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IPO Analysis: China Pacific Insurance (2601): The second largest

IPO this year

Author(s): Ho Tin Shing (SFC CE NO:AQW224)

China Pacific Insurance (**CPIC**), the third largest insurer in the PRC in terms of market shares in the life insurance and in property and casualty insurance, has begun its IPO activities today. Currently, the bank has 7,700M outstanding A shares. It is expected that the insurer could issue 861M H shares at HK\$26.8 to HK\$30.1 each. CPIC is seeking to raise up HK\$23,075M to HK\$25,916M to replenish capital and fund expansion.

According to official announcement, CPIC expects 2009 net profit of no less than RMB6.51B, representing a whopping 65.3% YOY increase, the fully diluted EPS could be RMB\$0.76. The maximum offer price for the H share IPO is HK\$30.1, implying a **09 diluted P/E of 35.7x**. As at 30 June 2009, the solvency ratio was still very sufficient at 224%. (Regulatory requirement: 100%) (Dec-08: 234%).

IPO Information

Total offer:	861M H shares
Offer Price:	HK\$26.8 to HK\$30.1 per share
O/S Shares after IPO:	8,483M shares
2009 estimated net profit:	no less than RMB6.51B
Prospective 09E PE:	35.7x (assuming HK\$30.1 per share)
Sponsors:	UBS
Application Close:	December 10, 2009
Listing date:	December 15, 2009

Use of the Proceeds

At an offer price of HK\$30.1 (high-end) per share, the group will receive net proceeds of HK\$23,075M for replenish capital and fund expansion.

Business Review

Currently, CPIC ranks the third in the PRC life insurance market with a market share of 8.1%, respectively, and ranks second and third in the PRC property and casualty insurance market with a market share of 11.4% and 11.6%, respectively, in terms of gross written premiums.

In 1H09, net premium income (NPI) of life insurance and property & casualty insurance grew steady by 25.6% YOY and 18.3% YOY to RMB17,091M and RMB18,682, respectively, due to the continued improvement in the quantity and productivity of agency force. Considering the under-penetrated of China insurance market, we are not surprised that CPIC continues to record a significant growth in premiums in coming years.

Table 1: Income Statements (RMB M)

	1H09	1H08	FY08	FY07	FY06
	Jun-09	Jun-08	Dec-08	Dec-07	Dec-06
Insurance					
Gross Premium Income					
-) Life insurance	17,091	13,603	25,921	21,332	17,729
-) Property and casualty Insurance	18,682	15,790	27,924	23,549	18,197
Total Gross Premium Income	35,773	29,393	53,845	44,881	35,926
-) Premium to Reinsurers	(5,538)	(4,690)	(8,435)	(6,762)	(6,394)
Net Premium Income (NPI)	30,235	24,703	45,410	38,119	29,532
Benefits & Claims	(9,211)	(9,176)	(16,781)	(12,390)	(9,207)
Policyholder Reserve	(10,497)	(10,919)	(12,688)	(18,632)	(11,467)
Unearned Premium Reserve	(6,697)	(6,308)	(9,060)	(6,043)	(4,259)
Deferred Acquisition Cost (DAC)	(3,786)	(2,517)	(5,634)	(5,155)	(3,880)
General and Admin Expenses	(3,741)	(4,258)	(7,778)	(8,693)	(6,323)
Acquisition Cost reimbursed by Reinsurers	(213)	(176)	(318)	(275)	(211)
Total Benefits & Expenses	(34,145)	(33,354)	(52,259)	(51,188)	(35,347)

Underwriting Profit / Loss	(3,910)	(8,651)	(6,849)	(13,069)	(5,815)
Net investment income	6,362	11,657	17,755	12,379	6,386
G/L on assets	2,516	2,795	(9,645)	14,851	3,148
Other income	165	344	816	535	284
Associates	26	(2)	(52)	70	(3)
Recurring EBT	5,159	6,143	2,025	14,766	4,000
Taxation	(1,158)	55	1,161	(2,500)	(1,363)
Minority Interest	(64)	(116)	(100)	(1,028)	(618)
Net profit	3,937	6,082	3,086	11,238	2,019

Source: *IPO prospectus*

Investment Income Recovers

As at 30 June 2009, the equity securities increased to **RMB29,292M** or **9.4%** of total investment assets (Dec-08: 5.1%); and the fixed maturity investments decreased to **RMB268,022M** or **85.6%** of total investment assets (Dec-08: 92.5%). The insurer timely adjusted the investment portfolio by increasing the proportion of equity investment. As A-share is still undemanding at the level of 3,300, there are more rooms on equity market to advance on corporate earnings growth.

