China / Hong Kong Industry Focus

China Insurance Sector

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DBS Group Research . Equity

25 Jan 2024

How much of the negatives are priced in?

- **Our stress test suggests another 14%-30% downside risk, negatives should have priced in**
- **The stress test on a conservative basis with 5%-50% impairment across asset classes and additional 0.8x justified P/B applied to the post-impairment fair value**
- **Three potential events may signal positive investment sentiment and beef up share prices**
- **Suggest investors gradually accumulate shares upon share price pullback. We like Ping An (2318 HK) for its leading market position**

Our stress test indicates a 14%-30% downside amid economic slowdown in China. We assume insurers property exposure would be impaired by 5%-50% across estimated asset classes vis-à-vis property risk under a destressed scenario, where China property sector may suffer extended downturn, there would be a 24%-28% trimming of insurers' book value. Additionally, we applied a 0.8x P/B to the post-impairment fair value to reflect an overall economic slowdown in China. As a result, our stress test indicates a 14%-30% downside to insurers' current market capitalization, we believe negatives should have already much priced in.

Three potential catalysts may lead to positive sentiment. The deteriorating property sector has eroded household wealth and consumption, leading to negative feedback for the macroeconomy in China, as many investors are left worried. We believe any of three potential events may signal positive investment sentiment and beef up share prices. These include 1) the 3rd Plenary Meeting of the 20th Central Committee; 2) effective policy stimulus to bolster the slumping property market, and 3) the end of another offshore bond repayment peak cycle for developers, which will likely be seen by end-1H24.

Suggest investors gradually accumulate shares upon pullback. With the risk-reward looking increasingly attractive and the current share prices already pricing in much of the negatives based on our stress test, we suggest investors gradually accumulate shares upon share price pullbacks. Among China insurers, we continue to like Ping An (2318 HK) for its leading market position and undemanding valuation.

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Recommendation & valuation

Insurance company	Ticker	Rating	Target Price	Potential Return
China Life - H	2628 HK	BUY	16.00	70.9%
CPIC - H	2601 HK	BUY	24.00	58.9%
Ping An Ins - H	2318 HK	BUY	66.00	90.7%

Source: Bloomberg Finance L.P., DBS Bank (Hong Kong) Limited ("DBS HK")

Closing price as of 25 Jan 2024

ed- BM / sa-CS / JY

How much of the negatives are priced in?

China insurers' share prices have retreated 38%, on average, since the end of July 2023, with concerns over insurers' exposure to the China property sector playing a central role. Despite regulators rolling out plenty of policy stimuli to stabilise the property sector, these measures haven't been deemed firm and effective enough to stabilise the market. The housing prices have dropped consecutive 7 months since then, and in 2H23, developers experienced significant losses due to asset impairment and declining profit margins. At the same time, concerns about local government financial vehicle (LGFV) debt and the potential default of mortgage and developer loans issued by banks have also accelerated the sell-off by investors, serving as a side effect of the turmoil in the property sector.

To address the frequently asked questions regarding how much insurers' share prices have factored in the worst-case scenario concerning their exposure to the property sector, we conducted a stress test to analyse the potential impairment of China insurers' property investment exposure. We assessed insurers' fair value after the impairment and discussed the potential catalysts needed to revisit China life insurers.

Our analysis encompasses a thorough examination of insurers' exposure to the property sector, including 1) bonds and debt, non-standard assets, equities, and commercial buildings, which are exposed to the property sector, and LGFV debt within the insurance investment portfolio; 2) mortgages, developer loans, and LGFV, and debt, trust, and asset management schemes relating to the property sector within the banking arm, as well as assets within the real estate subsidiaries. We also made impairment assumptions based on the asset class. Under an extreme, distressed scenario, we assume 1) debt, equities, NSAs would be impaired by 50%; 2) mortgage and developer loans would be impaired by 5% and 30%, respectively; 3) estimated LGFV exposure would be impaired by 5%; and 4) assets within the "real estate subsidiaries" would be impaired by 50%, except for investment properties, which would be impaired by 25%. It's important to note that our assumptions are based on an extreme, distressed scenario, when the housing price decline reaccelerates and property risk spills over to the broader financial system, possibly causing systemic risks, which we currently consider to be only a remote possibility.

