

中国：保险

周期性因素凌驾于行业基本面；中国人寿更具防御性，人保的周期性最强 (摘要)

周期性因素凌驾于行业基本面；较之银行，险商不太适合作为核心持股
2007年以来中国保险公司股价大幅震荡，反映了在内含价值/盈利中计入的高额投资盯市收益/亏损。我们认为中国保险股：(1) 均为贝塔值较高的周期性股票，尽管长期增长前景良好；而且(2) 较之银行，可能不太适合作为核心持股，因为其账面价值及盈利的稳定性/可预见性较低（除非大量不良贷款出现）。

中国保险股具有顺周期性的特征；资本市场的表现是关键

我们认为，资本市场的表现仍然是投资中国保险股时必须考虑的关键因素，原因在于保险公司具有顺周期性的特征：

1. 寿险公司的产品以“利差产品”为主导（约占保费的70%），投资利差是利润的主要推动力。
2. 财险的承保利润微薄，而且产品多为非分红型。
3. 由于投资渠道有限，投资收益仍然依赖于大幅波动的A股市场。
4. 递延收益和递延承保费用摊销均在一定程度上取决于投资收益，因而进一步提高盈利的波动性。
5. 由于资产按市值计算而负债却以成本列示，因此保险公司的账面价值和内含价值往往大幅波动。

中国人寿相对更具防御性，而人保财险的周期性特征则最强

中国人寿。由于投资策略较为保守（交易资产较少，固定收益投资的回报率上升），因此内含价值和利润对于资本市场表现的敏感度较低，防御性较其他险商为高。虽然其低利润率银保业务比重较大，可能会导致保费收入的较大波动，但我们认为其利润率存在上升空间而且从投资管制放开中受益更大。

平安。尽管收入来源多元化而且拥有交叉销售潜力，但其较进取的投资资产结构（权益类投资和交易资产较多）及其证券和财险业务却使其顺周期性的特征比中国人寿更明显。

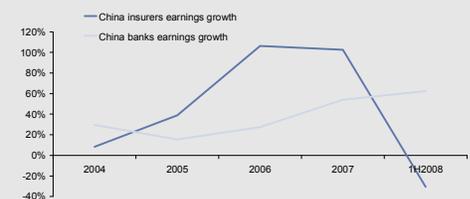
人保财险。对A股市场的敏感度最高，因为财险产品主要为非分红型。同时，承保压力导致其基本面依然面临挑战。

看好长期增长前景，但尚不是贝塔投资的良机；较为看好中国人寿

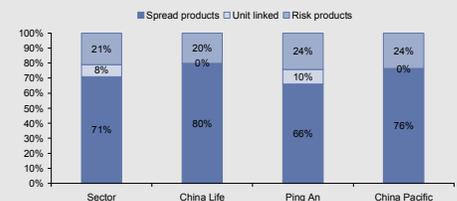
我们对寿险公司的长期基本面维持积极看法。但鉴于宏观前景尚不明朗，我们认为目前还不是“投资高贝塔值股票、预期市场反弹”的适当时机。我们需要看到通胀趋缓和经济软着陆的明确信号，和/或中国调控政策的放松（这均为A股市场持久复苏的关键），才会转为明确的积极看法。我们较为看好中国人寿(2628.HK, 中性)，因其新业务价值增长良好而且相对具有防御性特征；但仍对人保财险(2328.HK, 卖出)持谨慎看法。

*全文翻译将随后提供

我们认为，与银行股相比，保险股不太适合作为核心持股，因为其盈利的稳定性和可预见性较低



寿险公司的产品以“利差产品”为主导，投资利差是利润的主要推动力（2008年上半年保费收入明细）



很多投资资产按市值计算，但负债却以成本列示，因而导致保险公司的账面价值和内含价值波动较大

	As of 1H2008				
	China Life	China Pacific	Ping An	PICC	CIH
Asset mix (as % of total inv. assets)					
Cash, deposits and loans	26%	39%	20%	40%	18%
Bonds	61%	47%	61%	49%	66%
Equities	13%	14%	18%	11%	15%
Investment properties	0%	0%	1%	1%	0%
Measurement (as % of total inv. assets)					
Marked-to-market (MTM)	49%	38%	51%	55%	62%
Trading (through P&L)	4%	1%	13%	7%	8%
Available-for-sale (through B/S)	45%	37%	38%	48%	54%
At cost (held-to-maturity)	51%	62%	49%	45%	38%
Total MTM assets as % of shdr equity	248%	204%	272%	206%	506%

