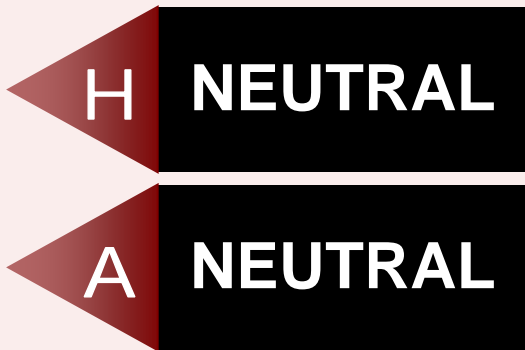


30 September 2011

# China Insurance

## 3Q11 results forecasts



As seen from the latest premium figures, P&C insurance premium income has continued to post stable growth, whereas life insurance remains dampened. Although the market interest rate and wealth management product yield have declined somewhat, the yield of insurance products remains relatively low. With comparatively lower appeal of insurance products, life insurance premium income continues to come under heavy pressure. Under our estimation, China Life, Ping An (based on comparable measures) and CPIC should put in respective net profit growth of -20%, 41% and 38% for 9M11. Our NEUTRAL call on the insurance sector remains intact.

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### Factors Affecting Sector Recently

Positive	Deposit and short-term capital yield increases under an interest rate hike cycle Required reserve appraisal rate curve is in the process of reversing Historically low valuations
Negative	Under a negative interest rate environment, the insurance policy loses appeal. Bancassurance sees no improvements. Insurance product sales face difficulty Continued depression in the stock market

Source: BOCI Research

\* Yao Yao made major contribution to this report.

- According to the latest figures released by China Insurance Regulatory Commission (CIRC), China's insurance sector registered a total premium income of RMB905.52bn in 7M11. Within this, P&C insurance income amounted to RMB272.65bn, up 16.6%, and life insurance income stood at RMB632.87bn.
- As revealed by the three insurers' latest data for 8M11, the growth of the cumulative life insurance premium income from January to August still exhibited a continued downtrend. The growth rates of the 8M11 life insurance premium incomes to China Life, Ping An and CPIC dropped 1.1ppts, 2ppts and 0.9ppt, respectively, compared with 7M11.
- The August auto sales improved. The BOCI auto team believes the September and October auto sales should fare better. We expect the P&C insurance premium income to continue to maintain relatively high growth.
- Currently, the 5-year or below appraisal rate curve has begun to reverse, while the bond yield curve remains upward but flattening. Looking ahead, we expect the bond yield to continue to go up but at a slower pace. The reason is that the cyclical economic downtrend may weaken market demand for funds.
- Our 9M11 earnings growth estimates for China Life, Ping An (based on comparable measures) and CPIC are -20%, 41% and 38%, respectively. Under the continued drag of the overall market recently, insurance stocks have posted considerable share price drops. Our preferred CPIC has performed more satisfactorily. In our view, as the overall market continues to sink to new lows, insurance stocks have limited room for further decline. Given the reversed appraisal rate curve, insurance companies' earnings should somewhat increase, providing certain investment opportunities.

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## INSURANCE PREMIUM INCOME

In 7M11, China's insurance sector recorded a total premium income of RMB905.52bn. Within this, P&C insurance premium income amounted to RMB272.65bn, up 16.6% YoY. Life insurance premium income stood at RMB632.87bn.

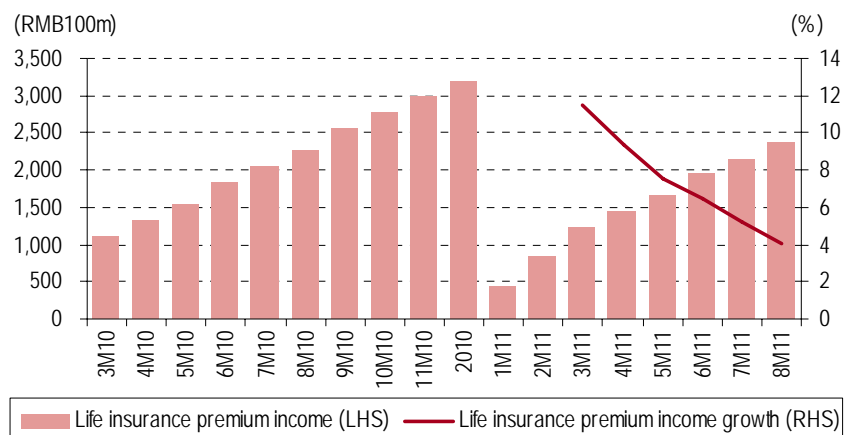
### Life Insurance Premium Income

According to the latest data by CIRC calculated under new measure, the 7M11 life insurance premium income totalled RMB571.48bn, while the July life insurance premium income amounted to RMB56.18bn, down 23% MoM.

