

China / Hong Kong Company Guide

China Taiping Ins

Version2|Bloomberg: 966 HK EQUITY|Reuters: 0966.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

9 Jan 2018

BUY

Last Traded Price(9 Jan 2018):HK\$31.70(HSI : 31,011)

Price Target 12-mth:HK\$42.00 (32% upside) (Prev HK\$38.00)

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What's New

- Credit spread in China continues to widen driven by higher liquidity premium and tighter liquidity
- China Taiping is considered the main beneficiary given its low base with higher new money yield to provide upside to its 4.7% recurring yield
- Along with higher equity investment amid positive market outlook, we expect it to deliver positive investment variance
- FY17-19F earnings raised by 6-17%; TP lifted to HK\$42; Reiterate BUY for 32% potential upside

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2016A	2017F	2018F	2019F
Net earned premiums	143,439	172,366	207,546	248,828
Net investment income	17,656	17,746	22,356	27,090
Net Profit	4,774	5,666	7,668	9,429
EPS (HK\$)	1.33	1.58	2.13	2.62
EPS (HK\$)	1.33	1.58	2.13	2.62
EPS Gth (%)	(29.8)	18.7	35.3	23.0
PE (X)	23.9	20.1	14.9	12.1
DPS (HK\$)	0.10	0.24	0.32	0.39
Net Div Yield (%)	0.3	0.7	1.0	1.2
BV Per Share (HK\$)	15.63	17.98	20.11	22.74
P/Book Value (X)	2.0	1.8	1.6	1.4
P/EV (X)	1.1	0.9	0.8	0.7
ROAE (%)	8.2	9.4	11.2	12.2

Earnings Rev (%)		6	15	17
Consensus EPS (HK\$)		1.50	1.93	2.34
Other Broker Recs:		B: 14	S: 1	H: 6

Source of all data on this page: Company, DBSV, Thomson Reuters, HKEX

Main beneficiary of widening credit spread

Credit spread continues to widen on higher liquidity premium: With the expectation that market liquidity will tighten amid the rising interest rate cycle, credit spreads between China's 10-year AAA/AA corp. bond and 10-year govt bond has continued to widen and reached 1.6%/2.2% in early Jan respectively, posting new highs since late 14/late 15. The continuous rise in China's yield curve is +ve to China life insurers, as the widening credit spread/bond yield will lead to higher investment return and less reserving pressure. Ultimately, this implies earnings upside.

Low recurring yield base provides most upside potential: We see China Taiping as the main beneficiary of the widening credit spread, mainly due to its low recurring yield base which was 4.7% in 1H17 versus peer's range of 4.6% to 5.3%. With 10-year AAA/AA corporate bond yield currently reached 5.4%/6.0% level, this implies China Taiping may enjoy the highest recurring yield upside among peers. As of 1H17, its fixed income position reached 45% of total investment assets (lower-end among peers) with 74% of such investment as Hold-to-Maturity (highest among peers). Therefore, it can simply increase investment position in fixed income to earn the widening credit spread.

Positive investment variance expected: China Taiping has streamlined its investments by realizing losses from investment in China's GEM (Growth Enterprise Market) in 1H17. Despite a temporary drag on its total investment yield, it now holds a +ve value of HK\$2.7bn in its available-for-sale category (4% of book value). With outlook for HK/China equity market expected to remain bright in 2018, China Taiping will be able to deliver +ve investment variance helping to lift its EV growth.

Raise target price to HK\$42. Reiterate BUY: We raised earnings by 6%-17% in FY17-FY19F to factor in a higher recurring yield/total investment yield assumption, and accordingly lifted our target price to HK\$42 (from HK\$38). Trading at 0.8x forward P/EV, China Taiping remains as one of the cheapest life insurers in China despite its 83% run in 2017. With the longest negative duration gap of 21 years, we see the insurer benefitting the most from an interest rate up-cycle. China Taiping remains our top pick in China insurance sector.

Valuation:

Our target price is based on SOTP valuation, pegged to 1.3x FY18F P/EV (in-line with past 5-year peers' average; previous 1.2x) for Taiping Life, 1x FY18F P/B for Taiping Insurance (P&C), 0.8x/1.0x FY18F P/B for Taiping Reinsurance/others, and refer a 15% conglomerate discount.