资料来源：公司数据、高盛研究



China: Insurance

Beta overriding alpha; China Life more defensive, PICC most cyclical

Beta dominating alpha; less suitable core holding than banks

With the boom-bust in share prices since 2007, reflecting sharp investment MTM gains/losses through EV/earnings, we believe China insurers are:

- (1) high-beta cyclical stocks despite secular growth prospects, and
- (2) probably a less appropriate core holding than banks due to lower stability/visibility of book value/earnings (unless massive NPLs emerge).

China insurers are pro-cyclical in nature; capital markets do matter

In our view, capital market performance remains a key factor to consider when investing in China insurers, which are inherently pro-cyclical:

1. Dominance of "spread products" (c.70% of premiums) among life insurers, with investment spreads being a key profit driver.
2. Non-participating P&C products coupled with thin underwriting margins.
3. Reliance on volatile A-share income due to limited investment channels.
4. Further earnings volatility from deferred income and DAC amortization, both of which are partly dependent on investment income.
5. Large BV/EV swings, as assets are marked to market but liabilities are not.

China Life relatively more defensive, PICC most cyclically geared

China Life. More defensive than peers with lower EV/profit sensitivity to capital markets, given more conservative investment strategies (less trading asset, rising fixed income yields). While its larger exposure to low-margin bancassurance could lead to more volatile premiums, we see room for margin pickup and stronger gearing to investment liberalization.

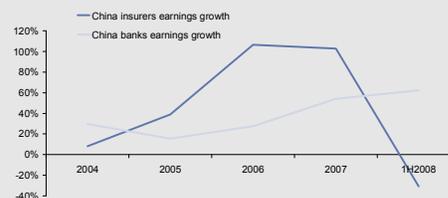
Ping An. More pro-cyclical than China Life despite diversified revenue and cross-selling potential, as a result of more aggressive investment mix (more equities and trading assets) and securities/P&C exposure.

PICC. Most geared to A-share market as P&C products are mostly non-participating, but fundamentally challenged due to underwriting pressure.

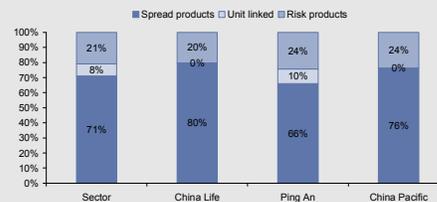
Fundamentally positive, but not time for beta yet; prefer China Life

We stay fundamentally positive on the secular prospects for life insurers, but are not yet prepared for the "time for beta and market rebound" call, given a still murky macro picture. To make an outright positive call, we need to see clear signs of moderating inflation *and* a soft landing, and/or policy easing in China (which are key to a sustainable A-share recovery). We prefer China Life (2628.HK, Neutral) for its good NBV growth and relative defensiveness, but stay cautious on PICC (2328.HK, Sell).

We see insurers as a less suitable core holding than banks due to lower earnings stability/visibility



Dominance of "spread products" among life insurers, with investment spreads as key profit driver (life premium breakdown for 1H2008)



Many investment assets are marked to market but liabilities are not, resulting in large BV/EV swings

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Source: Company data, Goldman Sachs Research.

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Source: Company data, Goldman Sachs Research estimates.

The prices in the body of this report are based on the market close of September 3, 2008.

Beta dominating alpha; less suitable core holding than banks

After their strong rallies in 2006 and 2007, China insurance stocks have pulled back sharply this year (see Exhibits 1-2). China insurers outperformed China banks and the local market indices on the way up, but underperformed on the way down. In our view, this mainly reflects the hefty investment mark-to-market (MTM) gains/losses through insurers' EV and earnings.