The three insurers' latest data show that although August alone posted MoM increases, the growth of the cumulative 8M11 life insurance premium income still went on a downtrend. Insurance policies have not gained in appeal, while the negative impacts of bancassurance continue. The following are the particulars for each company.

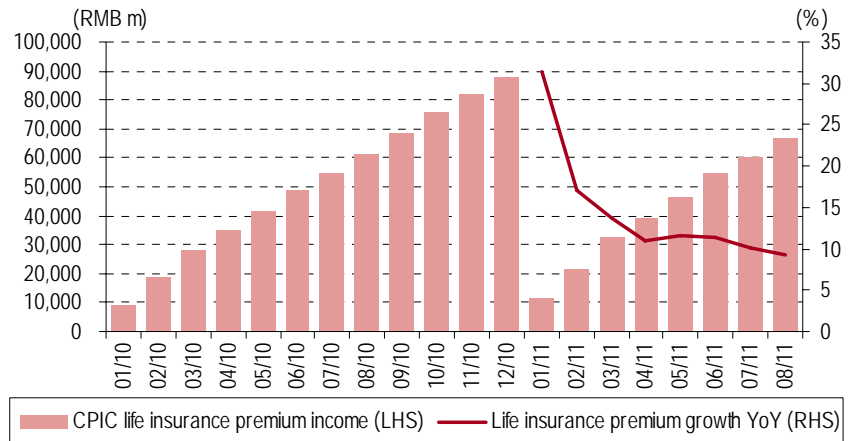
Under the new measure, China Life's 8M11 cumulative premium income totalled RMB237bn, up 4.1% YoY. The premium growth declined 1.1ppts from 7M11. The August premium income alone amounted to RMB21.7bn, up 9.6% MoM but down 6% YoY.

**Figure 1. China Life's Premium Income (New Calculation)**



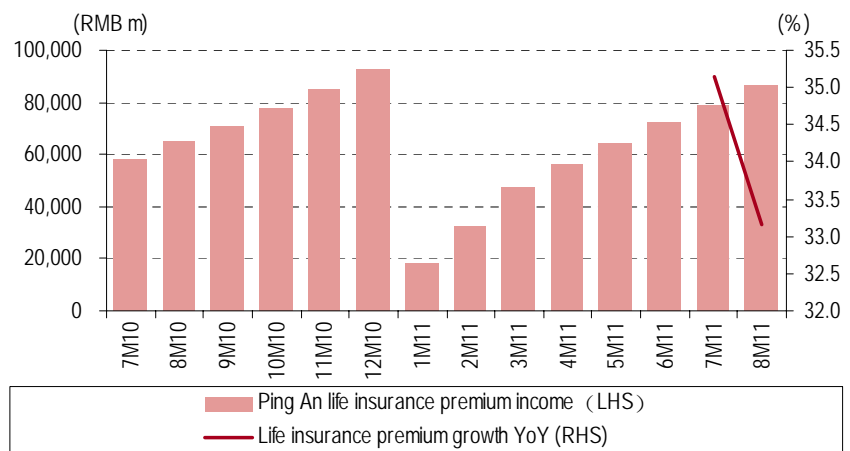
Source: Company data, BOCI Research

As for CPIC, the 8M11 life insurance premium income stood at RMB66.9bn under the new measure, up 9.3% YoY. The growth slowed by 0.9ppt, compared to 7M11. Within this, the August life insurance premium income came in at RMB6.5bn, up 12% MoM but only 1.5% YoY. The upward momentum significantly diminished.

**Figure 2. CPIC's Premium Income (New Calculation)**


Source: Company data, BOCI Research

For Ping An Insurance, under the new measure, its 8M11 life insurance premium income amounted to RMB86.2bn, up 33.2% YoY, but the growth decelerated by 2ppts from 7M11. In August alone, Ping An's life insurance premium income stood at RMB7.34bn, up 10.4% MoM.

