PICC Property & Casualty

Bloomberg: 2328 HK EQUITY | Reuters: 2328.HK

DBS Group Research . Equity

20 Jun 2022

BUY (Upgrade from Fully Valued)

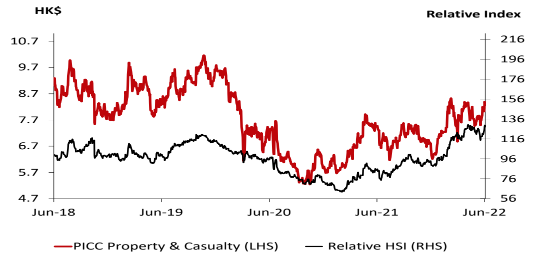
Last Traded Price (17 Jun 2022): HK$8.27 (HSI : 21,075)
Price Target 12-mth: HK$11.00 (33% upside) (Prev HK$5.50)

Analyst
Ken Shih +852 36684184 kenshih@dbs.com
Manyi Lu +852 36684186 manyilu@dbs.com

What's New

- We upgrade PICC P&C from FULLY VALUED to BUY with TP at HK$11.0
- Fundamental business set to improve with impact from auto insurance pricing reform alleviating and market discipline stabilizing
- Refocusing on quality growth in non-auto segment also helps improve underwriting profit. Pricing subsidy to drive agricultural insurance business quality
- Expect combined ratio to improve to 98.8%/98.6% in FY22/23F, revise up underwriting profit by 44%/74% and earnings by 2%/4%, respectively.

Price Relative



Forecasts and Valuation

FY Dec (RMB m)	2020A	2021A	2022F	2023F
Net earned premiums	393,127	396,997	429,690	466,320
Net investment income	17,709	17,996	18,172	19,307
Net Profit	20,868	22,360	23,742	25,963
EPS (RMB)	0.94	1.01	1.07	1.17
EPS (HK$)	1.10	1.17	1.25	1.36
EPS Gth (%)	*(14.1)*	*7.1*	*6.2*	*9.4*
PE (X)	7.5	7.0	6.6	6.1
DPS (HK$)	0.44	0.44	0.46	0.50
Net Div Yield (%)	5.3	5.3	5.6	6.1
BV Per Share (HK$)	9.85	10.66	11.45	12.31
P/Book Value (X)	0.8	0.8	0.7	0.7
P/EV (X)	N/A	N/A	N/A	7.1
ROAE (%)	11.7	11.5	11.3	11.5
Earnings Rev (%):			2	4
Consensus EPS (RMB)			1.17	1.33
Other Broker Recs:		B:31	S:1	H:4

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

Underwriting business improving

Investment Thesis

Expect noticeably improvement in combined ratio in FY22/ 23F. With the impact from comprehensive auto insurance pricing reform alleviating and market discipline stabilizing, couple with refocusing on quality growth in non-auto segment, we expect combined ratio to improve to 98.8%/98.6% in FY22/23F, from 99.6% in FY21.

Profit refocusing and agricultural insurance pricing subsidy to drive non-auto segment quality growth. Expect non-auto segment to reach 41% of total premium by FY23F, with profit refocusing and benefit from agricultural insurance pricing subsidy to help drive quality growth.

Continuous lengthening in asset duration helps to improve adjusted investment yield. P&C insurers' positive duration gap position should relatively benefit amid a declining bond yield environment. Continuously duration lengthening via invest more in government bond helps to improve adjusted investment yield given tax-exempt nature.

Valuation:

Our TP is based on a 0.9x FY23F P/BV (previously at 0.5x FY22F P/BV), which is in-line with the past-5 year mean and backed by 105% underwriting profit CAGR in FY21-23F.

Where we differ:

We have turned positive on PICC P&C for the first time since initiate coverage, while consensus remains overly positive. We see our concern over the structural issue in auto insurance segment gradually removed, with improvement also in non-auto segment. Its share price has been trading at 1-2 S.D. below mean since FY20, and we see re-rating opportunity ahead.

Key Risks to Our View:

Key risks include increasing market competition, unfavorable policy developments, natural catastrophes, and slower-than-expected economic growth in China.