In our view, the boom-bust of insurance stocks suggests China insurers are:

- **High-beta, cyclical stocks despite structural growth prospects** (e.g. still low insurance penetration, potential for investment liberalization, capital market reforms etc.); and
- **Probably a less appropriate core holding than banks**, given insurers' notably lower stability/visibility of book value and earnings that results from investment MTM gains/losses (unless massive NPLs and provisioning emerge, we see banks' earnings and book value as more resilient/predictable vis a vis insurers in a down cycle). Note China insurers' earnings growth has been highly volatile over time, in sharp contrasts to the steadily improving earnings growth of China banks that results from good margin expansion, robust fee income growth and benign credit cost (see Exhibit 3).

Exhibit 1: Boom-bust of China insurance stocks since 2007

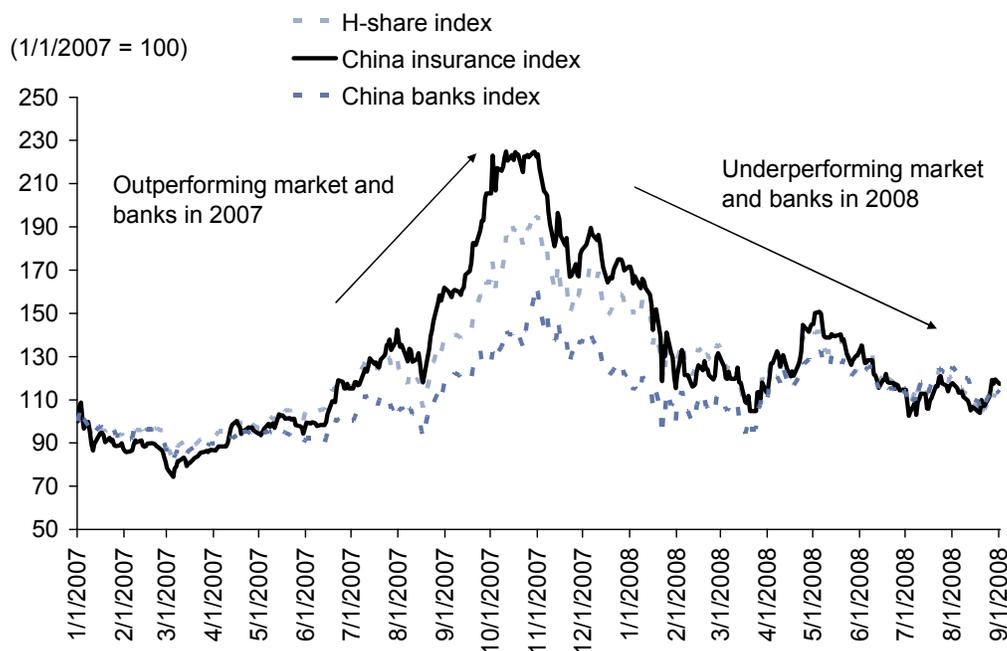
Share price performance of China insurers, China banks and local indices

	Curr	Share price 9/3/2008	Mkt cap (US\$ bn)	52-week		Absolute share price perf (%)		
				High	Low	2007	YTD	Versus 52W high
H-share index		11,077		20,400	10,714	55.9	(31.3)	(45.7)
H-share insurers								
China Life (H)	HKD	28.95	27.6	52.00	25.15	52.0	(28.3)	(44.3)
Ping An (H)	HKD	55.30	18.1	117.00	47.70	94.4	(33.9)	(52.7)
PICC	HKD	4.33	1.9	17.08	3.80	179.7	(61.2)	(74.6)
H-share banks								
BOC (H)	HKD	3.28	31.9	5.19	2.96	(11.5)	(13.2)	(36.8)
CCB (H)	HKD	6.13	176.4	8.79	4.98	33.5	(7.3)	(30.3)
ICBC (H)	HKD	5.19	55.2	7.43	4.43	15.9	(7.3)	(30.1)
BoCom (H)	HKD	8.68	25.6	14.46	7.89	15.3	(20.2)	(40.0)
CMB (H)	HKD	24.45	8.3	39.45	21.40	93.3	(23.2)	(38.0)
CNCB (H)	HKD	4.21	6.7	6.58	3.51	(26.8)	(13.9)	(36.0)
Shanghai Composite index		2,277		6,092	2,277	96.7	(56.7)	(62.6)
A-share insurers								
China Life (A)	Rmb	24.39	74.2	75.08	21.14	48.8	(57.9)	(67.5)
Ping An (A)	Rmb	43.79	30.6	144.99	39.40	126.8	(58.7)	(69.8)
A-share banks								
BOC (A)	Rmb	3.56	92.5	7.48	3.46	21.7	(46.1)	(52.4)
CCB (A)	Rmb	5.12	6.7	11.32	5.11	15.5	(48.0)	(54.8)
ICBC (A)	Rmb	4.64	170.2	8.84	4.55	31.1	(42.9)	(47.5)
BoCom (A)	Rmb	7.12	27.0	16.81	7.12	15.4	(54.4)	(57.6)
CMB (A)	Rmb	20.26	35.7	45.47	20.26	142.2	(48.9)	(55.4)
CNCB (A)	Rmb	5.20	20.2	12.23	4.96	(10.7)	(48.8)	(57.5)