**Figure 3. Ping An's Life Insurance Premium Income (New Calculation)**


Source: Company data, BOCI Research

## P&C Insurance Premium Income

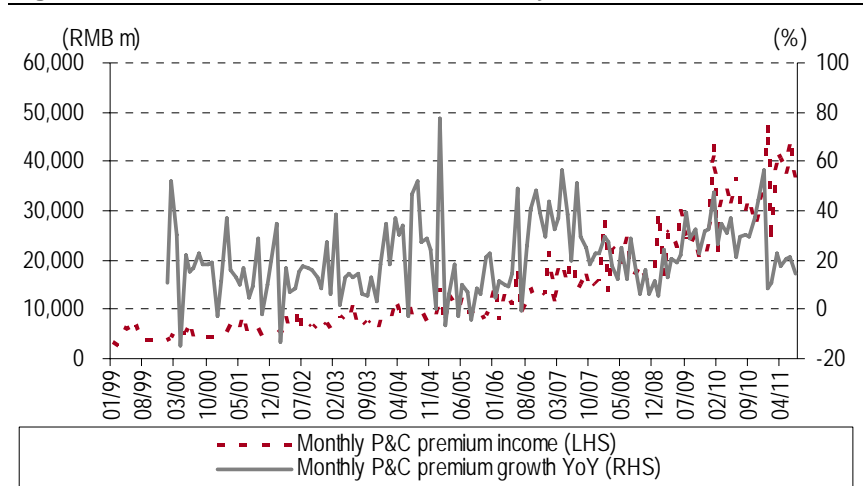
In 7M11, the cumulative P&C insurance premium income climbed 16.6% YoY to RMB272.65bn, with similar growth to that of 1H11. In July alone, the P&C insurance premium income totalled RMB36.7bn, growing at a slower pace of 14.7% YoY.

In 8M11, the auto production and sales volumes went up 3.2% and 3.5% YoY, respectively, to 11.855m and 11.984m units. The growth slightly increased. The single-month data also show some encouraging changes. The August auto production and sales volumes amounted to 1.393m and 1.382m units, respectively, up 9.0% and 4.5%.

The August auto sales amelioration and the September auto sales peak season bode well for auto sales in 2H11, likely to be better than those in 1H11. The BOCI auto research team opines that from the full-year perspective, auto sales growth may reach 4-5%. We maintain our growth estimate of the P&C insurance premium income at around 15-18%.

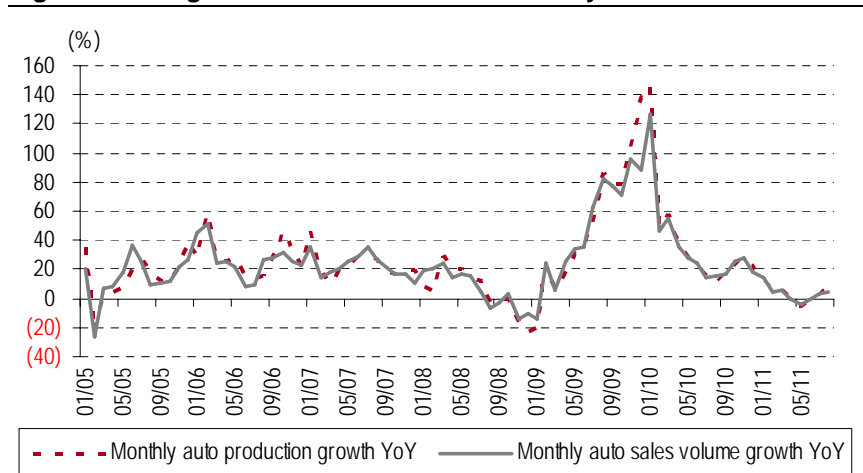
For individual insurers, Ping An's 8M11 P&C insurance premium income maintained strong growth by surging 35.8% YoY to RMB53.9bn. Its August premium income alone was RMB6.61bn, up 0.7% MoM. As for CPIC, its 8M11 P&C insurance premium income was as much as RMB41.5bn, up 19.1% YoY. The growth of such income had stayed at the 19% level for four consecutive months. In August, its P&C premium income stood at RMB4.5bn, which fell 6.3% MoM.