At A Glance

Issued Capital (m shrs)	22,243
Mkt Cap (HKm/US$m)	183,950 / 23,434
Major Shareholders (%)	
Schroder Investment Management Ltd. (SIM)	5.7
Free Float (%)	94.3
3m Avg. Daily Val. (US$m)	26.32
GICS Industry: Financials / Insurance	

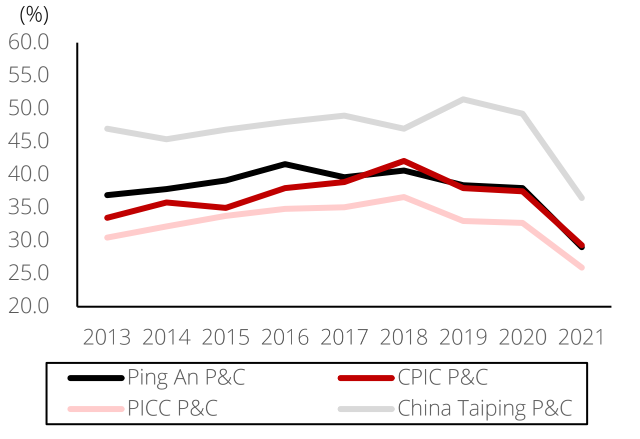
WHAT'S NEW

Underwriting business improving

Negatives alleviating with better market discipline seen
We believe the negative impact from the three-phase commercial vehicle insurance pricing reform since 2015 is alleviating, with the market consolidation stabilizing and industry discipline better established. The three-phase commercial vehicle insurance pricing reform basically aims to 1) lower auto insurance premium pricing by providing more pricing autonomy to P&C insurers, 2) to broaden auto insurance coverages to provide better protection to consumers, and 3) to establish a healthier industry landscape by discouraging direct competition on channel fees, including the implementation of consistency in expense rate reporting and implementation (报行合一).

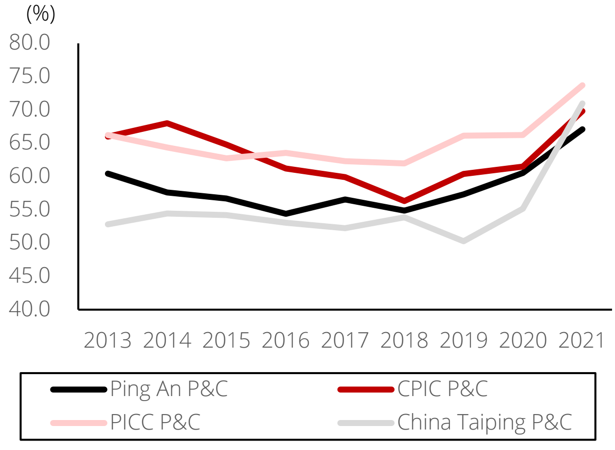
As the result, P&C insurers' expense ratio (figure 1) has started to trend downward since 2018, while loss ratio (figure 2) started to increase. The net effect was that major P&C insurers' combined ratio (figure 3) has marginally increased during this transitional period. Nonetheless, after the implementation of the third phase of reform, namely comprehensive auto insurance reform (车险综合改革) since September 2020 and a year long implementation, we believe the overall impact from the three-phase commercial vehicle insurance reform will start to alleviate.

Fig 1. Major P&C insurers expense ratio trend



Source: Company data, DBS HK

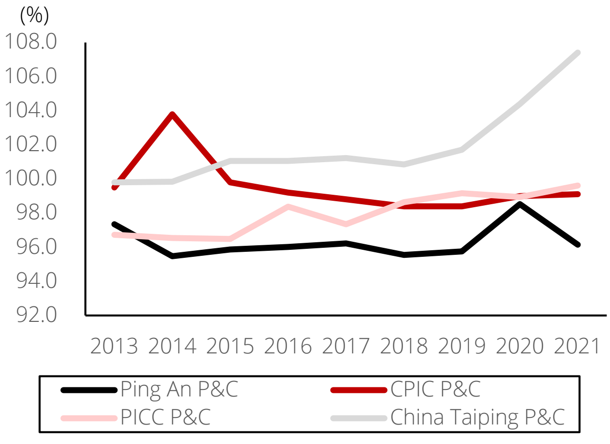
Fig 2. Major P&C insurers loss ratio trend



Source: Company data, DBS HK

Under the third phase of reform, CBIRC aims to direct the market by setting the upper limit of the additional expense ratio and expected loss ratio at 25%/75%, respectively, which is at the similar level of PICC P&C's auto insurance expense/loss ratio in FY21. Considering PICC P&C is a clear industry leader with its operating performance serving as a proxy to industry standard, we hence believe the industry adjustment from this multi-year auto insurance pricing reform should gradually come to an end and market consolidation to start stabilizing going forward.

