

China / Hong Kong Company Update

China Pacific Insurance Group

Bloomberg: 2601 HK EQUITY | 601601 CH Equity | Reuters: 2601.HK | 601601.SS

Refer to important disclosures at the end of this report

DBS Group Research . Equity

20 Apr 2022

H: BUY

Last Traded Price (H) (14 Apr 2022): HK\$19.18 (HSI : 21,518)
Price Target 12-mth (H): HK\$30.00 (56.4% upside) (Prev HK\$36.0)

A: BUY

Last Traded Price (A) (14 Apr 2022): RMB22.32(CSI300 Index : 4,166)
Price Target 12-mth (A): RMB25.86 (15.9% upside) (Prev RMB31.04)

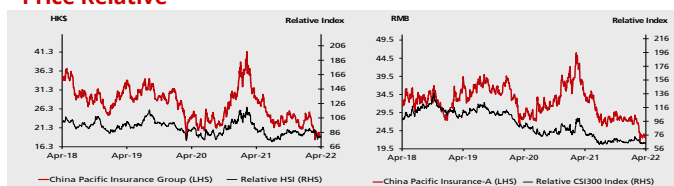
Analyst

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What's New

- Manageable impact from the resurgence of pandemic. Improvement in agent productivity the key highlight
- Benefitting from China-US negative yield spread given higher fixed income asset allocation
- Lowering dividend payout to mitigate on C-ROSS 2 Phase II implementation a short-term impact
- Revise down FY22/23F earnings by 8% and lower VNB assumption to -18%/+6% y-o-y, factoring in FY21A. Trim TP to HK\$30 on lower multiple

Price Relative



Forecasts and Valuation (H Shares)

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Net earned premiums	331,639	339,535	355,797	379,179
Net investment income	66,935	72,759	76,011	84,660
Net Profit	24,584	26,834	27,713	31,873
EPS (RMB)	2.63	2.79	2.88	3.31
EPS (HK\$)	3.24	3.43	3.55	4.08
EPS Gth (%)	(14.1)	6.1	3.3	15.0
PE (X)	5.9	5.6	5.4	4.7
DPS (HK\$)	1.60	1.23	1.35	1.55
Net Div Yield (%)	8.3	6.4	7.0	8.1
BV Per Share (HK\$)	29.22	29.85	32.26	35.11
P/Book Value (X)	0.7	0.6	0.6	0.5
P/EV (X)	0.3	0.3	0.3	0.3
ROAE (%)	29.6	38.5	41.7	38.8

Earnings Rev (%): (8) (8)
Consensus EPS (RMB) 2.97 3.41
Other Broker Recs: B:18 S:1 H:4

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Benefitting from China-US negative spread

Investment Thesis

VNB to see another year of decline before recovering in FY23F. The life agent channel reform, aggressive cut in agent headcount, and product mix change has resulted in a 25% y-o-y decline in VNB in FY21. We expect VNB to post -18% y-o-y in FY22F on continuous transition, but to recover to +6% y-o-y in FY23F driven by agent productivity improvement.

Negative China-US yield spread to support bond yields. The mounting inflation pressure and growing US rate hike expectations have resulted in a negative China-US yield spread in April 2022, which will provide downside support to China's bond yield. Our DBS economist team forecasts China's 10-year bond to reach 2.8%/3.0% by FY22/23F-end.

Share price upside remains substantial. With business transition likely to complete in FY22F, and growth momentum to resume in FY23F, the current historical low valuation of 0.3X FY22F P/EV with +7% dividend yield offers a long-term buying opportunity.

Valuation:

Our TP is based on sum-of-the-parts (SOTP) valuation, where we apply a multiple of 0.3x (previously 0.5x) FY22F price/embedded value (P/EV) to CPI Life, and 0.4x/0.6x FY22F price/book value (P/BV) to CPI P&C and other entities.