Source: Datastream, Goldman Sachs Research.

Exhibit 2: China insurers have been high-beta cyclical stocks, outperforming China banks and local market indices on the way up but underperforming on the way down

Share price performance of China insurers versus China banks



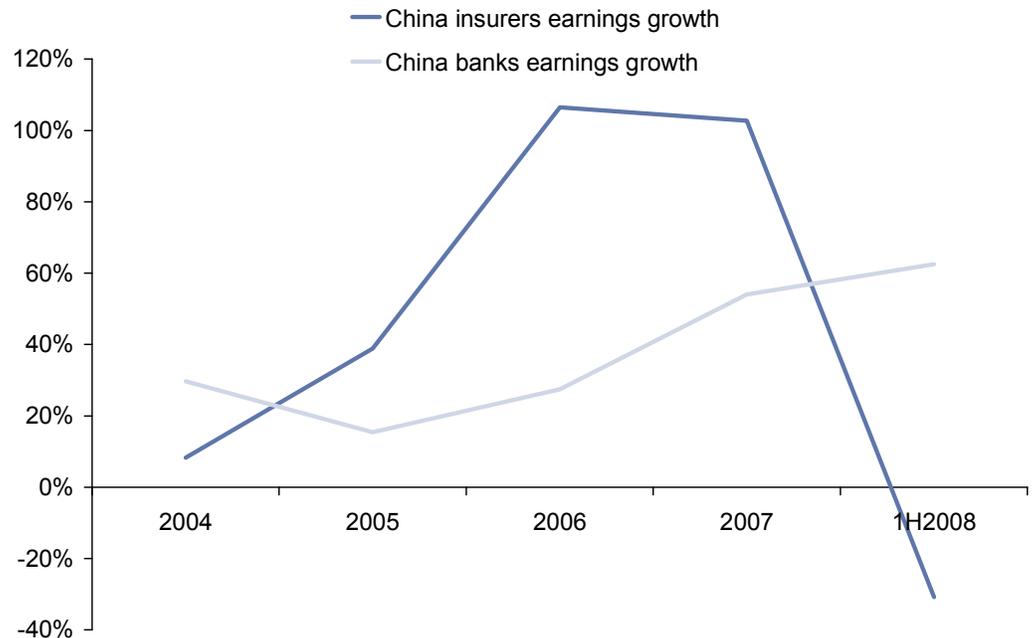
China insurance index includes China Life, Ping An and PICC.

China banks index includes BOC, CCB, ICBC, BoCom, CMB.

Source: Datastream, Goldman Sachs Research.

Exhibit 3: We believe insurers are a less appropriate core holding than banks, given their lower book value/earnings stability and visibility

Yoy net profit growth of China insurers has been much more volatile than that of China banks



China insurers include China Life, Ping An and PICC.

China banks include BOC, CCB, ICBC, BoCom, CMB.

Source: Company data, Goldman Sachs Research estimates.

China insurers are pro-cyclical in nature; capital markets do matter

In our view, capital market performance remains a key factor to consider when investing in China insurance stocks, since China insurers are pro-cyclical for business, A-share and accounting reasons.