Key Risks to Our View:

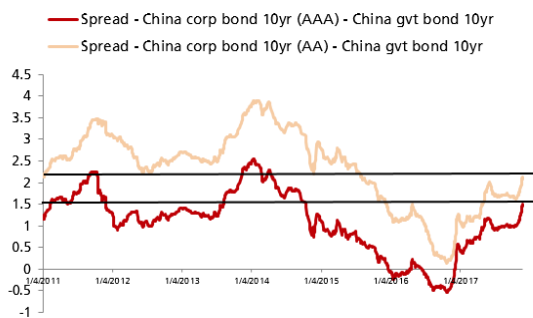
Increasing competition from peers, downward interest rate trend, declining bond yield, A/H share market volatility and slower than expected economic growth in China.

At A Glance

Issued Capital (m shrs)	3,594
Mkt. Cap (HK\$m/US\$m)	113,930 / 14,568
Major Shareholders	
China Taiping Insurance Group Ltd. (%)	59.6
Free Float (%)	40.4
3m Avg. Daily Val. (US\$m)	48.3
ICB Industry: Financials / Life Insurance	

WHAT'S NEW**Widening credit spread on higher liquidity premium****Credit spread between China's corporate bond and 10-year government bond reaching new high since late 2014.**

Triggered by US Fed fund rate hike, the Chinese government has adopted a tightening stance, in turn driving tighter liquidity in the overall market. The spread between China's 10-year AAA/AA corporate bond and 10-year government bond has reached a new high since late 2014 and late 2015 respectively, hitting 1.6% and 2.2% respectively. Life insurers are especially sensitive to interest rates as higher interest rates can benefit insurers through lower pressure on reserves (reserve is inversely proportional to 750-days MA 10-year government bond yield) and higher re-investment income (bonds represent a significant portion of investment portfolio). In our view, the widening spread of corporate bonds offer strong investment yield potential for insurers.

Figure 1. China Corporate credit spread reaching new highs

Source: Company Data, DBS Vickers

Figure 2. Investment portfolio breakdown of Chinese insurance companies in 1H17

Ticker Company name	966 HK China Taiping HKD (m)	1339 HK PICC RMB (m)	1508 HK China Re RMB (m)	2318 HK Ping An RMB (m)	2601 HK CPIC RMB (m)	2628 HK China Life RMB (m)
By asset class:						
Cash & deposit	47,828	140,456	23,601	257,976	133,114	542,987
Fixed income investment	213,527	256,207	64,463	1,201,629	615,214	1,149,251
Equity investment	78,364	98,461	37,474	383,673	116,512	420,753
Loan	85,327	195,029	46,493	328,104	157,973	327,345
Property investment	18,985	-	2,745	48,276	8,496	1,372
Others	32,586	133,151	9,562	-	-	153,772
Total investment asset	476,616	823,304	184,338	2,219,658	1,031,309	2,595,480
% of total						
Cash & deposit	10%	17%	13%	12%	13%	21%
Fixed income investment	45%	31%	35%	54%	60%	44%
Equity investment	16%	12%	20%	17%	11%	16%
Loan	18%	24%	25%	15%	15%	13%
Property investment	4%	0%	1%	2%	1%	0%
Others	7%	16%	5%	0%	0%	6%
Net investment yield (%)	4.7%	5.3%	4.6%	4.9%	5.1%	4.7%
Total investment yield (%)	4.0%	5.4%	5.7%	4.9%	4.7%	4.6%
Bond investment breakdown:						
Fair value through P&L	390	2,401	405	80,746	2,389	79,153
Available-for-sale	56,679	131,804	42,011	223,421	194,704	453,097
Hold to maturity	162,680	122,002	22,046	1,150,882	298,988	688,825
% of total						
Fair value through P&L	0%	1%	1%	6%	0%	6%
Available-for-sale	26%	51%	65%	15%	39%	37%
Hold to maturity	74%	48%	34%	79%	60%	56%

Source: Company Data, DBS Vickers

China Taiping's low recurring yield offers most upside potential.

We believe China Taiping's low recurring yield base of 4.7% in 1H17 has upside potential and offers a good comparable base, therefore putting the group as the main beneficiary of widening credit spreads. Compared to peers' net investment yield range of 4.6% to 5.3% (Figure 2), we believe China Taiping can enjoy stronger new money yield with 10-year AAA/AA corporate bond yield reaching 5.4%/6.0% level. This implies China Taiping may enjoy the highest recurring yield upside among peers, which would have a direct positive impact on the bottomline.

China Taiping has room to lift bond investments in order to enjoy larger credit spread.