Fig 1. Asset class and impairment assumptions

Major subsidiaries and asset class	Impairment assumption
Insurance funds	
Exposure to property sector	
Bonds and debts	50%
Non-standard assets	50%
Equities	50%
Commercial buildings	30%
Exposure to LGFV debts	**5%**
Bank	
Loans to property sector	
Mortgage	5%
Developer loans	30%
Financial investment	
Government bonds	5%
Debt, trust and asset management scheme	50%
Major real estate subsidiary	
Short-term debt receivables	50%
Equity investments (Projects)	50%
Long-term debt investments and receivables	50%
Receivables	50%
Investment properties	25%
Financial investments	50%

Source: DBS HK

Taking Ping An as an example, our analysis suggests that potentially Rmb225bn of Ping An's property exposure is at risk, accounting for 24% of its shareholder equity. The book value is expected to reduce from Rmb918bn by end-1H23 to Rmb694bn, which we consider to be Ping An's fair value under distressed scenario. We further apply a 0.8x P/B ratio to Ping An's post-impairment fair value to reflect an extended downturn in the property sector and an overall economic slowdown in China. The justified P/B ratio of 0.8x is derived from an average return on equity (ROE) of 11% for China insurers, a cost of equity of 13.4%, and a growth rate of 3%. We hence estimate Ping An's fair value to be Rmb555b, indicating a further 14% downside compared to the current market capitalization adjusted for H-share value (Figure 2).

We apply the same methodology to China Life's and CPIC's implied post-impairment values and estimating the downside based on their market capitalisation adjusted for H-share value. We hence estimate that China Life and CPIC may have further downsides of 30% and 20%, respectively (Figures 3 & 4).

We also conduct a sensitivitiy analysis on the P/B ratio applied to insurers' post-impairment fair value. We believe that a 0.7x P/B ratio suggests an extreme, distressed scenario, wherein systemic risk arises in China, prompting regulatory intervene – a situation we consider highly unlikely to materialize. In such a scenario, China life insurers' share prices may further decline by 25%-38% compared to their current prices.

Insurers' share prices have also been depressed due to the recent rumour that the regulator requires Ping An to take over distressed developer Country Garden (2007 HK). Ping An Group immediately denied the rumour and announced it had sold all of its shareholdings in Country Garden by 3Q23. We think investors are overly concerned about the potential implications, as it is highly unlikely that Ping An would directly take over the developer. Regulators have strict guidelines to regulate insurance fund investments, including limitations on the value of a single real estate asset not exceeding 5% of the company's total assets and a red line prohibiting insurance funds from directly investing in property development and the sale of commercial residential properties. Therefore, we believe insurers have minimal incentives to take over developers, and their internal risk management principles won't allow them to be involved with names that were already subject to default events. As the majority of POE developers are already in default, and insurers have already made credit charges in advance for another repayment cycle for developers in 1H24, we don't expect the credit charges to be a major concern for China life insurers' earnings in 2024.

Despite the gloomy investment outlook, we see the following potential events providing positive signals to the market, which will help drive an improvement in investment sentiment, in our view. These potential events include 1) the confirmed announcement of the 3rd Plenary Meeting of the 20th Central Committee to outline how Chinese leadership plans to manage the structural slowdown and boost domestic consumption; 2) effective policy stimulus to be rolled out to bolster the property market; and 3) the end of another offshore bond repayment peak cycle for developers, which will likely be seen by 1H24.

We maintain our BUY ratings on Ping An, China Life and CPIC with TP at HK$66, HK$16 and HK$24, respectively, indicating 70%-100% upside. With the risk-reward looking increasingly attractive and the current share prices already pricing in much of the negatives based on our stress test (Figure 4), we suggest investors gradually accumulate shares upon a share price pullback. Among China insurers, we continue to like Ping An (2318 HK) for its leading market positioning and undemanding valuation.