Where we differ:

Insurance stocks are rarely considered dividend plays given the volatile nature of investment income. However, we believe that CPIC's stable operating income growth with high dividend yield of +7% will lead to a recovery in valuation.

Key Risks to Our View:

Some of the key risks are i) intensifying market competition, ii) downward interest rate trend, iii) rising market volatility, and iv) slower-than-expected economic growth in China.

At A Glance

Issued Capital - H shares (m shs)	2,775
- Non H shrs (m shs)	6,845
H shs as a % of Total	29
Total Mkt Cap (HK\$m/US\$m)	241,387 / 30,784
Major Shareholders (%)	
Shenergy (Group) Company Limited	19.4
Hwabao Investment Co., Ltd.	18.8
Shanghai State-Owned Assets Operation	8.5
Shanghai Haiyan Investment Mgt Co. Ltd.	6.8
Major H Shareholders (As % of H shares)	
China Life Insurance Co Ltd	8.0
Shanghai International Group Co., Ltd.	7.2
Schroder Investment Management (HK) Ltd.	6.2
H Shares-Free Float (%)	78.7
3m Avg. Daily Val. (US\$m)	34.76
GICS Industry: Financials / Insurance	



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WHAT'S NEW

Benefitting from China-US negative spread

Manageable impact from pandemic resurgence in Shanghai.

Investors may be concerned over the recent resurgence of the global pandemic in the Shanghai area, and whether the strict lockdown measures will impact CPIC's near term new business growth momentum. Despite CPIC being headquartered in Shanghai and deriving 3.4% and 7.7% of its life and P&C business from the region, based on FY21 (figure 1-2), we see that the impact is manageable, since the global pandemic has been ongoing for two years while life insurers have laid increasing effort in digital transformation, including to increasingly empower life agents with digital tools. We hence believe CPIC, and other life insurers alike, are better equipped and experienced to encounter the situation.

On the other hand, CPIC had a steady start of the year, with accumulated premium growth in 3M22 posted +4% y-o-y, compared to -3% to +2% y-o-y among listed peers (excluding PICC [1339 HK. HOLD] whose growth was mainly drive by single premium products, figure 3).

Progress of agent transformation key to watch.

CPIC has launched restructuring in building a career-based, professional, and digitalised agent force as the key strategy in its life agent reform. Despite its progress in shrinking the agent headcount, it seems to be slower than peers, with agent headcount down 30% y-o-y in FY21 compared to peers' average of down 44% y-o-y (figure 4), the insurer had focused on upgrading its agent's compensation system, improving agent's sales supportive and empowerment of digital tools, and aims to enhance growth in core manpower and agent's productivity. Some positive initial results were seen, with its FYP (first-year premium) per agent grown 42% y-o-y in FY21, compared to peer's average of 33% y-o-y. We believe the next key to watch is how the insurer can balance its growth between the shrink in agent headcount with the increase in agent productivity. With the overall industry consolidating since FY20 and the noticeable improvement in agent's productivity, we believe it's likely to see an overall VNB growth recovery for the industry as we move into FY23F.

Fig 1: Listed life insurers' premium breakdown by major provinces/cities

China Life		CPIC		Ping An		China Taiping		PICC Life	
Province	% of total	Province	% of total	Province	% of total	Province	% of total	Province	% of total
Jiangsu	10.0%	Henan	10.5%	Guangdong	17.4%	Shangdong	9.5%	Guangdong	14.8%
Guangdong	8.8%	Jiangsu	10.3%	Beijing	6.3%	Sichuan	9.3%	Zhejiang	9.3%
Shandong	7.4%	Shandong	8.4%	Shangdong	6.1%	Hubei	5.4%	Sichuan	6.4%
Zhejiang	6.0%	Zhejiang	7.6%	Jiangsu	5.8%	Zhejiang	5.3%	Jiangsu	5.3%
Hebei	6.0%	Hebei	6.0%	Zhejiang	5.2%	Heilongjiang	5.3%	Henan	4.5%
		Guangdong	5.3%					Hunan	4.3%
		Heilongjiang	4.3%					Beijing	3.2%
		Hubei	4.1%					Shangdong	3.8%
		Shanxi	3.9%					Hubei	3.5%
		Shanghai	3.4%					Gansu	2.9%