**Figure 4. P&C Insurance Premium Income by Month**



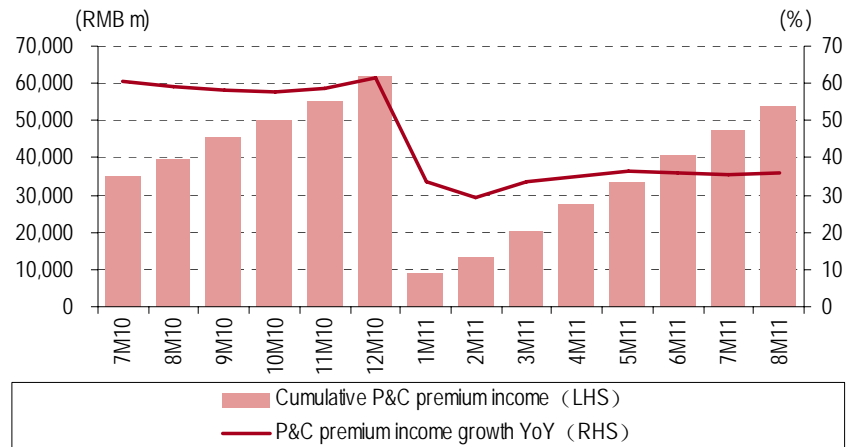
Source: CIRC, BOCI Research

**Figure 5. Changes in Auto Production & Sales by Month**



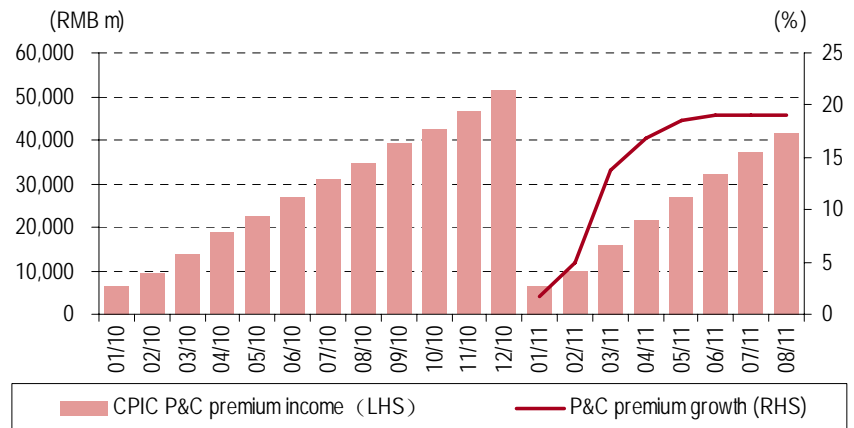
Source: WIND database, BOCI Research

**Figure 6. Ping An's P&C Insurance Premium Income**



Source: Company data, BOCI Research

**Figure 7. CPIC's P&C Insurance Premium Income**



Source: Company data, BOCI Research

## INVESTMENT YIELD

### Bond Yield

Overall, the yield curve for August seems to go on a flattening uptrend. The market interest rate on one-year or below government bonds went up 20-40bps. The three-year bonds' market interest rate rose to around 4.45%. The three to five-year government bond yield gained 20-25bps compared to end-July. The ten-year bond yield saw resurgence to the highest point near 4.17% for this year, after significantly correcting in early to mid-August. The main reasons include: the PBOC has expanded the base for collecting the required reserve, and the market expected higher fund cost for several months after September. The convertible bond issuance of GD Power Development (600795 CH/RMB2.31, NR) and China Shipping Development (600026 CH/RMB6.79, BUY) and the incremental fiscal deposits may have short-term impact on the market interest rate.

Looking ahead, we expect the bond yield to continue to increase but at a relatively slower pace, because the economic slowdown may cool the market demand for funds, in our view.

### Stock Investment Return

Since mid-July, the stock market (SHCOMP) has encountered another continued slump from 2,800pts to around 2,440pts.

Domestically, despite the healthy economic figures for August including exports, the market expectation of economic growth slowdown has intensified. Growth seems to have taken a downward course. Besides, the IPOs of various big-cap stocks have piled pressure on the market.

In our view, the larger factor is the beleaguerment by global markets. For the first time in history, the credit rating agencies downgraded the US' rating in early August. The European and US debt crises have dampened investors' outlook on the global economy. Since the financial crisis in 2008, the major developed economies of Europe and the US are faced with climbing debt ratios. As at late 2011, the total debts incurred by the US federal government and local governments accounted for around 100% of GDP. Besides, Japan's debts were as much as 227% of GDP, whereas those of Italy and Greece stand above 100%, respectively. The governments of nations such as Germany, France and the UK incur debts equivalent to 70-80% of GDP, far above the international alert range of 60%. In addition, the powerful trade unions in Greece, Italy and so on threaten the continuity of the various governments' fiscal tightening policies. Meanwhile, the opposition parties and the citizens of Germany and France, among others, are reluctant to help other nations. Hence, Europe seems to be beset with greater trouble than the US.

Looking ahead, we believe China's economy faces cyclical slowdown. Uncertainty worldwide, especially in Europe, will continue to trouble China's stock markets. Due to the complexity of the domino effects within the euro zone, the Europe debt crisis cannot be resolved in the short term. Given the weakening domestic and global economy, further tightening in the monetary policy seems less possible, and the policy execution is slowing. Short-term trading opportunities exist in the stock market, as we believe it is bottoming out.