As of 1H17, China Taiping's fixed income position reached 45% of total investment asset, the lower-end among peers which had an average of 74% of such investments held under Hold-to-Maturity. We believe China Taiping has room to increase the allocation to bond portfolios, which can thus translate into stronger net investment yield from higher credit spread of corporate bonds.

Low total investment yield sets a good comparison base.

China Taiping has streamlined its investments by realising losses from its previous investment in China's GEM (Growth Enterprise Market) in 1H17. This move led to it delivering disappointing total investment yield of 4.0%, lowest among the peers' 4.6% to 5.4% range. We regard this disappointing performance as one-off and sets a good comparable base going forward.

Looking deeper into China Taiping's other comprehensive income statement, the group in fact generated HK\$ 2.7bn (4% of total equity) of fair value change from available for sales securities, representing 0.57% of investment assets. This implies the group's overall investment performance is not as bad as implied by its total investment yield. Again, we believe this represents a good comparison base going forward post realising investment losses in China's GEM.

With H-share and China equity market outlook continuing to be bright in 2018, we believe China Taiping will be able to deliver positive investment variance, which would help to lift its Embedded value growth.

We raised our target price to HK\$ 42.0 from better investment assumptions.

By factoring in higher net & total investment yield assumptions, we raised earnings by 6%-17% in FY17-FY19F. The new target price HK\$ 42.0 is based on SOTP valuation, pegged to 1.3x FY18F P/EV for Taiping Life, 1x FY18F P/B for Taiping Insurance (P&C), 0.8x/1.0x FY18F P/B for Taiping Reinsurance/others, and refer a 15% conglomerate discount.

Figure 3. Fair value changes from available-for-sale (AFS) securities

Company name		Unit (mil)	FY1H15	FY2H15	FY1H16	FY2H16	FY1H17
China Life	FV. change on AFS. Securities	RMB	54,454	(374)	(30,210)	(14,299)	(4,838)
	Total equity						312,724
	% of total equity						-2%
Ping An	FV. change on AFS. Securities	RMB	3,307	(821)	(18,295)	2,269	20,089
	Total equity						532,698
	% of total equity						4%
CPIC	FV. change on AFS. Securities	RMB	19,300	(155)	(5,049)	(6,834)	(6,031)
	Total equity						134,327
	% of total equity						-4%
Taiping	FV. change on AFS. Securities	HKD	11,318	(8,306)	(7,234)	(1,870)	2,655
	Total equity						72,696
	% of total equity						4%

Source: Company Data, DBS Vickers

CRITICAL FACTORS TO WATCH

Critical Factors

Sensitive to China government bond yields:

Increase in 750-day moving average would lower the insurance reserve assessment. This is also positive to insurer's reinvestment yield under a rising yield environment. We believe China's tightening stance is favourable to life insurers.

First-year premium / Value of New Business

Taiping's first-year premium, reaching HKD 44,002m and up 6% y-o-y, composed of agency channel (51%), bancassurance (48%) and others (1%) in 1H17. Taiping is shifting to value focus, with agency channel increasing by 32% to HKD 22,414m and bancassurance decreasing by 12% to HKD 21,241m given more lucrative new business margin from agency channel (35.1%) than bancassurance channel (18.6%).

Value of new business reached HKD 8,155m in 1H17, increasing by 55% y-o-y. Agency, bancassurance and group channel contributed 97% and 10% and -7% respectively. Steering away from bancassurance to agency is positive to its new business value. The group's embedded value reached HKD 115bn in 1H17, up 12% h-o-h from HKD 102bn. Affected by RMB depreciation (down 6%) in 2016, Taiping's embedded value only grew by 5% y-o-y in 2016.

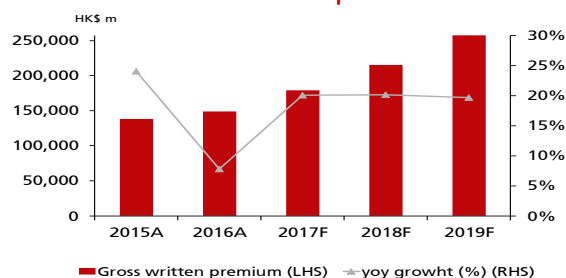
Agency growth and productivity

In 1H17, the group's individual agency sales force reached 391K, increasing by 49% h-o-h. Agency productivity, measured in new premium per average agency, reached RMB 68,692, a slight decrease of 3% y-o-y. The agency persistency ratio for 13/25 months were solid, standing at 95.6% / 92.4% in 1H17, 1.3%/4.2% higher than 1H16. Its persistency ratio was higher than the industry standard owing to product mix tilted towards annuity products.

