratio	98.1%	97.0%	97.6%	97.5%	97.0%

Source: Company data, SWS Research

We forecast PICC P&C's investment assets to grow 12.9% YoY in 18E, 12.0% YoY in 19E, and 13.1% YoY in 20E, with a stable total investment yield of 5.0% in 2018-20E and a net investment yield of 4.0% in 2018-20E. Moreover, we expect income contribution from Huaxia Bank to continue to support the firm's total investment income in coming years.

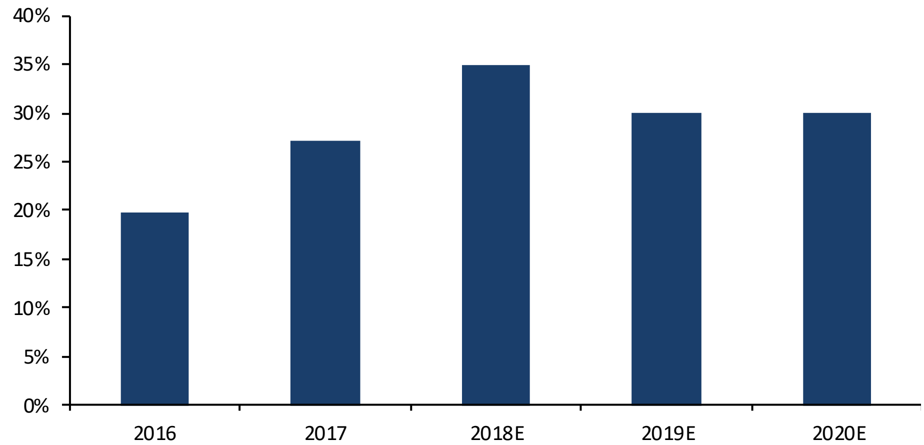
Fig 27: PICC P&C's investment assets forecasts

(Rmbm)	2016	2017	2018E	2019E	2020E
Total investment yield	5.2%	5.3%	5.0%	5.0%	5.0%
Net investment yield	4.2%	3.9%	4.0%	4.0%	4.0%
Profit from associate companies	2,945	4,575	3,753	4,202	4,755
Total investment assets	379,976	415,508	469,166	525,307	594,374

Source: Company data, SWS Research

We expect the firm's tax rate to reach 35% in 18E, due to a one-off commission expense. However, we believe the regulation will have a positive effect on high commission rates in the P&C insurance sector, with a potential increase in the tax deduction cap. We thus expect the company's tax rate to stabilise at 30% in 2019-20E.

Fig 28: PICC P&C's tax rate forecasts



Source: Company data, SWS Research

As a result, we forecast net profit to decline 7% YoY in 18E, but grow 25% YoY in 19E and 20% YoY in 20E, with an ROE of 12.9%, 14.2%, and 15.1%, respectively.

Valuation

We use a dividend discount model (DDM) to estimate PICC P&C's valuation, and derive a target price of HK$10.08, representing 1.14x 19E PB. Looking at historical data, we note the firm posted an average PB ratio of 2.29x since 2010, with an average ROE of 21.31%. At 0.91x, the current 19E PB multiple is thus below the historical average. While trading at a lower PB multiple than global peers, the stock also exhibits a higher ROE. We believe the current valuation level provides enough safety margin, while we are positive on the insurer's fundamentals improvement prospects. With 25% upside to our target price, we initiate coverage of the company with a BUY recommendation.

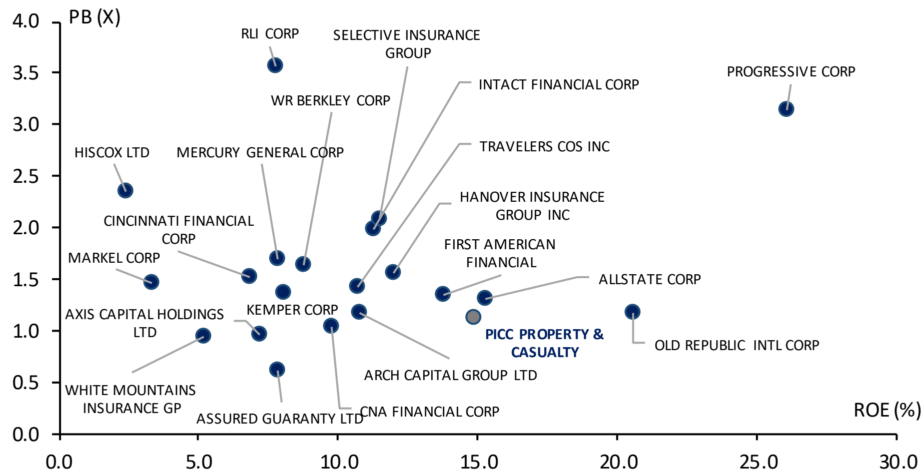
Fig 29: PICC P&C's stock valuation

(Rmbm)	2019E
Net profit	23,200
Net profit growth	25%
Dividend payout ratio	25%
Dividend paid	4,678
Total value	197,255
Share capital	22,242
Equity value per share (Rmb)	8.87
Rmb:HK$	0.88
Equity value per share (HK$)	10.08
PB (x)	1.14

Source: Company data, SWS Research

Stock catalysts include an increase of the tax-deductible ratio above 15% and new regulation mitigating the auto premium price war. Key downside risks include new car sales decline, a stronger-than-expected impact from China's auto insurance liberalisation reforms, weather disasters, and a declining market environment.