Note: China Life's figure based on FY17 numbers

Source: Company data, DBS HK

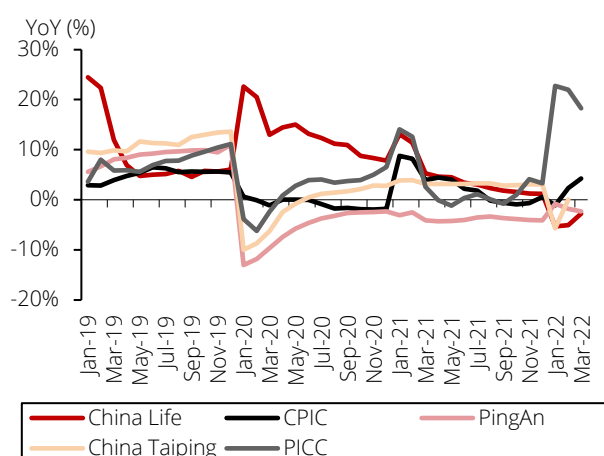
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Fig 2: Listed P&C insurers' premium breakdown by major provinces/cities

CPIC P&C		Ping An P&C		China Taiping P&C		PICC P&C	
Province	% of total	Province	% of total	Province	% of total	Province	% of total
Guangdong	12.5%	Guangdong	16.5%	Guangdong	9.3%	Guangdong	10.0%
Jiangsu	10.9%	Jiangsu	7.4%	Shandong	7.6%	Jiangsu	9.8%
Zhejiang	9.5%	Zhejiang	6.7%	Sichuan	6.5%	Zhejiang	8.0%
Shanghai	7.7%	Shanghai	5.8%	Shanghai	5.7%	Shandong	6.1%
Shandong	5.7%	Sichuan	5.5%	Beijing	5.5%	Hebei	5.4%

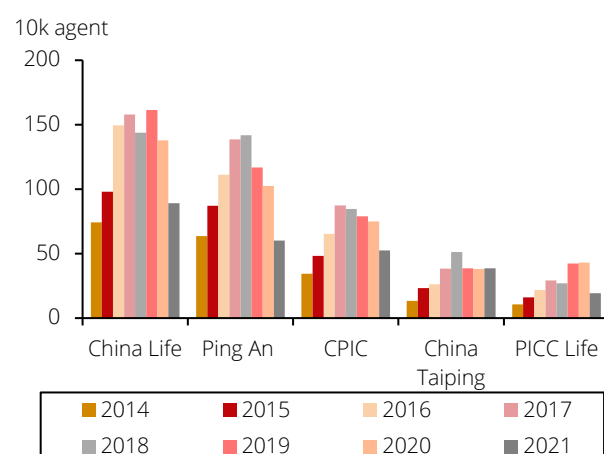
Source: Company data, DBS HK

Fig 3: Listed lifer's monthly premium y-o-y (%)



Source: Company data, DBS HK

Fig 4: Listed lifer's agent headcount



Source: Company data, DBS HK

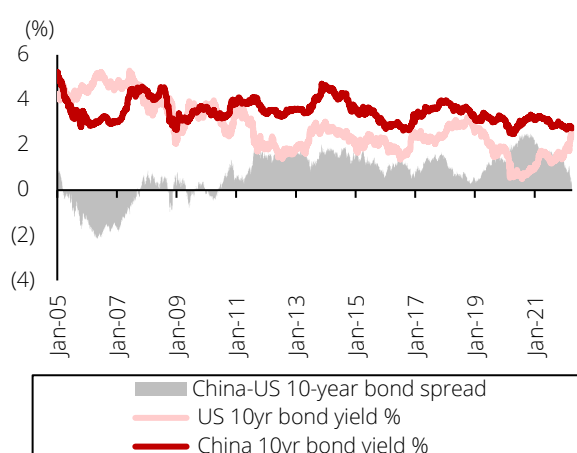
Benefitting from the negative China-US bond spread.

