

AIA Group

Bloomberg: 1299 HK Equity | Reuters: 1299.HK

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DBS Group Research . Equity

27 Jul 2022

BUY

Last Traded Price (26 Jul 2022): HK\$81.40 (HSI : 20,906)
Price Target 12-mth: HK\$124 (52% upside) (Prev HK\$127)

Analyst

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What's New

- Revise down FY22/23F VONB by 11%/9% to reflect 1) impact from China's 2Q lockdown measures and 2) as HK/China border reopening more likely in FY23F
- Strong pent-up demand expected from HK market once HK-China border reopens
- Concerns overdone on recent sharp US interest rate hike and MTM impact to bond portfolio, given low EV sensitivity to interest rates
- Revise down FY22/23F earnings by 6%/2% to reflect slower investment income growth. Roll over valuation base to FY23F and lower TP to HK\$124 on lower multiple

Expect strong pent-up demand in FY23F

Investment Thesis

Well positioned for next expansion. Targeting 10 new provinces/municipalities upon existing establishment by FY30F, there will be an addressable market 5x larger than the current footprint and offers a grand secular opportunity. The recent investment in China Post Life (non-listed) also helps to capture growth from the mass market segment.

VONB to expand fivefold by FY31F. The additional value of new business (VONB) contribution from the China expansion, under a 10-year view, is estimated to result in a 5x and 27% increase in VONB and embedded value (EV), respectively. The value of China Post Life's investment is equivalent to US\$3.9bn.

Embrace the next US interest rate upcycle. The mounting US rate hikes and tapering expectations have led the US 10-year bond yield to reach nearly 3% in July 2022. DBS Econ team is forecasting the US 10-year bond yield to reach 3.5% by end-FY22. The upward shift in the US bond yield is considered a positive for AIA.

Valuation:

Our TP is based on a two-stage EV growth model, with a) the first stage to factor in existing organic growth and b) the second stage to include the present value (PV) of the additional VONB from the China expansion by FY32F, and terminal value. This is pegged to a 1.8x FY23F P/EV multiple (2.1x FY22F P/EV previously). We also included a US\$3.9bn valuation from the China Post Life investment.

Where we differ:

We believe the street has yet to factor in the additional value from the China Post Life investment, where we estimate the investment will bring in an additional HK\$5/share to AIA.

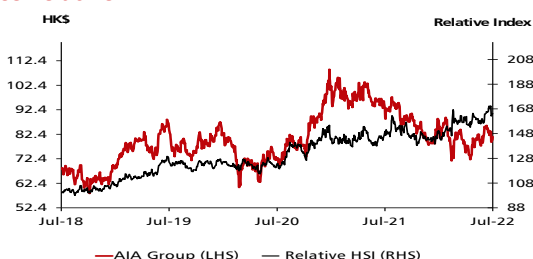
Key Risks to Our View:

Slower VONB growth, sharp deterioration of investment performance, slower economic growth in China, and any interest rate downcycle.

At A Glance

Issued Capital (m shrs)	12,097
Mkt Cap (HKm/US\$m)	984,696 / 125,449
Major Shareholders (%)	
Capital Research Global Investors	6.4
Free Float (%)	93.6
3m Avg. Daily Val. (US\$m)	247.22
GICS Industry: Financials / Insurance	

Price Relative



Forecasts and Valuation

FY Dec (US\$ m)	2020A	2021A	2022F	2023F
Net earned premiums	33,666	34,770	36,411	38,521
Net investment income	9,398	10,631	10,971	11,681
Net Profit	5,959	6,436	6,657	7,210
EPS (US\$)	0.44	0.51	0.55	0.62
EPS (HK\$)	3.43	4.01	4.32	4.86
EPS Gth (%)	(20.8)	16.8	7.8	12.4
PE (X)	23.7	20.3	18.8	16.8
DPS (HK\$)	1.36	1.47	1.52	1.64
Net Div Yield (%)	1.7	1.8	1.9	2.0
BV Per Share (HK\$)	41.01	39.23	42.03	45.24
P/Book Value (X)	2.0	2.1	1.9	1.8
P/EV (X)	1.9	1.7	1.6	1.5
ROAE (%)	8.7	10.0	10.6	11.1
Earnings Rev (%)			(6)	(5)
Consensus EPS (US\$)			0.59	0.71
Other Broker Recs:		B:39	S:0	H:2

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



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WHAT'S NEW

Expect strong pent-up demand in FY23F

Lower FY22/23F VONB growth assumption.