Fig 30: PB-ROE global peer comparison



Source: Bloomberg, SWS Research

Sensitivity analysis

We ran a sensitivity analysis on the firm's ROE, considering various net investment yield/combined ratio scenarios (vs our base case: 4.0% net investment yield and 97.5% combined ratio). We note that, under the scenario where underwriting profit margin only reaches 0.5% (representing a combined ratio of 99.5%) and net investment yield arrives at 3.5% (close to long-term bond yields), and given a tax rate of 30%, the company achieves a 19E ROE of 9.5%, still higher than global peers' average ROE.

Fig 31: ROE sensitivity analysis

	Net investment yield		
Combined ratio	**3.5%**	**4.0%**	**4.5%**
96.5%	14.5%	15.8%	17.1%
97.5%	12.8%	**14.2%**	15.5%
98.5%	11.2%	12.5%	13.8%
99.5%	9.5%	10.8%	12.1%

Source: Company data, SWS Research

Appendix

Fig 32: Income Statement Forecast

(Rmbm)	2016	2017	2018E	2019E	2020E
Direct written premiums	310,453	349,290	394,541	449,691	517,350
Reinsurance premiums assumed	707	1,024	614	676	743
Gross written premiums	311,160	350,314	395,155	450,367	518,093
Reinsurance premiums ceded	-30,386	-28,996	-32,708	-37,278	-42,883
Net written premiums	280,774	321,318	362,447	413,089	475,210
Net change in unearned premium reserves	-10,513	-12,242	-12,963	-14,421	-18,297
Net earned premiums	270,261	309,076	349,484	398,669	456,913
Net claims incurred	171,759	192,520	219,737	253,406	293,890
Net policy acquisition costs	62,954	74,348	84,892	93,879	102,276
General & admin expenses	30,524	32,913	36,596	41,248	47,110
Underwriting profit	5,024	9,295	8,259	10,135	13,637
Investment income	15,073	15,382	18,767	21,012	23,775
Net realised and unrealised gains on investments	922	1,136	50	593	322
Investment related expenses	-637	-675	-656	-666	-661
Interest expenses credited to policyholders' deposits	-2	-2	-2	-2	-2
Exchange (losses)/gains, net	422	-451	-15	-233	-233
Sundry income	369	372	371	371	371
Sundry expenses	-457	-473	-465	-469	-467
Finance costs	-1,208	-1,998	-1,603	-1,801	-1,801
Share of profits of associates	2,945	4,575	3,753	4,202	4,755
Profit before tax	22,451	27,161	28,459	33,145	39,696
Income tax expense	-4,430	-7,353	-9,961	-9,943	-11,909
Profit for the year	18,021	19,808	18,498	23,201	27,787
Profit attributable to owners of the company	18,020	19,807	18,497	23,200	27,786
Profit attributable to non-controlling interests	1	1	1	1	1

Source: SWS Research, Company data

Fig 33: Balance sheet forecast

(Rmbm)	2016	2017	2018E	2019E	2020E
Assets					
Cash and cash equivalents	25,144	34,688	29,916	32,302	31,109
Term deposits	68,286	61,300	78,468	89,051	106,200
Debt securities	110,645	153,728	173,580	194,351	219,904
Equity securities and mutual funds	67,038	64,701	73,056	81,798	92,553
Insurance receivables, net	30,479	37,845	34,162	36,004	36,004
Reinsurance assets	30,707	29,410	30,059	29,734	29,734
Prepayments and other assets	15,805	19,112	17,459	18,285	18,285
Investments in associates	37,045	41,832	47,234	52,886	59,840
Investment properties	4,902	4,976	5,619	6,291	7,118
Property and equipment	14,977	15,531	15,254	15,393	15,393
Prepaid land premiums	3,185	3,023	3,104	3,064	3,064
Deferred tax assets	3,878	7,240	5,559	6,400	6,400
Investments classified as loans and receivables	63,855	51,180	57,789	64,704	73,212
Total assets	475,949	524,566	571,259	630,262	698,814
Total investment assets	379,976	415,508	469,166	525,307	594,374
Liabilities					
Payables to reinsurers	16,443	17,319	16,881	17,100	17,100
Accrued insurance security fund	834	958	896	927	927
Income tax payable	2,680	4,396	3,538	3,967	3,967
Other liabilities and accruals	48,115	55,352	51,734	53,543	53,543
Insurance contract liabilities	242,093	264,748	296,543	334,022	380,655
Policyholders' deposits	2,330	2,296	2,313	2,305	2,305
Bond payable	23,112	23,262	23,262	23,262	23,262
Securities sold under agreements to repurchase	21,030	23,121	22,076	22,598	22,598
Total liabilities	356,637	391,452	417,242	457,724	504,356
Shareholders' equity					
Issued capital	14,828	14,828	22,242	22,242	22,242
Reserves	104,478	118,279	131,767	150,290	172,209
Equity attributable to owners of the company	119,306	133,107	154,009	172,532	194,451
Non-controlling interests	6	7	7	7	7
Total equity	119,312	133,114	154,016	172,539	194,458
Total equity and liabilities	475,949	524,566	571,259	630,262	698,814

Source: SWS Research, Company data

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