The rising inflation pressure in the US has led to a faster interest rate hike expectation, pushing the US's 10-year bond yield to 2.82% as of 14 April 2022, with the risk remaining on the upside. Accompanied by the divergence in China and the US's current interest rate cycle, as the result, the spread between China-US 10-year bond yield has entered a negative territory (figure 5). We believe the negative spread will provide firm support to China's bond yield going forward. That said, the negative spread is considered positive to Chinese insurers, given the high correlation between the share price and China's bond yield movement.

We see CPIC as one of the major beneficiaries, given that the insurer has allocated a total of 71% of its investment asset in fixed income related investments (including bond and debt/WMP scheme) whose investment return is highly correlated to the bond yield movement, compared to peer's average of 68% (figure 6). The bottoming and potential rise in China's 10-year bond yield may help insurers' gradually expand their net investment return (recurring). The DBS Economist team is also forecasting China's 10-year bond yield to reach 2.8%/3.0% by FY22/23F-end. Another than CPIC, China Life (2628 HK, HOLD) is considered to benefit from the bottoming of China bond yield the most, given that the insurer has 78% of its investment asset allocated in fixed income-related investment.

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Fig 5: China-US 10-year bond yield and spread

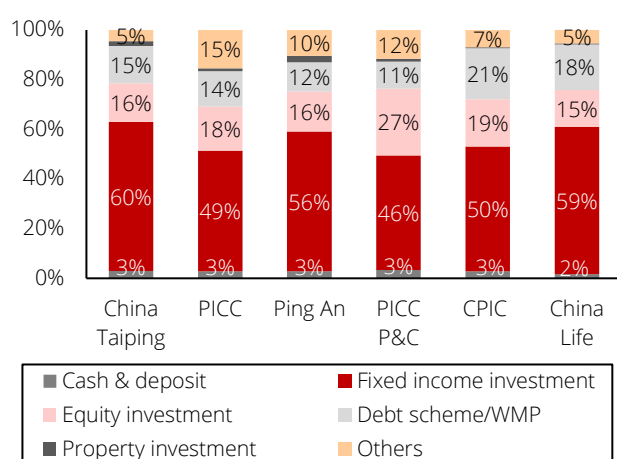


Source: Company data, DBS HK

which is noticeably lower than its average of 48% for the past five years. The insurer explained that the lowering of its dividend payout ratio was mainly to mitigate the impact of the implementation of C-ROSS 2 Phase II, and to accommodate for its future business growth. This has come as a negative surprise to the market, given CPIC has long been considered a high dividend yield play within the China insurance space with healthy capital structure.

With CPIC's prudent business philosophy, decent underwriting book quality, and good operating income generating capability if compared to peers, we see the lowering of its dividend payout in FY21 as temporary and suggest investors eye on its long-term sustainable growth ability. With CPIC's share price corrected by 9% year-to-date and trading at a historical low valuation of 0.3x FY22F P/EV, its FY21 dividend yield is equivalent to 6.4%, which is considered acceptable. With the steady growth in its operating income, we expect the insurer's FY22F dividend to recover to 7% level and should maintain at high ground going forward.

Fig 6: Listed lifer's investment asset allocation – FY21



Source: Company data, DBS HK

Lower TP to HK\$30. Maintain BUY.

By factoring the FY21 actual number, temporary premium growth impact from the resurgence of pandemic, and a lower investment return assumption given the volatile H/A-share market, we revise down FY22/23F earnings by 8% and lower VNB growth assumption to -18%/+6% y-o-y, respectively. By referring to a lower 0.3x P/EV multiple (previously at 0.5x) to its life insurance business, we further lower our TP to HK\$30 (from HK\$36). With a 56% share price upside, we maintain BUY on CPIC.