We lower AIA's FY22/23F VONB growth assumption by 11%/9%, respectively, so as to factor in a) the impact from China's lockdown measures in 2Q22, which affects growth for the quarter and beyond; b) the expectation that the VONB margin in China is to be impacted by the industry-wide annuity product mix shift; and c) that the HK-China border is more likely to reopen in FY23F, compared to the previous expectation of 2H22F. With AIA's VONB growth in 1Q22 posted a decline of 18% y-o-y under a constant exchange rate (CER) basis, mainly due to a high base from last year and impacts from the Omicron wave in the various markets it operates, we expect the magnitude of its y-o-y decline in 2Q22F to narrow and resume a positive y-o-y growth trajectory moving into 2H22F. Overall, we expect its VNOB growth to post a marginal reduction of 1% y-o-y in FY22F.

However, with the expectation that the HK-China border is likely to reopen in FY23F, and with the China market likely to resume its stronger growth rebound, mainly due to a low base and continuous expansion into new territories, we expect AIA's VONB to post a 17% y-o-y growth in FY23F.

Strong pent-up demand expected from MCV segment once border reopens.

Despite there being no official timetable for the reopening of the HK-China border, the recent statements from newly elected Hong Kong Chief Executive John Lee seem to be increasingly constructive (Fig 1). Moreover, we believe that the announcement on 30 June 2022 that China would reduce the quarantine days for overseas arrivals from "14+7" days previously to "7+3" days also represents the first move in easing border restrictions.

Once materialised, the reopening of the border should provide a strong boost to AIA's Hong Kong business, given that the Mainland China Visitor (MCV) segment has accounted for two-thirds of AIA Hong Kong's annual premium equivalent (APE) at its peak level; the percentage has dropped to merely 1% since the outbreak of the global pandemic (Fig 2).

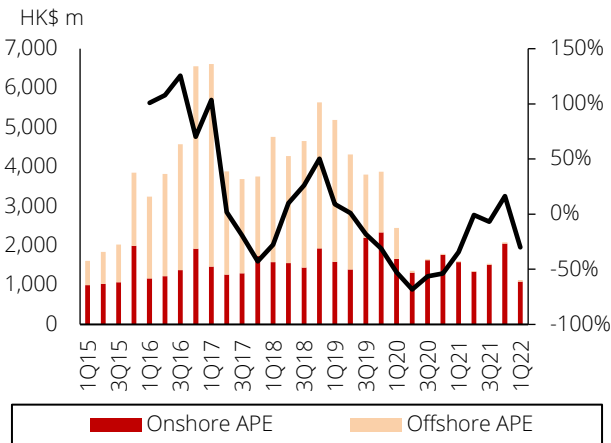
Fig 1: Recent official statement on HK-China border reopening

Date	Official statement on HK-China border reopening
Feb-22	China's President Xi Jinping has told Hong Kong's leaders that their "overriding mission" was to get control of the situation and maintain zero Covid-19 cases
Apr-22	John Lee Ka-chiu said there is room for Hong Kong and the mainland's preventive and control measures to gradually dovetail, so that Hong Kong does not bring unnecessary health risks to the mainland
May-22	John Lee Ka-chiu said to make the reopening of the territory's borders with China and the rest of the world a priority for his new administration.
Jun-22	John Lee said that many hurdles must be overcome before Hong Kong's border with the mainland can be reopened
Jun-22	China reduced quarantine time for overseas arrivals, in the first step towards easing its Covid-19 border restrictions
Jul-22	Hong Kong has formally proposed to the central government a closed-loop arrangement to reopen the border with mainland China, under which residents will complete their quarantine locally before travelling north

Source: Various news sources, DBS HK

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Fig 2. AIA HK APE breakdown by onshore/offshore



Source: HKIA, DBS HK

Accompanied by the robust growth from the domestic segment, we are expecting VONB growth in AIA Hong Kong to be +6% y-o-y in FY22F and accelerate to +27% y-o-y in FY23F, serving as one of the key growth drivers for VONB growth in FY23F at the group level.