Table 2: Investment Assets (RMB M)

	1H09	2008	2007	2006
	Jun-09	Dec-08	Dec-07	Dec-06
At Period End				
Bonds				
-Government	17,393	21,285	24,053	19,556
- Policy finance	25,926	26,553	22,049	21,659
- Financial institutions	47,222	42,701	26,404	22,383
- Corporate	83,596	74,359	54,028	27,852
- Other fixed investments	2,824	2,536	1,440	1,138
Term deposits				
- Loans and receivables	91,061	82,756	59,262	53,855
Investment in infrastructure projects				
- Equity	12,442	4,995	4,696	0

- Debt	2,799	1,544	0	0
Equity securities				
- Funds	11,343	7,981	30,470	15,444
- Equity	17,454	5,324	34,589	10,884
- Other Equity Investments	495	469	451	546
Total	312,555	270,503	257,442	173,317

Income Statement

Net investment income	6,362	17,755	12,379	6,386
G/L on assets	2,516	(9,645)	14,851	3,148
Total Investment Income	8,878	8,110	27,230	9,534
Total investment yield*	6.06%	2.92%	11.96%	5.97%

Balance Sheet equity

Unrealized g/l charged directly to equity	3,822	(22,484)	8,080	Nil
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Source: *IPO prospectus*

*Assumed on full year digits

Embedded value

As at 30 June 2009, the embedded value soared to RMB74,889M (Dec-08: RMB69,978M) on significant unrealized asset gains from its equity securities. In the first nine months of 2009, the Shanghai Composite Index climbed from 1,820 to 2,996. Looking ahead, A-share market is likely to continue its rally on corporate earnings growth. The embedded value at 2009 and 2010 year end might be **RMB103,110M** or HK\$13.74 per share and **RMB118,576M** or HK\$15.81 per share, respectively as shown in Table 3.

Table 3: Life Insurance Embedded Value Forecast (RMB M)

	FY09E	1H09	FY08	FY07
at the beginning	Dec-09	Jun-09	Dec-08	Dec-07
Adjusted net asset value	75,101	52,751	51,876	60,740
of which, life insurance	25,642	24,763	24,352	16,243
Value of in-force insurance business written prior to June 1999	(2,620)	(2,494)	(2,251)	(2,237)
Value of in-force insurance business written since June 1999	35,854	31,953	27,109	21,899
Cost of holding the required solvency margin	(7,325)	(6,937)	(6,441)	(5,336)
Embedded Value	103,110	74,889	69,978	74,755
of which, life insurance	62,259	45,770	42,769	30,570
Value of one year's new business	10,023	6,018	4,740	3,865
Cost of holding the required solvency margin	(1,852)	(1,082)	(1,089)	(850)
Value of one year's new business after cost of solvency	8,171	4,935	3,651	3,015
Embedded value per share	12.15	8.83	8.25	8.81
RMB/HK\$	1.13	1.11	1.10	1.06
Embedded value per share	13.74	9.80	9.07	9.34

Source: *IPO prospectus, Quam Estimates*

**based on the maximum of offer prices and Share O&S after IPO*

Valuation & Recommendation

As ups and downs of stock market is a big swing factor to the embedded value, the embedded value shrinks significantly when the stock market bottoms. As A-share is undemanding at the level of 3,300 in light of the corporate profit growth, the securities asset may record gains in 2009 and 2010. Table 5 and 6 shows the sum-of-parts valuation of CPIC at 2009 and 2010 year end. The 09 and 10 fair value could be **RMB240,211M** or **HK\$32 per share and RMB274,063 or HK\$36.8 per share**. At the maximum offer price for the H share IPO of HK\$30.1, CPIC trades 18.2% discount to its FY10 fair value.

In addition, as illustrated in table 4, the valuation of CPIC trades discount to its peers despite smaller market share in the PRC. **We are confident that the CPIC may grow steadily under decent outlook of PRC life insurance market, Investors may only subscribe a small exposure or accumulate on weakness after listing.**

Unexpected weak A-share and natural disasters could be major risks.

Table 4: Valuations comparison of China Life insurance players

	Price	P/Ev (09E)	P/Bv (09E)	P/E (09E)	Mkt share in PRC Life-insurance Mkt	Mkt share in PRC P&C-insurance Mkt
CPIC	30.1	2.2	2.6	35.7	9.0%	10.9%
China Life	39.5	3.3	4.9	31.9	42.7%	-
Ping An	69.95	4.1	4.9	37.6	14.0%	11.4%

Source: **Company reports, Quam Estimates**

**based on the maximum of offer prices*

***Based on market share in 2008*

Table 5: Sum-of-parts valuation (FY09)

(RMB\$ M)	FY09 (E)	Note
Life insurance	217,907	3.5x FY09(E) embedded value
P & C insurance	22,304	16x FY09(E) Earnings
Fair Value	240,211	
Shares (M)	8,483	
Fair value per share (RMB)	28.3	
HKD / RMB	1.13	
Fair value per share (HKD)	32.0	

Source: **Company reports, Quam Estimates**

**based on the maximum of offer prices*

Table 6: Sum-of-parts valuation (FY10)

(RMB\$ M)	FY10 (E)	Note
Life insurance	248,413	3.5x FY10(E) embedded value
P & C insurance	25,650	16x FY10(E) Earnings
Fair Value	274,063	
Shares (M)	8,483	
Fair value per share (RMB)	32.3	
HKD / RMB	1.14	
Fair value per share (HKD)	36.8	

Source: **Company reports, Quam Estimates**

**based on the maximum of offer prices*

Disclosure: Ho Tin Shing (AQW224), the author of this document declares that as of the date of the publication of this report, he does not hold an interest in stocks 2601