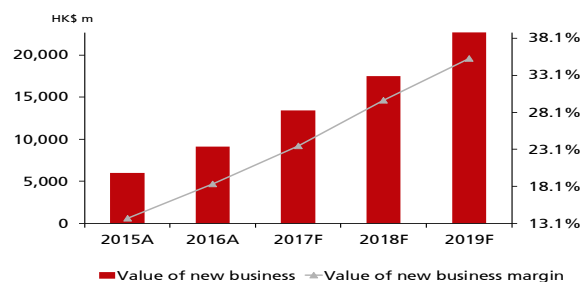
Investment Performance

Taiping achieved disappointing annualised investment yield of 4.01% in 1H17, 67bps lower than 1H16, as the insurer streamlined its equity investments and disposed of those which did not fall under its long-term investment strategy. Fixed income investments (Term deposits, Bonds and other fixed income investments) represented 79% of its investment portfolio. Thus, we believe the group's reinvestment yield will benefit under rising interest rate environment.

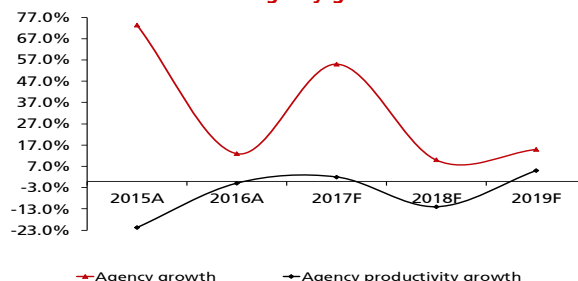
Gross written premiums



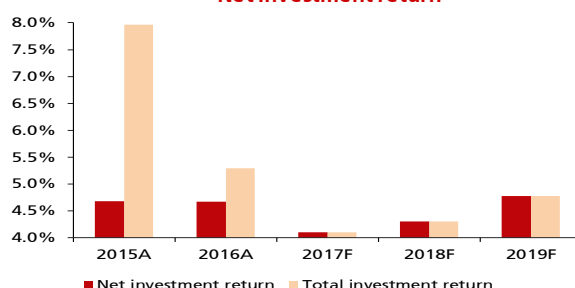
Value of new business



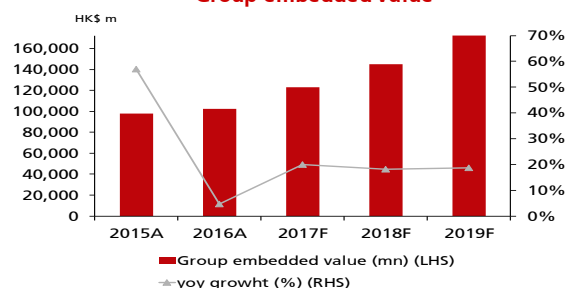
Agency growth



Net Investment return



Group embedded value



Source: Company, DBS Vickers

Appendix 1: A look at Company's listed history – what drives its share price?

Share price history



Source: Company Data, DBS Vickers

Share price performance vs China 10-year government bond yield

Remarks



Correlation of 0.85 between China 10-year government bond yield and share price since Jan16.

This is attributed to benefits from lower reserve required from increasing government bond yield and higher new money yield in its investment portfolio. The company is set to benefit from China's tightening stance.

Source: Bloomberg Finance L.P., DBS Vickers

Balance Sheet:

Taiping Life's comprehensive solvency ratio reached 244% at end-1H17, declining by 7% compared from end of 2016 but still higher than the 150% regulatory requirement. For its P&C business, TPI's comprehensive solvency ratio increased by 10% to 216% in 1H17. The leverage, measured in terms of total asset / total equity, increased from 7.5x in 2H16 to 8.1x in 1H17.

Share Price Drivers:**Sensitive to China government bond yields:**

Increase in 750-day moving average would lower the insurance reserve assessment. This is also positive to insurer's reinvestment yield under a rising yield environment. We believe China's tightening stance is favorable to life insurers.