Concerns overdone on bond portfolio mark-to-market impact from sharp US interest rate hikes.

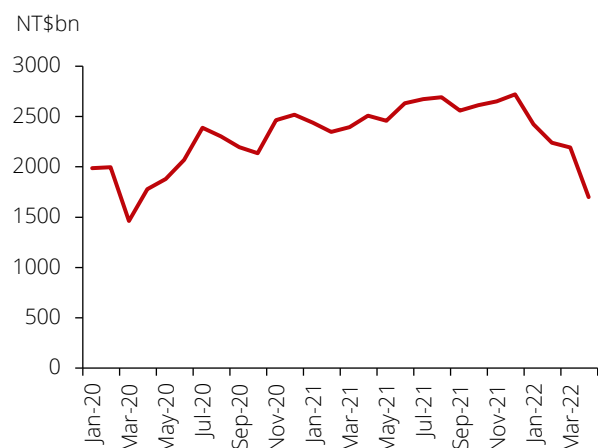
There are rising concerns in the wake of the recent incident with Nanshan Life (non-listed), Taiwan's third largest life insurance company, which book value in 1Q22 declined by 37% compared to end-FY21 (Fig 3, vs. average reduction of 14% among its major listed peers) on mark-to-market (MTM) loss resulting from its sizeable USD bond portfolio due to the rise in the US bond yield as well as the global equity market correction. As the US interest rate hikes further accelerated in 2Q22, along with a steeper global equity market correction during the quarter, the market is expecting the insurer's book value in 2Q22F to decline at an even steeper rate. This has led to further market concerns over the MTM impact to regional insurance companies, such as AIA, as a result of the rise in the USD bond yield.

In general, an interest rate upcycle is considered a positive for insurance companies, as the rise in interest rates (or bond yields alike) will enhance insurance companies' reinvestment returns, and the higher investment return can transform to higher margins for the business already written. Higher investment returns also imply that less

liability reserves are required for new products. For insurers that focus on the spread business, higher yields also help to expand its spread income.

We believe one of the main reasons for seeing such a drop in the book value of Nanshan Life is because insurance companies in Taiwan tend to allocate more investment assets to USD-dominated bonds in order to earn stable bond yields and lengthen the duration, as the interest rate level in Taiwan has remained relatively low due to the issue of over-banking and access to liquidity. Given IFRS 9, insurance companies are required to MTM its assets and with US interests rates rising in a sharp manner, this will temporarily impact insurers' asset values. Furthermore, the benefit on the liability side is not duly reflected, as the global adoption of IFRS 17 (rise in interest rates will lead to reduced liability reserves) will only be implemented from 2023, while Taiwanese insurance companies will delay adoption until 2026. Combine the above factors, this will cause a temporary sharp drop in insurance companies' book values. In addition, the MTM impact from insurance companies' bond portfolios is usually considered a non-cash item, given that insurance companies tend to choose hold-to-maturity on its bond investment account bookings, for the purpose of matching asset-liability durations.

Fig 3. Taiwanese life insurance companies' book values



Note: Above numbers based on the aggregate book value of life insurance companies in Taiwan

Source: FSC, DBS HK

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Limited impact to AIA, given the low interest rate sensitivity of EV.

As AIA adopts a liability-led duration-matching strategy and its business mainly focuses on protection and long-term savings rather than spread products, the overall interest rate sensitivity of its embedded value (EV) is actually low. In addition, AIA also has a variety of management actions and risk management tools in place, i.e., hedging strategy to protect from the risk of low interest rates, to manage its risk exposures. While its sizeable HK business is considered more sensitive to US interest rate volatility, due to the nature of the liability where AIA holds a substantial amount in participating business, its strict adoption of the asset-liability matching strategy ensures its interest rate sensitivity is relatively less. Overall, we believe the MTM impact on AIA's bond portfolio and balance sheet that

resulted from the rise in US interest rates is limited and manageable.