Fig 3. Major P&C insurers combined ratio trend



Source: Company data DBS HK

Fig 4: Major details and implication of the three phase Commercial vehicle insurance pricing reform

Phase	Commercial vehicle insurance pricing reform – Phase 1 (Feb 2015)	Commercial vehicle insurance pricing reform – Phase 2 (July 2017)	Comprehensive auto insurance reform – Phase 3 (Sep 2020)
Pricing formula/ coefficient range relaxed	Standardize auto insurance premium = Benchmark premium x Premium adjustment coefficient Among which: Benchmark premium = Benchmark pure risk premium/ (1-additional cost rate) Premium adjusted coefficient = No claim discount (NCD) x Autonomy underwriting coefficient x Independent channel coefficient x Traffic violation coefficient	Autonomous underwriting /Independent channel coefficient = [0.70 – 1.25] in pilot run Shenzhen [0.70 to 0.80 – 1.15 to 1.25] in pilot run Henan [0.75 – 1.25] in pilot run Tienjin, Hebei, Fujian, Guangxi, Sichuan, Qinghai, Qingdoa and Xiamen [0.75 to 0.85 – 1.15 to 1.25] = in all other jurisdiction area	Autonomous underwriting /Independent channel coefficient = [0.65 – 1.15] in pilot run Sichuan [0.70 – 1.15] in pilot run Shanxi ,Shandong, Fujian, Henan and Xiamen [0.75 – 1.15] in pilot run Xinjiang [0.75 to 0.85 – 1.15] = in all other jurisdiction area
Major impact	- Widen autonomy/independent channel coefficient range [+- 15%] - NCD coefficient based on # claims - Premium pricing has declined while loss ratio contracted due to NCD pricing mechanism with expense ratio substantially increased	- Introduce "Expense rate reporting/ implement consistency" policy - Premium pricing further declined, expense ratio gradually scaled back but loss ratio noticeable climbed up as NCD incentive subdued.	- Enhance protection of Compulsory automobile Liability Insurance and broaden insurance liabilities - Upper limit on additional expense /expected loss ratio at 25%/75% - Premium pricing further declined, loss ratio climbed, and expense ratio declined

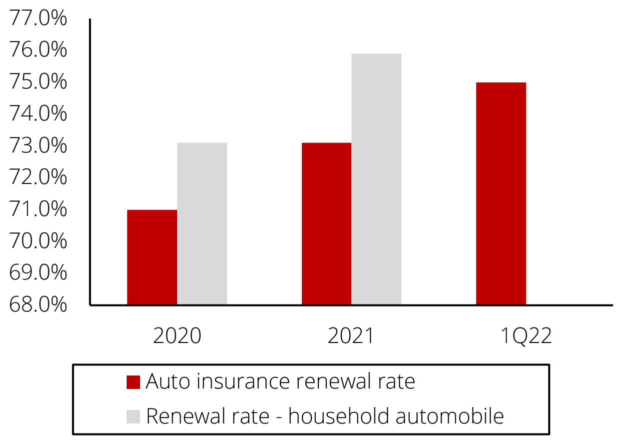
Source: CBIRC, DBS HK

Auto renewal market driving growth with new auto demand also stabilizing

With the decline in auto insurance premium and high base effect gradually diminishing as the third round of reform has now implemented for more than a year and half. PICC P&C and other P&C insurers alike, have started to post positive premium y-o-y growth since 4Q21. In 4M22, PICC P&C premium growth further posted +10% y-o-y, with auto insurance segment +8% y-o-y and showing further sign of premium growth recovery and we believe the trend will continue despite possible near-term slowdown due to the recent lock-down measure In China to overcome the Omnicron wave.

In particular, we have seen further market share gain in PICC P&C's auto insurance renewable business, as the insurer focused in improving its efficiencies, upgrading service capabilities and enhancing customer's loyalty for the past few years and good progress has seen. In 2021, its auto insurance renewal rate has improved from 71% in 2020, to 73.1% in 2021. The renewal rate further improved to 75% in 1Q22, and we believe this is mainly driven household automobile segment (figure 5).