Value of New Business:

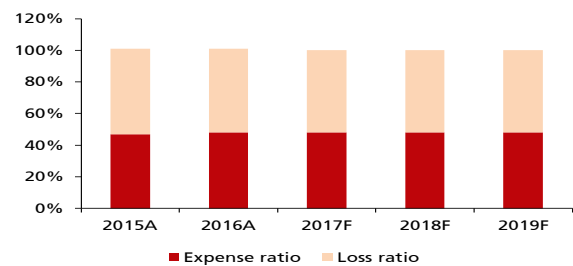
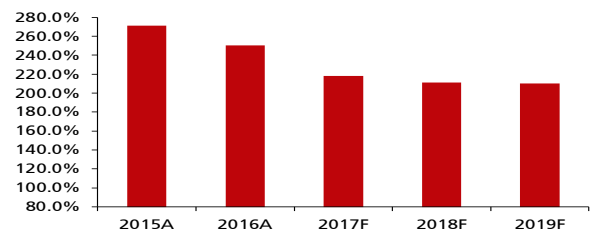
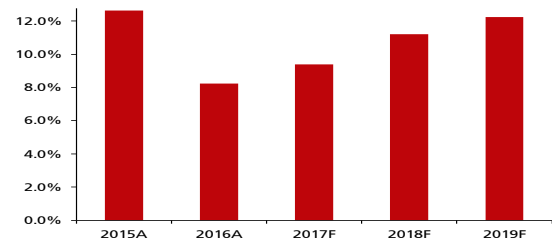
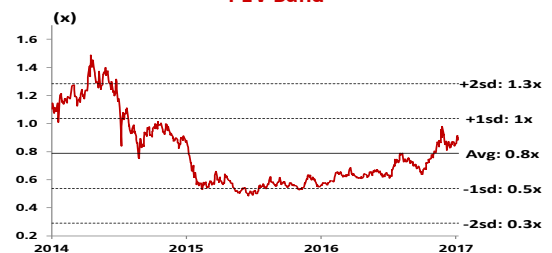
The share price performance is linked to the group's ability to deliver growth in value of new business. Change in product mix or channel that is favourable to value of new business is positive.

Key Risks:

Substantial decline in China government bond yields would require higher reserve. Increase in pricing competition would affect new business margins. Rising A/H share volatility. Slower China economic growth.

Company Background

China Taiping Ins, the former overseas insurance arm of PICC and the only China life insurance company set up outside China, was established in July 2003. It was listed on HKEX in November 2003. Its insurance products include life (individual and group life insurance, health and accident insurance and annuity) and P&C (motor vehicle, commercial property, cargo and liability etc). At end-2016, its total assets and equity reached HK\$ 505bn and HK\$ 51bn respectively.

Expense/Loss/Combined ratio**Solvency ratio****ROE****PEV Band****PB Band**

Source: Company, DBS Vickers

Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
Gross written premium growth	24.1	7.8	20.1	20.1	19.7
Agency growth	73.3	13.0	55.0	10.0	15.0
Agency productivity growth	(21.8)	(0.9)	2.0	(12.0)	5.0
Expense ratio	46.8	48.0	48.0	48.0	48.0
Loss ratio	54.2	53.1	52.1	52.1	52.1
Combined ratio	101.1	101.0	100.0	100.0	100.0
VNB margin	13.7	18.4	23.5	29.7	35.3
Net investment return	4.7	4.7	4.1	4.3	4.8
Total investment return	8.0	5.3	4.1	4.3	4.8
EV growth	56.9	4.6	19.9	18.1	18.7
Solvency ratio	271.0	250.5	218.0	211.1	210.4

Source: Company, DBS Vickers

Income Statement (HK\$ m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Gross written premiums	138,356	149,136	179,044	215,092	257,367
Net earned premium	130,581	143,439	172,366	207,546	248,828
Investment income	16,525	17,656	17,746	22,356	27,090
Other operating income	13,562	5,403	4,441	6,351	6,901
Total income	160,668	166,499	194,553	236,253	282,819
Benefits and claims	(50,824)	(83,643)	(77,968)	(95,844)	(116,158)
Underwriting and policy acquisition costs	(36,264)	(39,385)	(46,056)	(55,520)	(66,032)
Finance cost	(1,049)	(1,377)	(1,337)	(1,317)	(1,307)
Other expenses	(61,520)	(32,833)	(59,173)	(69,886)	(82,466)
Total expenses	(149,658)	(157,238)	(184,533)	(222,567)	(265,963)
Share of profit of associated and JVs	(2)	(10)	365	321	274
Profit before tax	11,008	9,250	10,385	14,008	17,130
Income tax expense	(2,840)	(2,948)	(3,082)	(4,124)	(5,013)
Minority interest	(1,827)	(1,528)	(1,637)	(2,215)	(2,688)
Preferred dividend	0	0	0	0	0
Net income attributable to shareholders	6,341	4,774	5,666	7,668	9,429