Fig 4. Stress test sensitivity

Insurers/PB ratio	0.6x	0.7x	0.8x	0.9x	1.0x
Ping An	-36%	-25%	-14%	-4%	+7%
China Life	-47%	-38%	-30%	-21%	-12%
CPIC	-40%	-30%	-20%	-10%	+0%

Source: Company data, Bloomberg Finance L.P., DBS HK

Fig 2. Ping An's real estate exposure and implied fair value post-impairment

Major subsidiaries	% owned	Total amount (Rmb bn)	% impaired	Impairment amount (Rmb bn)
Ping An insurance funds	100%			
Bonds and debts		**39.2**	**50%**	**19.6**
Equities		**11.9**	**50%**	**6.0**
China Fortune Land		2.2	50%	1.1
China Jinmao		6.8	50%	3.4
Country Garden*		2.7	50%	1.4
Other equities		0.2	50%	0.1
Commerical building **		**158.3**	**30%**	**47.5**
Raffles Cityplazas		30.0	30%	9.0
Ping An HK Building		10.1	30%	3.0
Beijing Lize CBD		18.8	30%	5.6
SITC, Shanghai		6.1	30%	1.8
Lloyd's Building London		0.9	30%	0.3
Shanghai Yibin		13.3	30%	4.0
Vivid Synergy		10.4	30%	3.1
Hangzhou Pingjiang Investment		1.4	30%	0.4
Shenzhen Anpu Development		5.6	30%	1.7
Other		61.6	30%	18.5
LGFV - based on DBS estimate		**230.1**	**5%**	**11.5**
Total (Insurance funds)		**439.5**		**84.5**
Ping An Bank	**58%**			
Loan				
Mortgage		841.6	5%	42.1
Developer		275.9	30%	82.8
Sub-total		1,117.6	11%	124.9
(-) Estimated reserve buffer				50.0
Adjusted sub-total				**74.8**
Financial asset investments				
Government bonds		689.9	5%	34.5
Debt, trust and asset management scheme		99.4	50%	49.7
Sub-total		789.3		84.2
Total (Ping An Bank)		**1,906.8**		**159.0**
Major subsidiaries - Ping An Real Est	**100%**			
Short-term debt receivables		41.8	50%	20.9
Equity investments (Projects)		34.6	50%	17.3
Long-term debt investments and receivables		11.9	50%	5.9
Receivables		6.9	50%	3.4
Investment properties		1.9	25%	0.5
Financial investments		0.3	50%	0.1
Total (PARE)		**97.3**		**48.2**
Grand-total				**224.6**
Ping An Group's 1H23 equity attributable to shareholders				918.1
Estimated book value after impairment				693.6
Adj. P/B ratio		0.6x	0.7x	0.8x
Implied post-impairment value of Ping An Group		416.2	485.5	554.9
Market cap. as of 23 Jan (Rmb bn)				647.0
Implied downside risk to current share price		**-35.7%**	**-25.0%**	**-14.2%**

Source: Company data, Bloomberg Finance L.P., DBS HK

Fig 3. China Life's real estate exposure and implied fair value post-impairment

Major subsidiaires	% owned	Total amount (Rmb bn)	% impaired	Impairment amount (Rmb bn)
China Life insurance fund	**100%**			
Bonds and debts		10.8	50%	5.4
Non-standardized asset		32.3	50%	16.2
Equities		21.5	50%	10.8
Commercial building		161.6	30%	48.5
LGFV - based on DBS estimate		177.8	5%	8.9
Total (Insurance funds)		**404.0**		**89.7**
China Guangfa Bank	**44%**			
Loan				
Mortgage		284.8	5%	14.2
Devloper		116.2	30%	34.9
Sub-total		401.0		49.1
(-) Estimated reserve buffer				8.8
Adjusted impair amount				**40.3**
Financial asset investments				
Government bonds		413.9	5%	20.7
Other debt scheme		77.6	50%	38.8
Sub-total		491.6		59.5
Total (China Guangfa Bank)		**892.58**		**99.8**
Grand-total				**133.3**
China Life's 1H23 equity attribute to shareholders				477.9
Estimated book value after impairment				344.6
Adj. P/B ratio		0.6x	0.7x	0.8x
Implied post-impairment value of Ping An Group		206.8	241.2	275.7
Market cap. as of Jan 17 (Rmb bn) adjusted for H-share value				392.2
Implied downside risk to current share price		**-47.3%**	**-38.5%**	**-29.7%**