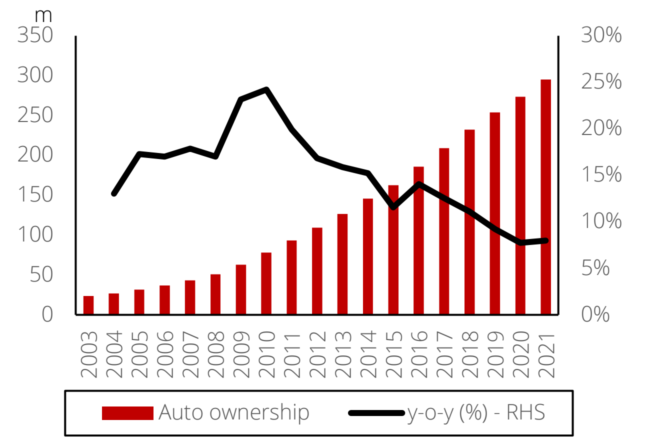
Fig 5. PICC P&C's auto insurance renewal rate



Source: Company data DBS HK

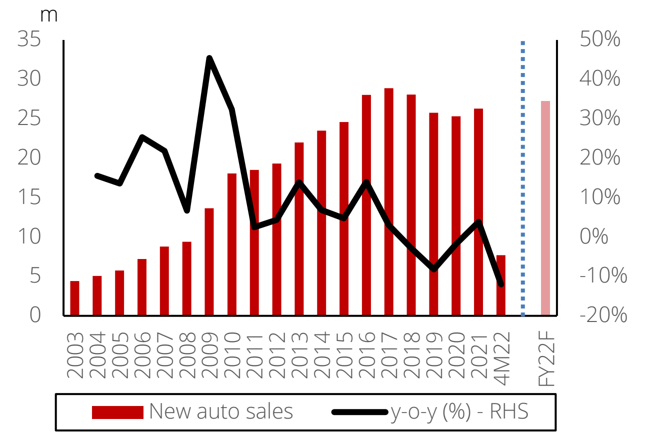
China automobile ownership continue to rise
China's automobile ownership continue to grow, with automobile ownership reaching 295m scale in 2021, or +8% y-o-y (figure 6), despite the growth slowdown in China's new auto sales in recent years. We believe there's still high potential for PICC P&C's auto insurance renewal business to further grow. This is despite China's new auto sales being substantially contracted by 48% y-o-y in April, and dragged down 4M22 new auto sales, which posted down 12% y-o-y (figure 7), as impact by the lockdown measures.

Fig 6. China's automobile ownership and y-o-y (%)



Source: WIND, DBS HK

Fig 7. China's new automobile sales and y-o-y (%)

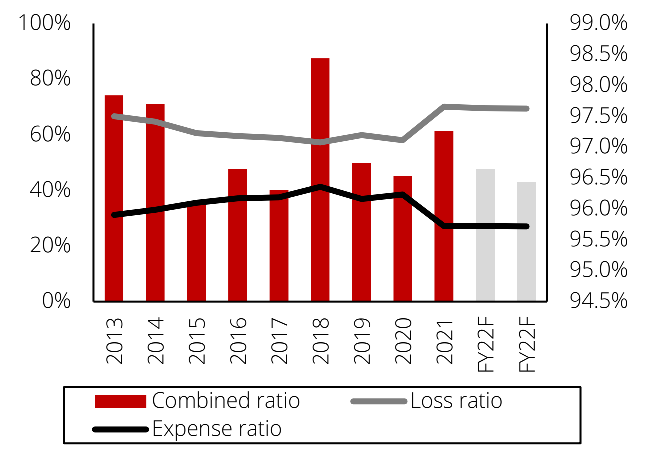


Note FY22F based on DBS HK forecast. Source: WIND, DBS HK

Expect China new auto sales reach 27.25m in FY22F
Nonetheless, with the supply chain issue on automobile chips alleviating, and China government's recent announcement to provide stimulus supports on vehicle purchase tax exemption and ensure for steady factory resumption/reducing logistic bottlenecks. We thus believe this will substantially help to boost up new auto sales in 2H22F. Our China auto analyst is forecasting new auto sales to reach 27.25m, or +3.8% y-o-y (see latest China auto report: Supportive measures to boost vehicle sales). As such, we believe auto insurance demand from new auto sales market will also gradually stabilize.

