

Analyst: Paul Sham
PICC PROPERTY AND CASUALTY COMPANY LIMITED (中國財險)

Sector	: Insurance	Chairman	: Mr. Wu Yan
HKSE Code	: 2328	President & CEO	: Mr. Wang Yi-cheng
Market Price	: HK\$4.00 (20/08/2008)		
Shares Issued	: 3,455.98m (H shares)		
Mkt. Cap.	: HK\$13,823.92m (H shares)		
52 weeks Hi/ Lo	: HK\$17.92 / HK\$3.60		
HSI / HSCEI	: 20,931.26 / 11,179.16 (20/08/2008)		
Main Business	: Non-life insurance businesses		

SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30TH JUNE 2008
Interim Results Highlights

	1H2008	1H2007	Change
	RMB million	RMB million	
• Direct premiums written	58,912	49,452	+19.1%
• Net premiums earned	40,181	33,062	+21.5%
• Net claims incurred	(30,481)	(22,185)	+37.4%
• Amortisation of deferred acquisition costs	(5,695)	(4,852)	+17.4%
• Insurance protection expenses	(506)	(423)	+19.6%
• G&A expenses	(5,586)	(4,381)	+27.5%
• Underwriting profit/(loss)	(2,087)	1,221	-270.9%
• Net investment income (recurring)	2,188	1,647	+32.8%
• Net realized/unrealized gain/(loss) from investments	668	2,836	-76.4%
• Profit before taxation	(528)	5,041	-110.5%
• Taxation	236	(1,853)	-112.7%
• Profit attributable to equity holders	(292)	3,188	-109.2%
•			
• Basic EPS (RMB)	(0.026)	0.286	-109.1%
• Interim DPS (RMB)	0.000	0.091	N/A

- PICC reported a net loss of RMB292m in 1H08, significantly down from a profit of RMB3,188m in 1H07. The disappointment was due to the combination of natural disasters and the sharp correction of A-share market, leading to the higher-than-expected net claims and mark-to-market losses of equity investments. No interim dividend was declared.
- Direct premiums grew 19.1% y-o-y in 1H08. The increase was primarily due to an increase of RMB4,908m, or (+14.2% y-o-y) in the turnover of motor vehicle insurance segment compared to the same period in 2007. The turnover of non-motor vehicle insurance such as liability insurance (+20.9% y-o-y), accidental injury & health insurance (+31.4% y-o-y) and other insurance products (related to marine hulls, homeowners, agriculture, aviation and energy, +77.4% y-o-y) also posted strong growth.
- PICC delivered a disappointing underwriting loss of RMB2,087m in 1H08, primarily due to an increase in claims brought by the catastrophic snowstorms in southern China and the super earthquake that took place in Wenchuan on 12 May 2008, resulting in a jump of loss ratio from 67.1% in 1H07, to 75.9% in 1H08. Expense ratio remained relatively unchanged, from 29.2% in 1H07 to 29.3% in 1H08, mainly attributable to a 27.5% y-o-y increase in general and administration expenses amid a substantial increase in advertising and marketing expenses to build up PICC's image during the period of 2008 Olympic Games. Overall, the combined ratio surged to 105.2% in 1H08 from 96.3% in 1H07.

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein.

Business Review

- Breakdown of net premiums earned and loss ratios by segments:

(RMB million)	1H2008		1H2007		Change
Net premiums earned					
Motor vehicle	30,569	76.1%	25,413	76.9%	+20.3%
Commercial property	2,980	7.4%	2,994	9.1%	-0.5%
Cargo	1,308	3.3%	1,144	3.5%	+14.3%
Liability	1,488	3.7%	1,250	3.8%	+19.0%
Accidental injury	1,157	2.9%	850	2.6%	+36.1%
Other	2,679	6.7%	1,411	4.3%	+89.9%
Total	40,181	100.0%	33,062	100.0%	+21.5%
Loss ratio	1H2008		1H2007		
Motor vehicle	73.5%		71.1%		
Commercial property	107.8%		63.7%		
Cargo	54.3%		40.3%		
Liability	74.8%		51.9%		
Accidental injury	78.3%		64.1%		
Other	77.7%		39.5%		
Total	75.9%		67.1%		