1. Dominance of “spread products” among life insurers

Life insurers profit from their products in the following ways (see Exhibits 4-5):

- **Risk margin.** This is the major source of profit for traditional/protection/risk products (e.g. term life, health, disability). Risk margin is basically the risk premiums¹ collected less risk benefits paid to policyholders. This relies on the underwriting skills and actuarial capability of the life insurer (e.g. what they assumed for mortality/morbidity, versus the actual outcome). Risk margin is relevant to products with meaningful protection elements (i.e. sufficiently significant insurance risk).
- **Investment spreads.** This mainly applies to participating products (including endowment, whole life and annuity) and universal life products. Insurers invest the

¹ Generally speaking, premiums comprise of “risk premiums” (to cover the cost of risk protection provided by the insurer) and “expense loading” (to cover the commission expenses, acquisition cost and other operating expenses incurred by the insurer).

collected premiums into various investment assets, earn an investment income, but have to “share” part of the profit with policyholders as benefits. In China, the payout ratio for participating products is at least 70%. For unit linked, the investment risk is borne by the policy holder; hence the insurer does not earn any investment spreads.

- **Expense gains.** This is the spread between the expense loading built into premiums (i.e. expenses assumed) and the actual expenses (e.g. acquisition cost, commissions, G&A expenses). In China, expense gains are usually higher for long-dated protection products, since the regulator allows insurers to build in higher expense loadings for these products, all other factors being equal.
- **Fee income.** This revenue stream mainly applies to investment-type products, particularly unit linked and universal life products. For example, in China, unit linked and universal life products entail front-end charges of up to 50% of FYP. Unit linked products also entail buy-sell spreads of up to 2% of unit price and asset management fees of up to 2% of NAV.

In China, participating products and universal life account for c.70% of life premiums (see Exhibits 6 and 7), and these two products are “spreads products” with investment spreads being a key profit driver (risk margin or mortality/morbidity gains are relatively small for participating and universal life products since they entail relatively small amount of risk protection). As a result, the profitability of “spread products” and the insurers offering these products is pro-cyclical geared to capital market performance.

Moreover, although unit linked products do not rely on investment spreads (the policyholder bears all investment risk), the fee income involved is dependent on NAV and unit price, which in turn are a function of capital market performance. And since unit linked products are mutual fund-like products, they are usually sold well in bull markets but poorly when the stock market falls. Hence the fee income from unit linked products is also pro-cyclical.

In our view, product mix is quite similar across different life insurers in China in the sense that most products are capital-market dependent. Combining “spread products” and unit-linked, capital-market dependent products account for 76%-80% of total premiums for Chinese life insurers (see Exhibit 7).

Exhibit 4: Risk/expense/investment spread structure and profitability of life insurance products in China

Product type	Risk protection	Expense loading	Investments					Separate account	Pricing transparency	Solvency requirement	Profitability	
			Policyholders' investment choice	Who bears investment risks	Guaranteed return	Investment payouts	Type of profit				Margin and ROE	
Non-participating	High	High, due to large protection element and long duration (e.g. up to 60%-75% of FYP for death/health coverage)	No	Insurer	Yes	Pre-determined by insurer	No	Low	4% of insurance reserves	Mortality gains Expense loading Investment spreads	High margin due to high protection element, high expense loading and absence of investment profit sharing	
Participating	Medium	Medium, due to sizable savings element and usually shorter duration (e.g. up to 35%-50% of FYP for endowments)	No	Insurer and policyholder	Yes	At least 70% of investment returns (in excess of guaranteed return)	No	Low	4% of insurance reserves	Mortality gains Expense loading Investment spreads	Medium margin	
Universal life	Low to medium, but at least 5% of account value; can be raised by riders	Medium (sizable front-end charges of up to 50% of FYP, but tail-end falls to 5% of premiums)	Typically no	Insurer and policyholder	Yes	Crediting rate; depends on insurer's investment performance and market competition	Typically no	Quite high	4% of insurance reserves	Mortality gains Expense loading Investment spreads	Medium margin	
Unit linked	Usually low, but at least 5% of account value; can be raised by riders	High; various fees (similar front-end charges to universal life, asset management fees, buy-sell spreads)	Yes; basically mutual product but with some risk protection	Policyholder	No	N/A	Yes	High	1% of insurance reserves	Mortality gains Fees	Low/medium margin but high ROE Margin could stack up well (vs other products) when investment spreads are low	

Source: Goldman Sachs Research.