Overall, we expect PICC P&C's auto insurance premium to post +6% y-o-y both in FY22/23F, driven mainly by the robust growth from its renewal segment with stabilizing new auto insurance demand, first time since 2018 to see reaccelerating growth. With market consolidation stabilizing, scale benefit from the resumption in premium growth, better pricing accuracy post the launch auto insurance pricing reform and fewer claim incident expected given the China's lockdown measures, we expect its auto insurance combined ratio to improve to 96.6%/96.4% in FY22/23F, respectively, down from 97.3% in FY21 (figure 8).

Fig 8. PICC P&C's auto insurance combined ratio



Source: Company data, DBS HK

Quality refocusing in non-auto segment to also help drive profitability
In addition to the expected improvement in PICC P&C's auto insurance business, its strategy to refocus on underwriting book quality for non-auto segment by adopting "lower expense, reduce losses (降费减损)" policy and to proactively scale back higher underwriting risk with ill-quality business especially in liability and commercial property insurance segment. In FY21, liability and commercial property insurance business collectively accounted for 11% of total premium, however, the business

was under underwriting loss with combined ratio at 107.4% and 130.6%, respectively. The former was due an increase in personal injuries claims given the rise in social income level, and the decrease in policy-oriented businesses, which led to a rise in expenses. The latter was due to the substantial rise in claims given the impact from natural disasters.

In addition, its agricultural insurance, which accounted for 10% of total premium in FY21, also incurred underwriting loss with combined ratio at 101.6%, as the insurer was impacted by the higher frequencies in natural disasters. Given government-subsidized agricultural insurance business (as opposed to commercial agricultural insurance) is subsidized via fiscal appropriation, and the pass-through mechanism will be reflected in the premium pricing adjustment, which is based on whether the business has made underwriting profit/loss from last year. Hence, we expect PICC P&C's agricultural insurance premium pricing to be adjusted upward in FY22F, in order compensate its underwriting losses in FY21. As such and with larger premium scale, we expect the quality of the business to also improve in FY22F.

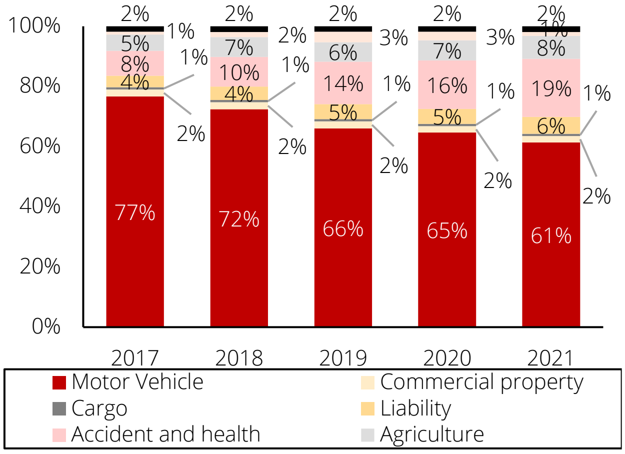
Fig 9. PICC P&C 1Q22 combined ratio by business

Business type	1Q21	1Q22
Motor vehicle	94.6%	96.0%
Accident injury and health	102.1%	100.6%
Agruculture		92.1%
Credit and surety	102.2%	63.7%
Liability	93.2%	104.4%
Commercial property		79.3%
Cargo		79.6%
Others		71.5%
Total	95.7%	95.6%
Implied non-auto segment	96.5%	95.3%

Source: Company data, DBS HK

In 1Q22, PICC P&C's overall combined ratio posted at 95.6%, down 10bps y-o-y, which was mainly driven by the quality improvement from non-auto segment business. With the insurer continue to adopt quality-refocus strategy on its non-auto segment, in exchange for a moderately slower premium growth, we believe the net effect is to continue to see underwriting profit improvement in the non-auto segment.