Source: Company, DBS Vickers

Balance Sheet(HK\$ m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Total Investment	364,188	392,572	472,384	566,266	568,918
Property, plant and equipment	7,617	8,321	10,016	11,641	13,563
Other assets	116,226	104,512	125,928	129,140	241,277
Total assets	488,031	505,406	608,328	707,048	823,758
Net life reserves - traditional	254,021	291,844	347,713	445,593	543,117
Net life reserves - investment contracts	18,763	22,437	23,171	24,794	25,038
Other Liabilities	143,449	124,122	160,356	149,689	156,515
Total liabilities	416,233	438,403	531,240	620,076	724,669
Shareholder's equity	59,728	56,169	64,618	72,286	81,715
Minority interest	12,071	10,834	12,470	14,685	17,373
Total equity	71,799	67,003	77,089	86,972	99,089

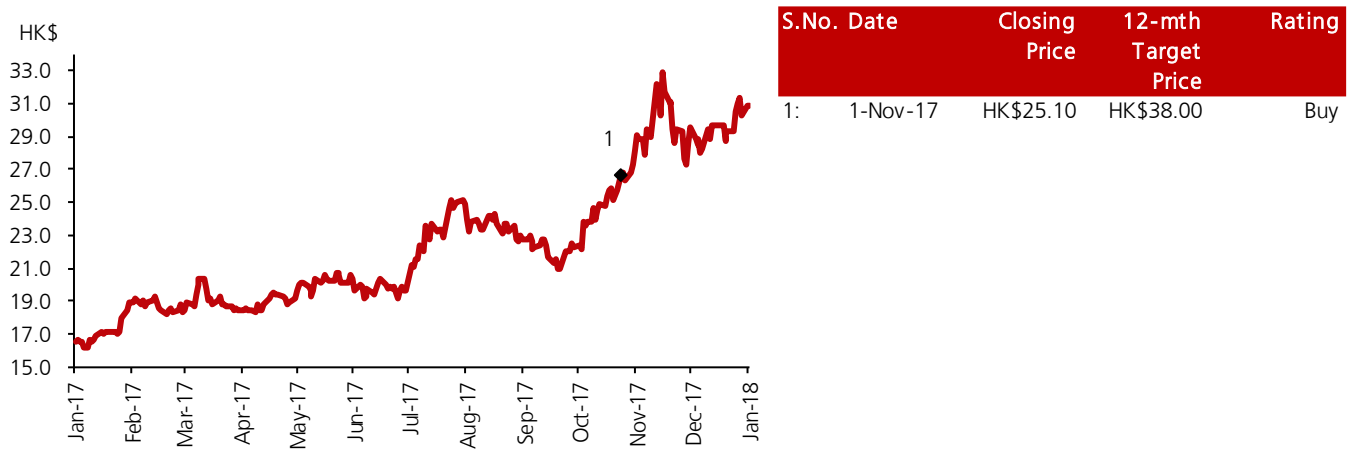
Source: Company, DBS Vickers

Key Financials & Ratios

FY Dec	2015A	2016A	2017F	2018F	2019F
Du Pont analysis (%)					
Net profit / premium income	4.9	3.3	3.3	3.7	3.8
Premium income / total asset	26.8	28.4	28.3	29.4	30.2
Total asset / total equity	7	8	8	8	8
Return on equity	12.6	8.2	9.4	11.2	12.2
Embedded value(HK\$ m)					
Book value	59,728	56,169	64,618	72,286	81,715
Adjusted items	21,334	24,759	28,693	38,424	50,566
Adjusted book value	81,062	80,928	93,311	110,710	132,281
Value-in-force	41,911	47,919	57,643	69,230	83,225
Adjustment (if any)	(24,993)	(26,373)	(28,053)	(34,844)	(43,210)
Group embedded value	97,980	102,474	122,901	145,096	172,296
Per share analysis(HK\$)					
EPS	1.89	1.33	1.58	2.13	2.62
BPS	16.62	15.63	17.98	20.11	22.74
DPS	0.00	0.10	0.24	0.32	0.39
EVPS	27.26	28.51	34.20	40.37	47.94
Capital Strength (%)					
Leverage ratio	7	8	8	8	8
Solvency ratio	271.0	250.5	218.0	211.1	210.4

Source: Company, DBS Vickers

Target Price & Ratings History



Source: DBS Vickers

Analyst: Ken SHIH

DBSVHK recommendations are based on 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 catalysts within this time frame)

Share price appreciation + dividends

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

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