Exhibit 5: Participating products and universal life are “spread products”, with investment spreads being a key profit driver

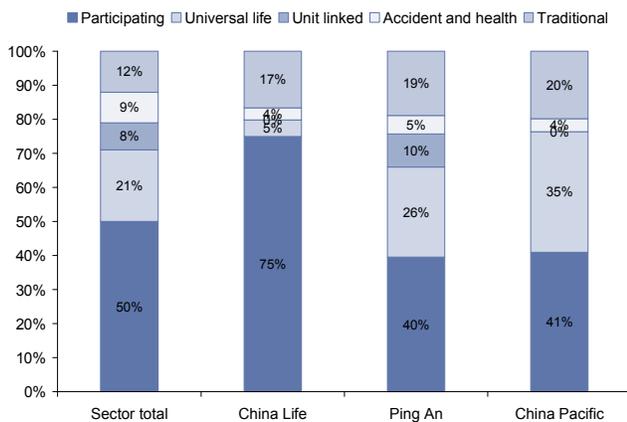
Importance of various profit drivers for different life insurance products in China

	Profit drivers			
	Risk margin	Investment spreads	Expense gains	Fee income
Traditional/protection/risk products (e.g. term life, disability, health)	Significant	Medium	Significant	Usually none
Participating products (incl. endowment, whole life, annuity)	Medium	Significant	Medium	Investment-type products entail some policy fees
Universal life	Low to medium	Significant	Medium (in the form of front-end charges)	Medium (e.g. front-end charges, administration, account servicing)
Unit linked	Usually low	Nil (policyholder bears investment risks)	Medium (in the form of front-end charges)	Significant (front-end charges, asset mgmt, buy-sell spreads)

Source: Goldman Sachs Research.

Exhibit 6: Chinese life insurers focus on participating products and universal life, both of which are “spread products” with investment spreads as key profit driver

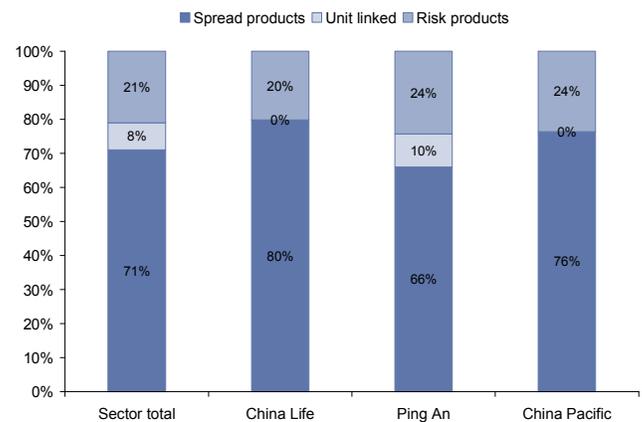
Life premium breakdown as of 1H2008 (including deposits)



Note: China Life, Ping An and China Pacific account for about 65% market share in the life insurance sector.

Exhibit 7: Including “spread products” and unit linked, most life insurance products in China are capital market-dependent

Life premium breakdown as of 1H2008 (including deposits)



Note: China Life, Ping An and China Pacific account for about 65% market share in the life insurance sector.

Source: Company data, Goldman Sachs Research.

2. Non-participating nature of most P&C products coupled with thin underwriting margins

There are two major sources of profit for P&C insurers – underwriting profit and investment income.

The underwriting margins of Chinese P&C insurers are very thin due to fierce competition (on pricing and commissions), and combined ratios are seldom below 95%. For example, most Chinese P&C insurers, including PICC and Ping An, made underwriting losses in 1H2008 due to natural disasters and pricing pressure.

As a result, investment income is a key earnings driver for P&C insurers.