Fig 10. PICC P&C premium breakdown by type



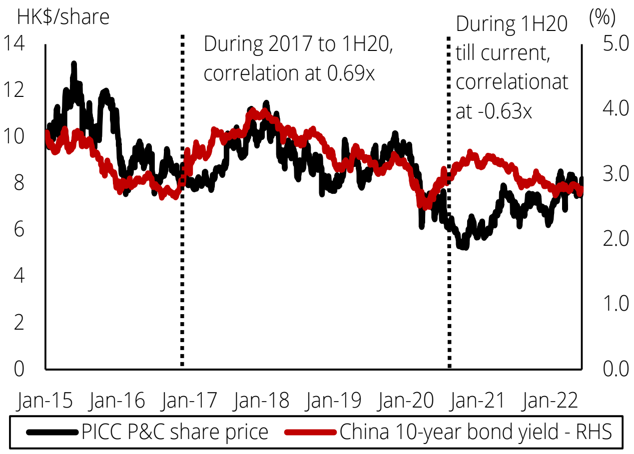
Source: Company data, DBS HK

Critical factor revisit

We revisited two critical factors which we believe has high correlation and will drive future share price performance.

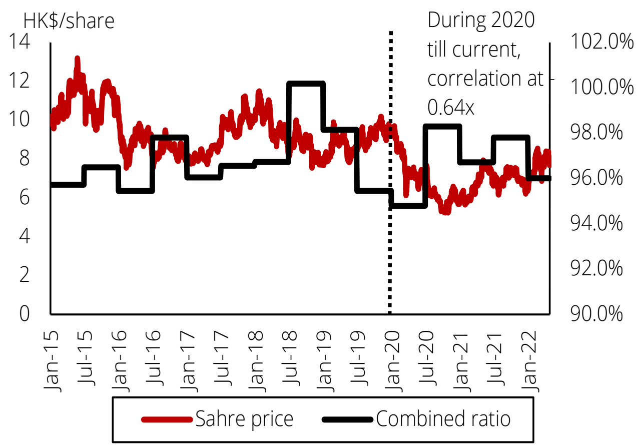
1) China 10-year bond yield – PICC P&C has continued to lengthen its asset duration over the years and as of FY21, its asset duration has reached 7 years compared to liability duration of 1 year. With its positive duration balance sheet position, this bodes well under a declining interest rate environment and may help to drive its book value growth. Since 1H20, PICC P&C's share price has -0.63x negative correlation with China's 10-year yield movement (figure 11), which coincide with the period where China has gradually entered an interest rate downcycle. DBS Econ Team is expecting a further 20bps and 100bps decrease in the LPR and RRR over the remainder of the year. We believe the further decline in interest rate in China will continue to drive PICC P&C's share price.

Fig 11. PICC P&C premium breakdown by type



Source: Company data, DBS HK

Fig 12. PICC P&C premium breakdown by type



Source: Company data, DBS HK

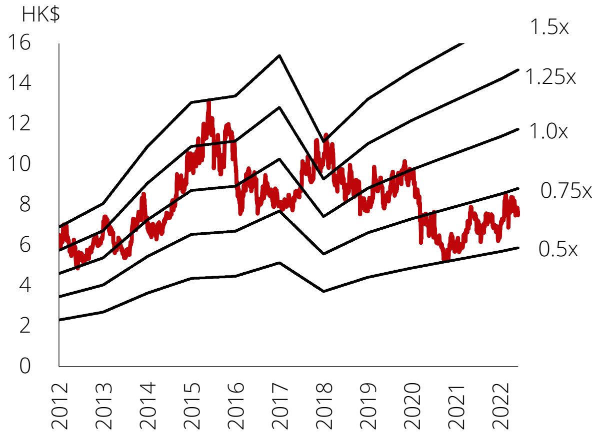
2) Auto insurance combined ratio – Auto insurance pricing reform has been a major overhang to PICC P&C's share price in the past. With the third-round of comprehensive auto insurance reform released in August 2020, we believe the policy overhang has been gradually removed. Since 2020, PICC P&C's share price has a -0.64x negative correlation (figure 12) with its auto insurance combined ratio trend and the correlation has been more significant, compared to the period prior to 2020. We believe this may attribute to the fact that the policy impact and overhang should be gradually removed, and PICC P&C's share price tend to respond positively when seeing an improvement in auto insurance combined ratio.