Source: Company data, Bloomberg Finance L.P., DBS HK

Fig 4. CPIC's real estate exposure and implied fair value post-impairment

Major subsidiaires	% owned	Total amount (Rmb bn)	% impaired	Impairment amount (Rmb bn)
CPIC insurance funds	98%			
Bonds and debts		1.5	50%	0.7
Non-standardized asset		64.2	50%	32.1
Equities		25.4	50%	12.7
Commercial building		12.7	30%	3.8
Shanghai (Chongming) Project		0.9	30%	0.3
Xinbaoyu		3.6	30%	1.1
LGFV - based on DBS estimate		166.0	5%	8.3
Sub-total (Insurance funds)		**269.8**		**57.7**
Shanghai Rural Commercial Bank (SR	6%			
Loan				
Mortgage		113.3	5%	5.7
Devloper		100.5	30%	30.1
Sub-total		213.8		35.8
(-) Estimated reserve buffer				18.7
Adjusted impair amount				**17.1**
Financial asset investments				
Government bonds		120.0	5%	6.0
Other debt scheme		2.3	50%	1.1
Sub-total		122.3		7.1
Total (SRCB)		**336.06**		**24.2**
Grand-total				**59.1**
CPIC's 1H23 equity attribute to shareholders				243.0
Estimated book value after impairment				183.9
Adj. P/B ratio		0.6x	0.7x	0.8x
Implied post-impairment value of CPIC		110.4	128.7	147.1
Market cap. as of Jan 17 (Rmb bn) adjusted for H-share value				184.4
Implied downside risk to current share price		**-40.2%**	**-30.2%**	**-20.2%**