Meanwhile, unlike life insurance products (e.g. participating products, universal life), **most P&C insurance products in China are non-participating in nature, with the P&C insurers keeping all the investment profits/losses** and hence bearing all the investment risks.

As a result, this makes P&C insurers' bottom-line earnings highly sensitive to investment yields, in turn rendering P&C insurers highly pro-cyclically geared to capital market performance.

We note that in recent years, some smaller P&C insurers have started to offer savings/investment products, which usually offer fixed-rate/guaranteed returns to policyholders. This also leads to high investment risks (on both the up and down sides) for the insurers. Despite rapid growth, such investment-type P&C products have remained a small percentage of total P&C premiums.

Exhibit 8: Thin underwriting margins coupled with non-participating nature of most P&C products make P&C insurers' earnings pro-cyclically geared to investment yields
Profit breakdown for Chinese P&C insurers (Rmb mn)

	2006		2007		1H2008	
	Ping An P&C	PICC	Ping An P&C	PICC	Ping An P&C	PICC
Net earned premiums	11,583	55,616	15,614	68,728	10,276	40,181
Underwriting profit ex-investment benefits	460	604	189	(1,427)	(690)	(2,087)
Investment benefits	0	138	0	248	0	88
Other net revenue	46	(663)	123	(1,252)	29	(1,019)
Pretax profit	1,190	3,800	2,761	4,456	329	(528)
Underwriting margin ex-investment benefits	4.0%	1.1%	1.2%	-2.1%	-6.7%	-5.2%
Retained investment income as % of pretax profit	57%	102%	89%	160%	301%	-488%

Source: Company data, Goldman Sachs Research.

3. Reliance on A-share income due to limited investment channels

The investment channels available to China insurers have remained limited

despite ongoing efforts by the regulators to open up new asset classes. The main investable instruments are still bank deposits and government bonds. In the absence of a deep/large corporate bond market and other long-dated instruments domestically, and given still relatively strict regulations on overseas investments, China insurers often invest in the A-share market and domestic mutual funds for investment return enhancement (dividend income, potential capital gains during bull markets).

Meanwhile, however, the A-share market has been highly volatile.

As a result, although most insurers' assets are invested in fixed-income instruments (bank deposits and bonds account for more than 80% of total portfolios), equities investments still account for a significant portion of insurers' investment income (more than 20% of total investment income even in a sluggish stock market, by our estimate).

See Exhibit 9 for breakdown of investment assets, investment income and investment yields.

Exhibit 9: China insurers are reliant on the volatile A-share income due to limited investment channels

Breakdown of investment yields, income and assets for China insurers (Rmb mn)

	Ping An				China Life				PICC			
	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E	2007	2008E	2009E	2010E
Total investment assets	495,090	483,937	564,464	646,198	844,436	890,831	1,039,065	1,200,743	80,544	79,183	88,970	99,967
Total investment income	51,744	19,510	23,441	27,686	78,248	41,241	54,414	65,336	7,383	4,388	3,925	4,465
Core investment income (ex-equities)	8,064	13,685	17,396	20,579	20,715	31,676	42,574	51,211	1,959	2,364	3,021	3,426
Total investment yield	12.14%	3.99%	4.47%	4.57%	10.26%	4.75%	5.64%	5.83%	10.32%	5.49%	4.67%	4.73%
Core investment yield (ex-equities)	2.38%	3.56%	4.02%	4.15%	3.35%	4.43%	5.09%	5.32%	3.32%	3.51%	4.02%	4.08%
Net investment yield	3.58%	4.18%	4.45%	4.56%	5.77%	5.61%	5.64%	5.83%	4.51%	4.94%	4.76%	4.82%
Investment asset breakdown												
Cash, deposits and others	19%	21%	19%	19%	23%	29%	24%	24%	39%	38%	36%	36%
Bonds	55%	62%	63%	63%	54%	59%	62%	62%	40%	52%	53%	53%
Equities	26%	17%	18%	18%	23%	13%	14%	14%	21%	10%	11%	11%
Investment income breakdown												
Cash, deposits and others	4%	18%	17%	16%	10%	27%	24%	23%	12%	22%	30%	30%
Bonds	12%	52%	58%	58%	17%	50%	54%	55%	15%	32%	47%	47%
Equities	84%	30%	26%	26%	74%	23%	22%	22%	73%	46%	23%	23%
Investment yield												
Cash, deposits, repos and placements	2.63%	4.11%	4.43%	4.62%	4.34%	5.35%	5.62%	6.01%	3.55%	3.86%	4.19%	4.30%
Bonds	2.48%	3.54%	4.11%	4.21%	3.24%	4.18%	5.01%	5.21%	3.77%	3.80%	4.17%	4.20%
Equities	49.7%	5.5%	6.6%	6.5%	39.6%	6.2%	9.2%	9.0%	43.5%	16.3%	10.2%	10.0%
Investment properties	11.1%	7.5%	7.9%	8.0%								