Share price likely to re-rate on improving quality

PICC P&C's share price has been trading between 1 to 2 standard deviation below past 5-year mean since 2020 (figure 13), and we believe this is due to a) sluggish premium sales growth, b) consecutive deterioration in both auto insurance and overall combined ratio for the past 2 year and c) muted earnings growth. With the overhang from auto insurance pricing gradually removed, PICC P&C's premium has resumed to a positive growth since 4Q21, and we expect its underwriting quality will start to improve. Overall, we forecast its FY22/23F combine ratio to improve to 98.8%/98.6%, up from 99.2% previously.

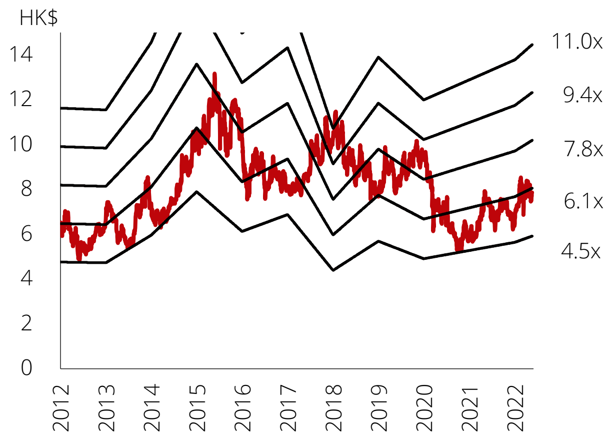
As such, we raise FY22/23F underwriting profit by 44%/74%, and raise earnings by 2%/4%, respectively. We lift TP to HK$11, based on 0.9x FY23F P/B, which is in-line with the past 5-year mean. With 33% share price upside, we upgrade our rating from FULLY VALUED to BUY.

Fig 13. PICC P&C share price and P/B trend



Source: Company data, DBS HK

Fig 14. PICC P&C share price and P/E trend

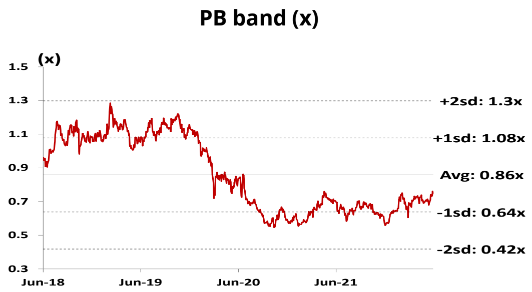


Source: Company data, DBS HK

Company Background

PICC P&C is the largest property and casualty insurer in China and was established in July 2003. It was listed on the HKEX in November 2003. Its insurance products include motor vehicle, commercial property, cargo, liability, accidental injury, and short-term health policies. In FY20, its total assets and equity reached Rmb647bn and Rmb190bn respectively.

Historical PB band



Source: Bloomberg Finance L.P. DBS HK

Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Gross written premium growth	11.4	0.0	3.8	8.3	8.6
Agency growth	0.0	0.0	0.0	0.0	0.0
Agency productivity growth	0.0	0.0	0.0	0.0	0.0
Expense ratio	33.0	32.7	25.9	25.9	25.7
Loss ratio	66.2	66.2	73.7	73.0	72.9
Combined ratio	99.2	98.9	99.6	98.8	98.6
VNB margin	0.0	0.0	100.0	200.0	300.0
Net investment return	4.2	4.1	3.9	3.7	3.6
Total investment return	4.2	4.1	3.9	3.7	3.6
EV growth	0.0	0.0	0.0	0.0	0.0
Solvency ratio	261.0	244.5	241.9	236.7	229.6

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Total weighted premium income	0	0	0	0	0
Gross written premiums	433,175	433,187	449,533	486,673	528,408
Net earned premium	380,683	393,127	396,997	429,690	466,320
Investment income	16,986	17,709	17,996	18,172	19,307
Other operating income	5,060	4,850	7,876	6,315	6,551
Total income	402,729	415,686	422,869	454,177	492,178
Benefits and claims	(251,822)	(260,320)	(292,588)	(313,537)	(340,136)
Underwriting and policy acquisition costs	(116,343)	(118,804)	(92,680)	(102,828)	(110,887)
Finance cost	(1,424)	(1,547)	(1,533)	(1,485)	(1,598)
Other expenses	(13,607)	(14,290)	(14,564)	(13,529)	(14,413)
Total expenses	(383,196)	(394,961)	(401,365)	(431,379)	(467,033)
Share of profit of associated and JVs	4,250	3,951	4,524	4,815	5,051
Profit before tax	23,783	24,676	26,028	27,613	30,196
Income tax expense	496	(3,808)	(3,663)	(3,866)	(4,227)
Minority interest	3	0	(5)	(5)	(6)
Preferred dividend	0	0	0	0	0
Net income attributable to shareholders	24,282	20,868	22,360	23,742	25,963