Lower TP to HK\$124. Reiterate BUY.

We lower FY22/23F earnings by 6%/2% to reflect the lower investment income growth due to higher market volatility in 1H, as well as the smaller scale benefit, given the impact of the Omicron wave. Factoring in slower VONB growth, rolling over our valuation base to FY23F, and now based on 1.8x P/EV multiple (previously based on 2.1x FY22F P/EV), we lower TP to HK\$124 (from HK\$127). With a 56% share price update, we reiterate BUY. AIA remains one of our top picks within this space.

Fig 4. AIA 2-stage valuation model

USD (mil)	FY18	FY19	FY20	FY21	FY22F	FY23F
VoNB	3,955	4,186	2,789	3,399	3,369	3,947
VoNB growth	23%	6%	-33%	22%	-1%	17%
VIF	29,880	33,744	36,744	39,685	39,807	40,956
ANW	24,637	28,241	28,503	33,302	37,173	41,622
EV	54,517	61,985	65,247	72,987	76,980	82,578
EV growth	7%	14%	5%	12%	5%	7%
PV of additional VONB from China expansion (by FY32F)						18,871
Investment value of China Post Life @ 24.99%						3,901
Adjusted EV						105,350
No. of shares	12,074	12,074	12,074	12,087	12,087	12,087
USD / HKD						7.8
EV per share (HKD)						68.2
Multiple (x)						1.8x
Target price						124.00

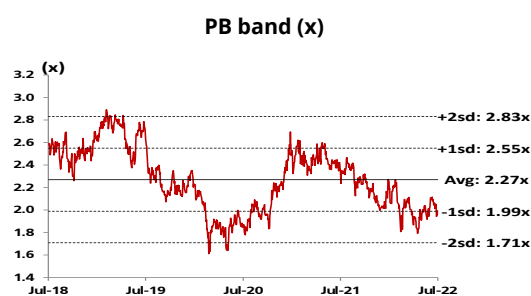
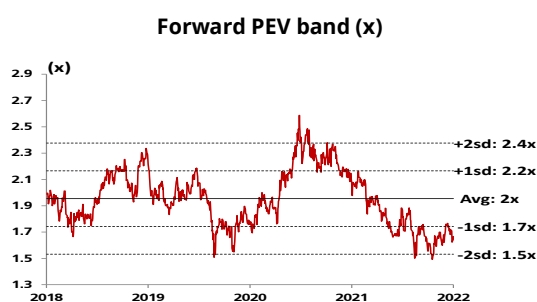
Source: DBS HK

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Company Background

AIA Group Limited (AIA) is the largest independent publicly listed Pan-Asian life insurance group that was first established in Shanghai in 1919. It is a market leader in the Asia-Pacific region (ex-Japan), based on life insurance premiums, and holds leading positions across the majority of its markets. AIA meets the long-term savings and protection needs of individuals by offering a range of products and services, including life insurance, accident and health insurance, and savings plans. The group also provides employee benefits, credit life, and pension services to corporate clients.

Historical PEV and PB band



Source: Bloomberg Finance L.P. DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Total weighted premium growth	11.3	4.1	4.1	2.1	4.2
VNB growth	5.8	(33.4)	21.9	(0.9)	17.2
VNB margin	63.6	53.4	60.2	57.1	58.2
Net investment return	4.6	4.1	4.2	3.7	3.7
Total investment return	4.6	4.1	4.2	3.7	3.7
EV growth	13.7	5.3	11.9	5.5	7.3
Solvency ratio	362.3	489.0	436.0	437.4	441.5