Source: Company data, Bloomberg Finance L.P., DBS HK

Fig 5. Peers' comparison table

		Price	DBS	TP	Mkt Cap	PBV (x)		PEV* (x)		Div Yield (%)		ROE (%)	
Coverage	Ticker	(LC)	rating	(HK$)	(US$ m)	FY24F	FY25F	FY24F	FY25F	FY24F	FY25F	FY24F	FY25F
H-share insurers													
AIA	1299 HK	65.05	BUY	118.00	88,954	1.9	1.8	1.3	1.2	2.7%	2.9%	13.5%	13.8%
China Life - H	2628 HK	9.36	BUY	16.00	82,519	0.6	0.5	0.2	0.1	7.2%	7.9%	12.6%	13.1%
CPIC - H	2601 HK	15.10	BUY	24.00	25,529	0.5	0.5	0.3	0.3	8.5%	9.6%	13.7%	14.0%
Manulife	945 HK	168.00	BUY	182.00	38,724	1.0	1.0	0.8	0.7	5.4%	5.0%	11.5%	12.1%
PICC Group - H	1339 HK	2.54	HOLD	2.80	25,702	0.4	0.3	0.3	0.3	10.9%	12.0%	8.8%	8.9%
PICC P&C	2328 HK	9.95	BUY	12.50	26,953	0.8	0.7	n.a.	n.a.	6.2%	7.0%	12.4%	12.8%
Ping An Ins - H	2318 HK	34.60	BUY	66.00	88,863	0.5	0.5	0.5	0.5	9.1%	9.9%	13.6%	13.8%
China Taiping	966 HK	6.72	BUY	9.50	2,779	0.2	0.2	0.1	0.1	8.2%	9.6%	6.2%	6.3%
ZhongAn	6060 HK	13.96	BUY	27.00	2,446	1.0	1.0	n.a.	n.a.	0.0%	0.0%	1.8%	2.9%
Prudential	2378 HK	82.50	BUY	130.00	28,293	1.4	1.3	0.6	0.6	2.1%	2.3%	13.1%	13.0%
Average						**0.8**	**0.8**	**0.5**	**0.5**	**6.0%**	**6.6%**	**10.7%**	**11.0%**
A-share insurers													
China Life - A	601628 CH	28.69	HOLD	27.68	82,520	2.1	2.0	0.6	0.5	2.0%	2.2%	12.6%	13.1%
CPIC - A	601601 CH	24.77	HOLD	24.62	25,530	1.0	0.9	0.5	0.5	4.5%	5.0%	13.7%	14.0%
Ping An Ins - A	601318 CH	41.15	BUY	52.74	88,864	0.7	0.7	0.7	0.6	6.6%	7.2%	11.5%	12.1%
PICC Group - A	601319 CH	5.10	HOLD	5.51	25,703	0.9	0.8	1.6	1.5	4.7%	5.2%	8.8%	8.9%
Average						**1.2**	**1.1**	**0.9**	**0.8**	**4.5%**	**4.9%**	**11.7%**	**12.0%**
Regional Insurers													
Sun Life Financial	SLF CN	69.17	NR	NA	29,727	1.8	1.6	n.a.	n.a.	4.6%	4.8%	17.6%	17.3%
Great-West Lifeco	GWO CN	43.84	NR	NA	30,133	1.7	1.5	n.a.	n.a.	4.9%	5.1%	16.3%	16.5%
AXA	CS FP	30.71	BUY	35.00	75,451	1.4	1.3	2.3	2.0	6.5%	7.0%	17.0%	16.6%
Allianz SE	ALV GY	247.50	BUY	286.00	104,356	1.6	1.5	2.0	1.9	5.3%	5.6%	16.8%	16.6%
Legal & General Gp	LGEN LN	2.52	NR	NA	18,993	2.5	2.3	n.a.	n.a.	8.4%	9.0%	28.7%	29.2%
Aviva PLC	AV/ LN	4.34	NR	NA	15,066	1.2	1.2	n.a.	n.a.	8.1%	8.6%	12.7%	11.8%
Average						**1.7**	**1.6**	**2.1**	**2.0**	**6.3%**	**6.7%**	**18.2%**	**18.0%**
Japan & Korea insurers													
Samsung Life	032830 KS	63,800	NR	NA	9,257	0.3	0.2	0.2	0.2	6.4%	6.9%	4.8%	4.9%
Hanwha Life	088350 KS	2,690	NR	NA	1,728	0.1	0.2	n.a.	n.a.	7.3%	8.4%	4.6%	4.8%
Tongyang Life	082640 KS	4,470	NR	NA	536	0.2	0.2	n.a.	n.a.	9.8%	10.0%	5.6%	6.3%
Japan Post Insuranc	7181 JP	2,172	NR	NA	6,942	0.3	0.3	n.a.	n.a.	4.3%	4.4%	3.5%	3.2%
Dai-ichi Life Holding	8750 JP	2,361	NR	NA	21,102	0.7	0.6	0.3	0.2	3.7%	3.8%	9.0%	8.8%
Average						**0.3**	**0.3**	**0.2**	**0.2**	**6.3%**	**6.7%**	**5.5%**	**5.6%**
Other Asian insurers													
Cathay FHC	2882 TT	44.35	NR	NA	20,656	0.9	0.8	n.a.	n.a.	3.5%	3.8%	10.2%	10.2%
Fubon FHC	2881 TT	64.60	NR	NA	26,495	1.1	1.0	n.a.	n.a.	3.4%	3.7%	11.2%	11.1%
Shin Kong FHC	2888 TT	8.57	NR	NA	4,199	n.a.	n.a.	n.a.	n.a.	1.8%	2.3%	n.a.	n.a.
Bangkok Life	BLA TB	19.10	NR	NA	922	0.7	0.6	n.a.	n.a.	4.1%	4.7%	8.8%	9.5%
BAO Viet Holdings	BVH VN	40,700	NR	NA	1,232	1.3	1.3	n.a.	n.a.	2.3%	2.5%	8.0%	8.8%
ICICI Prudential Life	IPRU IN	485.25	NR	NA	8,302	6.4	6.1	1.5	1.3	0.4%	0.4%	11.5%	12.7%
Tokio Marine	8766 JP	3820.00	HOLD	3,800.00	51,790	1.8	1.7	n.a.	n.a.	3.2%	3.7%	14.8%	13.7%
Average						**1.0**	**0.9**	**n.a.**	**n.a.**	**3.0%**	**3.4%**	**9.5%**	**9.9%**

Note: BBG or Visible Alpha consensus used for non-rated (NR) stocks

Closing price as of 25 Jan 2024

Source: Company data, Bloomberg Finance L.P., DBS HK

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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