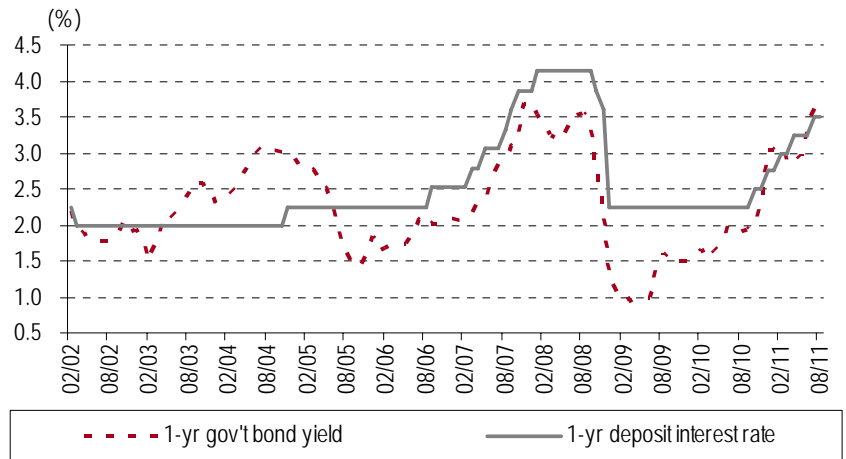
## Insurers' Investment Structures

According to CIRC data, as of end-July, the insurers' balance of funds amounted to RMB5.2trn, down from end-June. At end-July, insurance funds in bank deposits stood at RMB1,598.189bn, down RMB167.576bn MoM. This is the largest monthly decline this year, possibly due to the higher proportion of bond investments, in our view. Meanwhile, the insurance investments rose correspondingly. At end-July, the balance of insurance investment funds totalled RMB3,572.716bn, up RMB133.455bn from June, which represents the largest increment this year.

As at end-July, the insurers' balance of funds amounted to RMB5.2trn. Among this, bank deposits accounted for 30.9% of total investment assets, down 1.6ppts from end-June; bond investments accounted for 47%, up 1.2ppts from end-June. In line with our estimates, the insurers allocated less funds to deposits but more to bonds. Moreover, securities fund and stock investments accounted for 13.9%, up 0.7ppt from end-June. Given the stock market weakness in August-September, the insurers face losses. Their end-July total asset scale stood at RMB5.6trn, down RMB139.6bn from end-June. This is the second total asset scale shrinkage this year, probably owing to the stock market weakness.

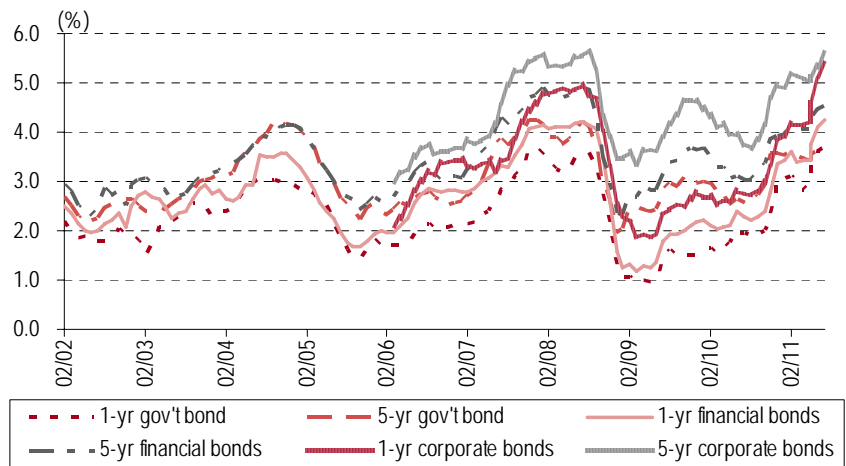
Looking ahead, we believe the insurance companies may continue to increase fund allocation to bonds in their asset portfolios. The allocation to agreement deposits should slow overall, but may soar at end-September and end-December.

**Figure 8. One-year Deposit Rate and One-year Government bond Yield**



Source: WIND database, BOCI Research

**Figure 9. Various Bond Yield Curves**



Source: WIND database, BOCI Research

## 3Q11 RESULTS ESTIMATES AND STOCK PICKS

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China Life: Despite the sharp earnings decline in 1H11 and the possible negative growth in earnings for the first three quarters, we do expect the decline to narrow significantly. The negatives include: The 3Q11 premium income remains downtrodden, and should record deceleration YoY. Moreover, the stock market continues to fare poorly in 3Q11. Since the end of June, the SHCOMP Index has shed 250pts or 9%. This affects China Life's investment yield and leads to asset impairment losses. On the other hand, positives include: Under our estimation, the 750-day moving average curve for the 6 to 30-year government bond yield is still lingering at the bottom, but the 750-day moving average curve for the 5-year or below government bond yield has begun to go up. The positive effect on required reserve gradually surfaces. The 3Q10 base for YoY comparison was relatively low. Overall speaking, we estimate that China Life's net profit for 3Q11 will decline 20% to about RMB20bn, exhibiting a slower drop than in 1H11.