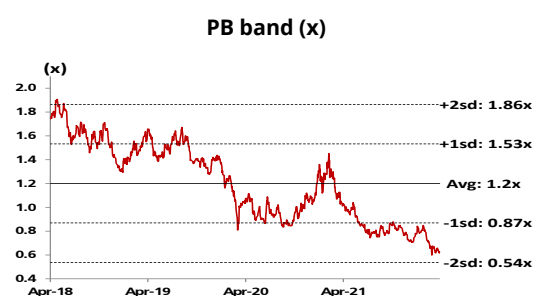
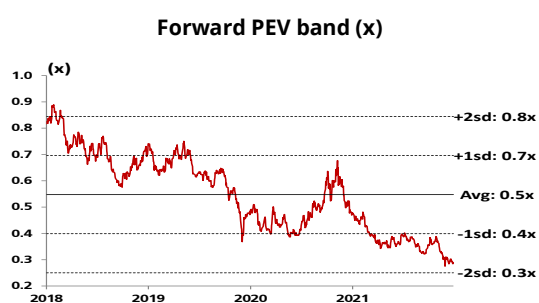
Company Background

China Pacific Insurance (CPIC) was established in April 1994. It was listed on the HKEX in December 2009. The company mainly provides life, P&C, and health insurance products through CPIC Life, CPIC P&C, CPIC HK, and CPIC Allianz Health. In FY20, its total assets and equity stood at Rmb1,771bn and Rmb221bn respectively.

Eye on long-term sustainable growth in dividend payout.

CPIC previously announced its FY21 dividend payment ratio as 35%, or distributing cash dividend of Rmb1/share,

Historical PEV and PB band



Source: Bloomberg Finance L.P. DBS HK

China Pacific Insurance Group

Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross written premium growth	8.0	4.2	1.3	7.5	5.8
Agency growth	(6.7)	(5.2)	(29.9)	(8.0)	(5.0)
Agency productivity growth	(9.1)	(22.7)	43.6	8.0	8.0
Expense ratio	38.2	37.8	29.7	29.5	29.3
Loss ratio	60.4	61.6	69.8	70.0	70.0
Combined ratio	98.6	99.4	99.4	99.4	99.2
VNB margin	43.3	38.9	23.5	18.5	19.5
Net investment return	4.6	4.4	4.2	4.2	4.2
Total investment return	4.6	4.4	4.2	4.2	4.2
EV growth	17.8	16.0	5.1	3.2	3.4
Solvency ratio	256.8	242.0	218.2	245.0	260.4

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross written premiums	347,517	362,064	366,782	394,433	417,239
Net earned premium	313,246	331,639	339,535	355,797	379,179
Investment income	61,094	66,935	72,759	76,011	84,660
Other operating income	8,342	20,390	24,037	23,508	24,008
Total income	378,976	414,379	431,178	450,308	482,839
Benefits and claims	(241,236)	(267,689)	(292,031)	(307,879)	(319,310)
Underwriting and policy acquisition costs	(87,844)	(90,074)	(77,032)	(83,173)	(95,031)
Finance cost	(3,511)	(3,405)	(3,441)	(3,528)	(3,617)
Other expenses	(22,619)	(29,070)	(33,830)	(27,420)	(31,467)
Total expenses	(355,210)	(390,238)	(406,334)	(422,000)	(449,425)
Share of profit of associated and JVs	494	512	799	777	777
Profit before tax	27,966	29,238	30,796	34,094	39,199
Income tax expense	388	(3,886)	(3,178)	(5,571)	(6,394)
Minority interest	(613)	(768)	(784)	(810)	(931)
Preferred dividend	0	0	0	0	0
Net income attributable to shareholders	27,741	24,584	26,834	27,713	31,873