- Motor vehicle insurance** remains the primary income source of PICC, accounting for 76% of total net premiums earned in 1H08. The vehicle segment recorded a 20.3% y-o-y increase in net premiums earned in 1H08. However, due to the snowstorms disaster in southern China in early 2008, the loss ratio deteriorated from 71.1% in 1H07 to 73.5% in 1H08, leading to a meagre 0.6% y-o-y profit growth.
- Commercial property insurance** saw a decrease of 0.5% y-o-y in net premiums earned in 1H08. This division was hit hardest by the catastrophe losses, reporting a loss ratio of 107.8% in 1H08, from 63.7% in 1H07. As a result, it posted a loss of RMB649m, compared to the profit of RMB727m in 1H07.
- Cargo** and **Liability** segments posted a moderate y-o-y growth of 14.3% and 19.0% respectively, in net premiums earned in 1H08. Net claims incurred by cargo segment increased by 54.0% y-o-y on intensified competition and hence a decrease in premium rates, while liability segment also experienced 71.5% y-o-y increase of net claims.
- Accidental injury & health insurance** segment posted strong results in 1H08, with net premiums earned increased 89.9% y-o-y amid the rapid development of the health insurance business.

Investment portfolio	30/06/2008	31/12/2007
	%	%
Bank deposits	38.8%	34.2%
Government & financial bonds	38.8%	32.7%
Corporate bonds	9.8%	6.9%
Mutual funds & common stocks	11.4%	22.1%
Others	1.2%	4.1%
Total	100.0%	100.0%

- Being the key driver of this set of interim results, **total investment income** dropped 36.3% y-o-y to RMB2,856m. Net investment income rose 32% y-o-y in 1H08 on increased dividend income from equity mutual funds in 1H08. Unsurprisingly, net realised and unrealised gains fell 75% y-o-y to RMB668m from Rmb2,836m amid the turbulent A-share stock markets.
- However, it is likely that PICC took major losses on AFS securities directly to the reserves account in the balance sheet rather than through the profit and loss account. The decline in equity reserves to RMB9,343m from RMB14,936m in 1H08 suggests some RMB5,301m direct write-down of capital (as there should be a RMB292m loss on retained earnings).



Outlook & Prospects

- **Motor insurance rate capped** As Motor vehicle insurance continues to play the dominating role for PICC, with the premium rates of Compulsory Motor Vehicle Insurance (CMVI) still controlled by the government, improvement on profitability for this segment is limited unless the government lends its helping hand in this regard. However, as combating inflation is now the top priority matter for the Chinese government, the likelihood of a CMVI rate hike is diminishing.
- **Investment income unlikely to repeat in 1H08** Around RMB1.0bn dividend came primarily from equity mutual funds, where poor market performance could constrain further dividend payout to PICC. In addition, we also believe that the realized gains of AFS securities (1H08: RMB2,322m) could unlikely to repeat in 2H08 making the total investment return to trend lower in 2H08 on poor sentiment of the A-share market.
- **Unsettled disaster claims** PICC has not fully paid off its bills on the major catastrophes that hit China this year, especially the earthquake that happened in the later time of 1H08. Therefore, it is quite likely that even if there are fewer disasters in 2H08, the claims would continue to be on the rise. It is therefore quite uncertain that underwriting at PICC, especially on loss ratio, will be seeing any improvement in the near term.
- **Solvency ratio at risk** PICC's book value declined by 21.4% h-o-h, reflecting asset write-downs on slump of equity markets, and its solvency ratio also dropped from 189% to 120%. Similar to Ping An, if the stock market continues to decline, capital-raising activities could eventually be required.
- **Under-performance to continue** Trading at around HK\$4.00 or 1.67x FY08E price-to-book, valuation of PICC seems not too expensive. However, we believe FY08 would be a tough and challenging year for mainland insurers, especially the non-life insurance provider, PICC. The unfavourable macro industry developments (the catastrophic claims & inflation-combating strategy by the Chinese government) and turbulent A-share stock markets have created significant headwinds for PICC's value drivers (core underwriting business and investment income). Overall, PICC remains our least preferred play in the China insurance sector.

Recommendation: *Under-perform*

Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.