Ping An: We anticipate Ping An's 3Q11 earnings growth will outpace that of 1H11. For its insurance business, Ping An's premium income still maintain relatively high growth. Even though the investment yield may decline QoQ, the 3Q10 earnings provide a relatively low base for comparison, and the growth YoY should still be relatively fast. As for its banking business, we expect Shenzhen Development Bank's (SDB) 3Q11 earnings to keep increasing at around 50%. The third quarter alone may post lower growth due to the higher comparison base of 3Q10. Besides, with the slowing pace of trust product issuance in 3Q11, Ping An Trust's earnings may be flat YoY. We estimate that Ping An should record 44% YoY increase in 3Q11 net profit, considering its 29.99% stake in SDB. If we take into account Ping An's consolidation of financial statements with SDB in 3Q11, Ping An's 3Q11 net profit growth YoY may reach 48%.

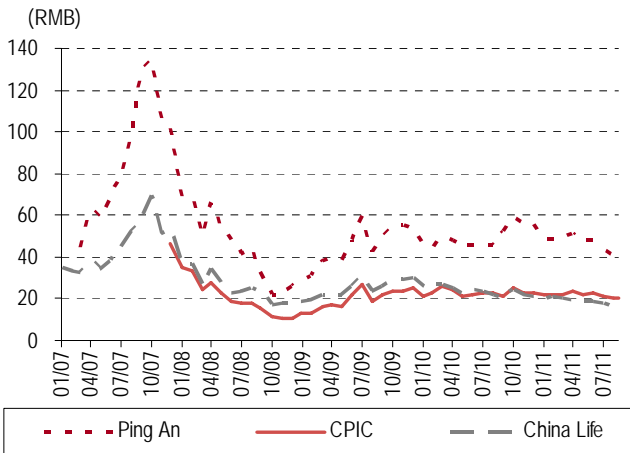
CPIC: We expect CPIC's 3Q11 results to extend its good interim performance. In spite of the sustained weakness in life insurance premium growth, the P&C premium income growth should still near 20% YoY, driving the total premium income to grow around 12% YoY. Improvements in the P&C insurance profitability will continue to be the engine for CPIC's overall profitability. Life insurance provisioning may also benefit from the gradual uptrend in the government bond yield curve. In consideration of the stock market slump in 3Q11, we have conservative estimation of CPIC's 3Q11 investment yield. However, given the expansion in the investment scale, investment yield may still register decent growth YoY. Moreover, the lower comparison base of 3Q10 may also help CPIC to lift its YoY growth rate. Overall, we estimate its 3Q11 net profit growth at around 38% YoY.

In our view, as the market continues to reach new lows, the insurers' downside is limited. Given the reversal of the appraisal rate curve, the insurers' earnings should be lifted to a certain extent, providing some investment opportunities.

## APPENDICES. KEY MONTHLY FIGURES OF INSURANCE SECTOR

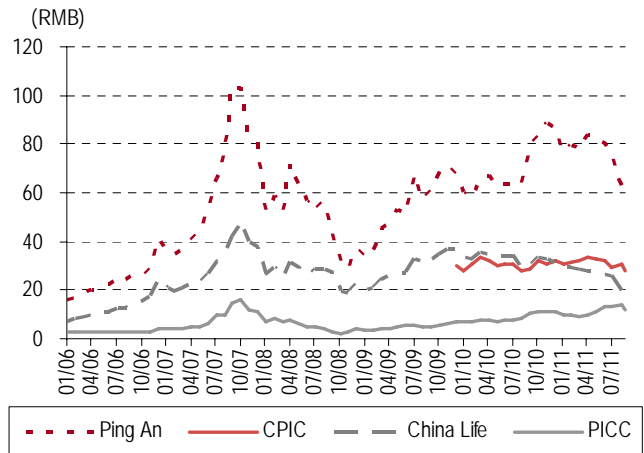
### I. China Listed Insurers' Market Performances

**Figure 10. A-share Insurers' Performances since 2007**



Source: WIND database, BOCI Research

**Figure 11. H-share Insurers' Performances since 2006**



Source: WIND database, BOCI Research

**Figure 13. A-share Insurers' Stock Price Performances**

	Latest price	Price change (%)		
	(RMB)	1 week	1 month	Year-to-date
Ping An	34.68	(13.58)	(17.15)	(37.64)
CPIC	18.39	(12.05)	(12.47)	(18.45)
China Life	15.00	(6.31)	(7.64)	(28.23)
SHCOMP	2392.00	(4.81)	(8.42)	(14.81)