Source: Company, DBS HK

China Pacific Insurance Group

Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Total Investment	1,418,900	1,645,171	1,808,100	2,018,635	2,234,438
Property, plant and equipment	19,365	19,293	20,142	20,142	20,142
Other assets	90,068	106,471	118,703	118,703	118,703
Total assets	1,528,333	1,770,935	1,946,945	2,157,480	2,373,283
Net life reserves - traditional	1,068,021	1,225,176	1,385,333	1,539,053	1,691,181
Net life reserves - investment contracts	75,506	87,056	102,773	118,490	134,207
Other Liabilities	201,486	237,937	225,653	247,582	272,974
Total liabilities	1,345,013	1,550,169	1,713,759	1,905,125	2,098,362
Shareholder's equity	178,427	215,105	226,741	245,101	266,735
Minority interest	4,893	5,661	6,445	7,255	8,186
Total equity	183,320	220,766	233,186	252,355	274,921

Source: Company, DBS HK

Key Financials & Ratios

FY Dec	2019A	2020A	2021A	2022F	2023F
Du Pont analysis (%)					
Net profit / premium income	8.9	7.4	7.9	7.8	8.4
Premium income / total asset	20.5	18.7	17.4	16.5	16.0
Total asset / total equity	8	8	8	9	9
Return on equity	34.2	29.6	38.5	41.7	38.8
Embedded value (RMB m)					
Book value	70,602	81,533	93,169	111,529	133,163
Adjusted items	44,075	54,365	68,711	87,485	109,922
Adjusted book value	114,677	135,898	161,880	199,013	243,085
Value-in-force	190,844	205,450	214,763	207,240	197,158
Adjustment (if any)	90,462	117,967	121,661	107,912	91,417
Group embedded value	395,983	459,315	498,304	514,165	531,660
Per share analysis(RMB)					
EPS	3.06	2.63	2.79	2.88	3.31
BPS	19.69	23.74	24.24	26.21	28.52
DPS	1.20	1.30	1.00	1.09	1.26
EVPS	43.70	50.69	53.28	54.97	56.84
Capital Strength (%)					
Leverage ratio	8	8	8	9	9
Solvency ratio	256.8	242.0	218.2	245.0	260.4

Source: Company, DBS HK

China Pacific Insurance Group

H Share - Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	7-May-21	HK\$28.25	HK\$46.50	Buy
2:	9-Aug-21	HK\$22.60	HK\$38.00	Buy
3:	13-Dec-21	HK\$23.00	HK\$36.00	Buy

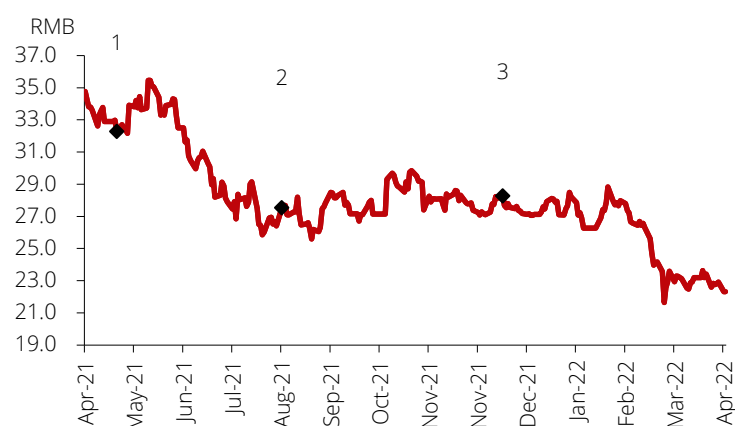
Source: DBS HK

Analyst: Ken Shih

Manyi Lu

Sam Lu

A Share - Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	7-May-21	RMB32.97	\$MB40.79	Buy
2:	9-Aug-21	RMB26.40	RMB32.76	Buy
3:	13-Dec-21	RMB28.14	RMB31.04	Buy

Source: DBS HK

Analyst: Ken Shih

Manyi Lu

Sam Lu

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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