Source: Company, DBS HK

Income Statement (US\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Total weighted premium income	34,002	35,408	36,859	37,633	39,205
Gross written premiums	0	0	0	0	0
Net earned premium	32,896	33,666	34,770	36,411	38,521
Investment income	8,899	9,398	10,631	10,971	11,681
Other operating income	0	0	0	0	0
Total income	41,795	43,064	45,401	47,383	50,203
Benefits and claims	(27,624)	(28,346)	(29,442)	(30,860)	(32,520)
Underwriting and policy acquisition costs	(4,297)	(4,402)	(4,597)	(4,758)	(5,031)
Finance cost	(582)	(658)	(755)	(765)	(785)
Other expenses	(2,468)	(2,695)	(3,031)	(3,190)	(3,417)
Total expenses	(34,971)	(36,101)	(37,825)	(39,573)	(41,753)
Share of profit of associated and JVs	0	0	0	0	0
Profit before tax	6,824	6,963	7,576	7,810	8,450
Income tax expense	(1,030)	(960)	(1,110)	(1,123)	(1,209)
Minority interest	(45)	(44)	(30)	(30)	(30)
Preferred dividend	0	N/A	N/A	N/A	N/A
Net income attributable to shareholders	5,749	5,959	6,436	6,657	7,210

Source: Company, DBS HK

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Balance Sheet(US\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Total Investment	212,776	247,461	253,634	269,013	285,557
Property, plant and equipment	2,865	2,722	2,744	2,744	2,744
Other assets	68,491	75,938	83,496	89,454	95,864
Total assets	284,132	326,121	339,874	361,211	384,165
Net life reserves - traditional	189,597	223,071	239,423	255,659	272,602
Net life reserves - investment contracts	12,273	12,881	11,860	11,860	11,860
Other Liabilities	24,306	26,501	27,657	28,424	29,460
Total liabilities	226,176	262,453	278,940	295,943	313,922
Shareholder's equity	57,508	63,200	60,467	64,771	69,717
Minority interest	448	468	467	497	527
Total equity	57,956	63,668	60,934	65,268	70,244

Source: Company, DBS HK

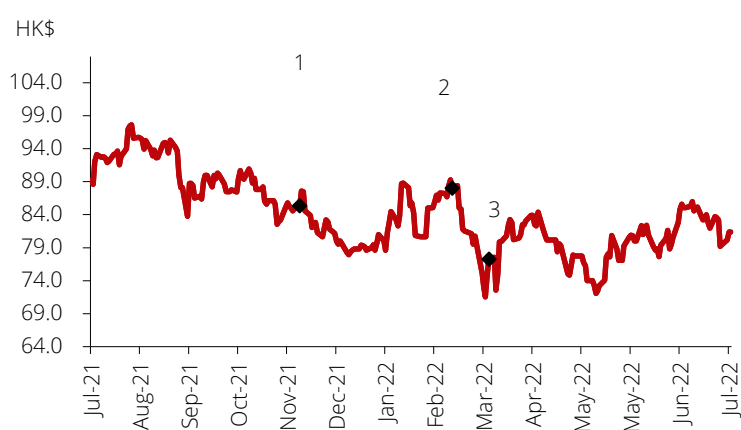
Key Financials & Ratios

FY Dec	2019A	2020A	2021A	2022F	2023F
Du Pont analysis (%)					
Net profit / premium income	20.2	15.7	17.7	18.2	19.4
Premium income / total asset	11.6	10.3	10.2	10.1	10.0
Total asset / total equity	5	5	6	6	5
Return on equity	13.8	8.7	10.0	10.6	11.1
Embedded value(US\$ m)					
Book value	57,508	63,200	60,467	64,771	69,717
Adjusted items	(29,267)	(34,697)	(27,165)	(27,598)	(28,095)
Adjusted book value	28,241	28,503	33,302	37,173	41,622
Value-in-force	33,744	36,744	39,685	39,807	40,956
Group embedded value	61,985	65,247	72,987	76,980	82,578
Per share analysis(US\$)					
EPS	0.55	0.44	0.51	0.55	0.62
BPS	4.76	5.23	5.00	5.35	5.76
DPS	0.16	0.17	0.19	0.19	0.21
EVPS	5.13	5.39	6.03	6.36	6.83
Capital Strength (%)					
Leverage ratio	0	0	0	0	0
Solvency ratio	362.3	489.0	436.0	437.4	441.5

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	23-Nov-21	HK\$85.60	HK\$125.00	Buy
2:	18-Feb-22	HK\$89.30	HK\$127.00	Buy
3:	11-Mar-22	HK\$77.25	HK\$127.00	Buy

Source: DBS HK
 Analyst: Ken Shih
 Iris GAO

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