Source: WIND database, BOCI Research

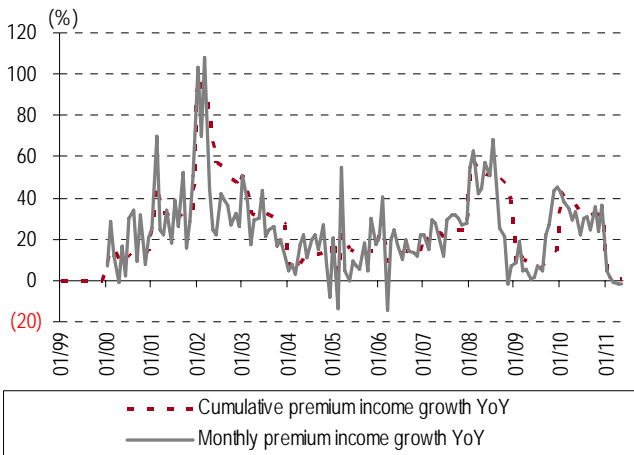
**Figure 13. Listed Insurers' Rolling P/B and P/E**



Source: WIND database, BOCI Research

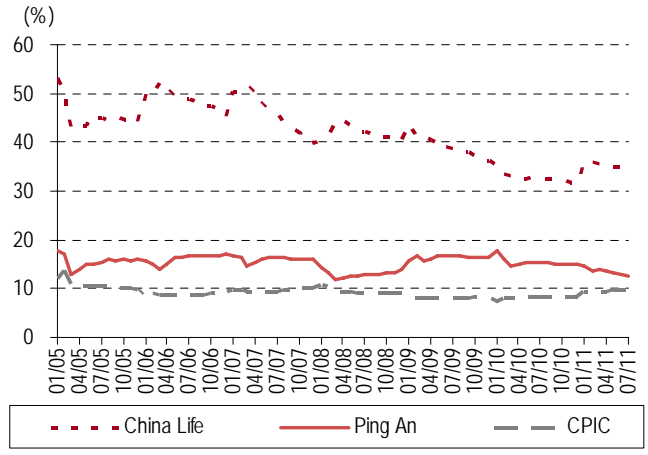
## II. China Insurance Sector Fundamental Data