Source: Company, DBS HK

Balance Sheet(RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Total Investment	460,184	502,189	529,077	566,848	607,640
Segregated funds net assets	0	0	0	0	0
Property, plant and equipment	18,086	25,725	23,743	23,743	23,743
Other assets	117,811	118,887	129,802	160,888	185,310
Total assets	596,081	646,801	682,622	751,478	816,693
Net life reserves - traditional	305,140	312,873	338,781	384,538	424,656
Net life reserves - investment contracts	N/A	N/A	N/A	N/A	N/A
Segregated funds net liabilities	0	0	0	0	0
Other Liabilities	120,987	143,897	138,192	146,329	155,062
Total liabilities	426,127	456,770	476,973	530,866	579,719
Shareholder's equity	169,953	187,513	202,887	217,844	234,201
Participating policyholders' equity	0	0	0	0	0
Minority interest	1	2,518	2,762	2,767	2,773
Total equity	169,954	190,031	205,649	220,612	236,974

Source: Company, DBS HK

Key Financials & Ratios

FY Dec	2019A	2020A	2021A	2022F	2023F
Du Pont analysis (%)					
Net profit / premium income	6.4	5.3	5.6	5.5	5.6
Premium income / total asset	63.9	60.8	58.2	57.2	57.1
Total asset / total equity	4	3	3	3	3
Return on equity	15.6	11.7	11.5	11.3	11.5
Embedded value(RMB m)					
Book value	0	0	0	0	0
Adjusted items	0	0	0	0	0
Adjusted book value	N/A	N/A	N/A	N/A	N/A
Value-in-force	0	0	0	0	0
Adjustment (if any)	0	0	0	0	0
Group embedded value	N/A	N/A	N/A	N/A	N/A
Per share analysis(RMB)					
EPS	1.09	0.94	1.01	1.07	1.17
BPS	7.64	8.43	9.12	9.79	10.53
DPS	0.27	0.38	0.38	0.39	0.43
EVPS	0.00	0.00	0.00	0.00	1.00
Capital Strength (%)					
Leverage ratio	4	3	3	3	3
Solvency ratio	261.0	244.5	241.9	236.7	229.6

Source: Company, DBS HK

Target Price & Ratings History

S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	9-Aug-21	HK$6.61	HK$5.10	Fully Valued
2:	13-Dec-21	HK$6.85	HK$5.50	Fully Valued

Source: DBS HK

Analyst: Ken Shih

Manyi 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*

Completed Date: 20 Jun 2022 09:02:08 (HKT)
Dissemination Date: 20 Jun 2022 15:40:55 (HKT)

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

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DBS Bank (Hong Kong) Limited

13th Floor One Island East, 18 Westlands Road, Quarry Bay, Hong Kong

Tel: (852) 3668-4181, Fax: (852) 2521-1812

DBS Regional Research Offices

HONG KONG
DBS Bank (Hong Kong) Ltd
Contact: Dennis Lam
13th Floor One Island East,
18 Westlands Road, Quarry Bay, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

SINGAPORE
DBS Bank Ltd
Contact: Paul Yong
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
e-mail: groupresearch@dbs.com
Company Regn. No. 196800306E

INDONESIA
PT DBS Vickers Sekuritas (Indonesia)
Contact: Maynard Priajaya Arif
DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia
Tel: 62 21 3003 4900
Fax: 6221 3003 4943
e-mail: indonesiaresearch@dbs.com

THAILAND
DBS Vickers Securities (Thailand) Co Ltd
Contact: Chanpen Sirithanarattanakul
989 Siam Piwat Tower Building,
9th, 14th-15th Floor
Rama 1 Road, Pathumwan,
Bangkok Thailand 10330
Tel. 66 2 857 7831
Fax: 66 2 658 1269
e-mail: research@th.dbs.com
Company Regn. No 0105539127012
Securities and Exchange Commission, Thailand