Figure 14. Premium Income Growth



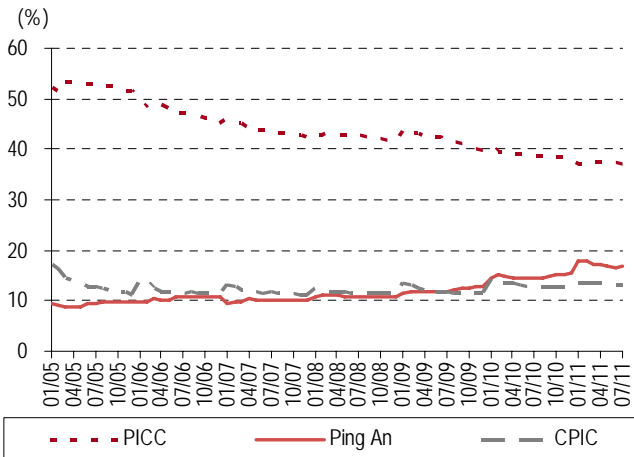
Source: CIRC, BOCI Research

Figure 15. Life Insurance Market Share



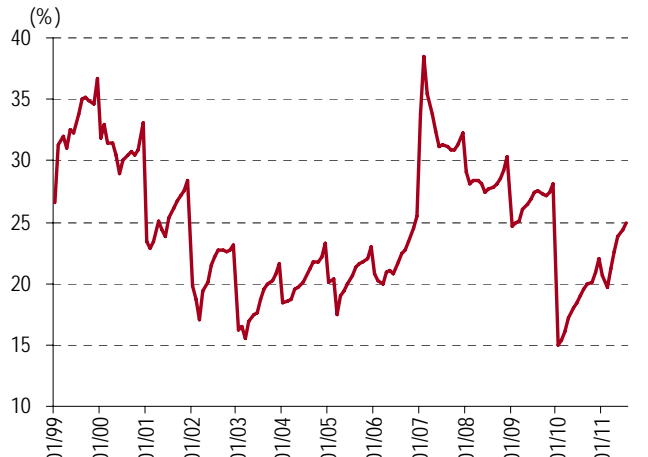
Source: CIRC, BOCI Research

Figure 16. P&C Insurance Market Share



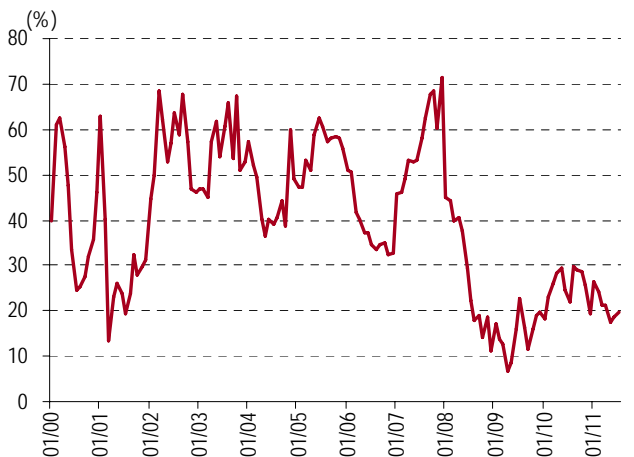
Source: CIRC, BOCI Research

Figure 17. Compensation Rate



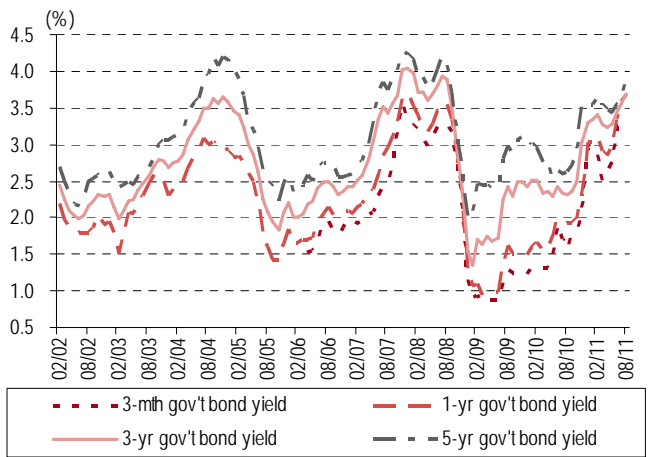
Source: CIRC, BOCI Research

Figure 18. Investment Asset Growth

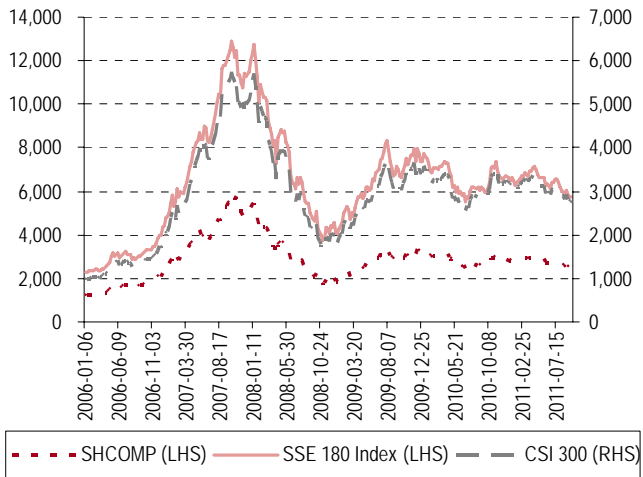


Source: CIRC, WIND database, BOCI Research

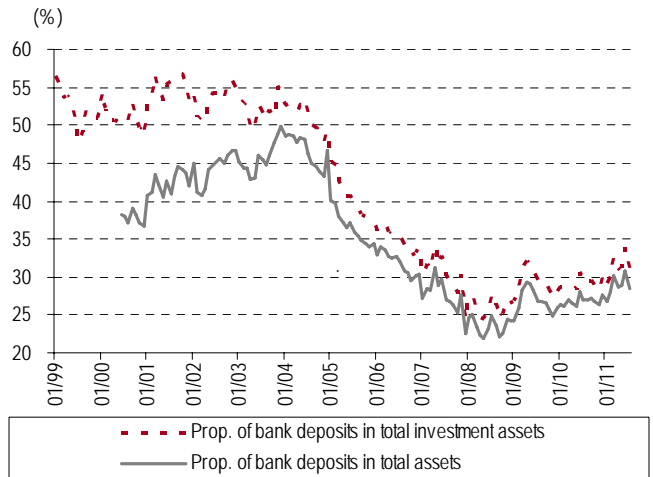
Figure 19. Interbank Market Treasury Bond Yield Curve



**Figure 20. Stock Market Performance**



**Figure 21. Bank Deposit Weighting**



Source: CIRC, WIND database, BOCI Research

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## LISTED COMPANIES IN THIS REPORT

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CPIC (2601 HK/HK\$23.80, HOLD; 601601 CH/RMB18.39, BUY)

China Life (2628 HK/HK\$18.58, HOLD; 601628 CH/RMB15.00, BUY)

China Shipping Development (600026 CH/RMB6.79, BUY)

GD Power Development (600795 CH/RMB2.31, NR)

PICC (2328 HK/HK\$9.13, HOLD)

Ping An Insurance (2318 HK/HK\$47.00, HOLD; 601318 CH/RMB34.68, BUY)

*Closing prices as of 28 September 2011  
All figures subject to rounding*

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