Source: Company data, Goldman Sachs Research estimates.

4. Further earnings volatility from deferred income and DAC amortization

The volatility of insurers' earnings is further amplified, if not complicated, by deferred income and deferred acquisition cost (DAC) amortization, both of which are expense items on the P&L.

To put it simply:

- Deferred income and DAC amortization of investment-type contracts are dependent on the gross profit generated from the product.
- Since investment income is a key profit driver for investment-type contracts, **deferred income and DAC amortization are dependent on investment income** (in addition to other factors such as amount of new businesses and in-force policies).
- **Deferred income makes insurers' earnings even more pro-cyclical.**
- **DAC amortization, on the other hand, helps to smooth out earnings.**

In Exhibit 10, we use China Life as an example to demonstrate how "increase in deferred income" and DAC amortization correlate with investment income.

Exhibit 10: Insurers' earnings are made even more volatile (and also more difficult to estimate) by deferred income and DAC amortization, both of which are dependent on investment income

Impact of investment income on deferred income and DAC amortization, China Life as an example (Rmb mn)

	2006	2007	2007 growth	1H2007	1H2008	1H2008 growth	GS comments
Total revenue	147,311	191,372	30%	101,429	99,284	-2%	
Net earned premiums	98,847	111,404	13%	63,417	78,737	24%	
Total investment income	46,581	78,248	68%	37,175	19,549	-47%	Pro-cyclically geared to capital market performance
Other income	1,883	1,720	-9%	837	998	19%	
Total claims, benefits and expenses	121,706	146,390	20%	76,918	83,103	8%	
Risk benefits and claims	62,034	69,107	11%	38,662	46,630	21%	
Investment benefits	24,999	37,570	50%	17,566	6,830	-61%	Positively correlated with investment income
Increase in deferred income	11,607	9,859	-15%	4,454	14,463	225%	Negatively impacted by investment income; making earnings more pro-cyclical
DAC amortization	10,259	13,461	31%	9,466	6,757	-29%	Positively impacted by investment income; making earnings less pro-cyclical
Acquisition cost	2,415	2,725	13%	1,468	1,803	23%	
G&A expenses	10,392	13,668	32%	5,302	6,620	25%	
Associate profits	0	409	NM	321	707	120%	
Pretax profit	25,605	45,391	77%	24,832	16,888	-32%	

Note: Deferred income and DAC amortization are not only impacted by investment income, but also by other factors such as new business growth, product mix and amount of in-force business. For example, the strong single-premium growth in 1H2008 was also a reason for the sharp rise in "increase in deferred income".

Source: Company data, Goldman Sachs Research.

Deferred income

The excess first year premiums and revenue of long-term products is deferred, and appears on the balance sheet as a liability item. The deferred income is released to the P&L over the remaining lifetime of the product. In every reporting period, the "increase in deferred income" (new revenue deferred less release of previously deferred income) would appear on the P&L as an expense item.

For insurance contracts, the release of deferred income is based on a constant relationship with expected premiums.

But for investment-type contracts, deferred income is released to the P&L in a constant relationship to the present value of expected gross profits from the product. At each reporting date, the actual gross profit would replace the original profit estimate, and the deviations would be reflected in the P&L. For example, when actual investment income is lower than expected, the release of deferred income would be lower, in turn leading to higher "increase in deferred income" on the P&L and hence higher expenses. The reverse would hold when actual investment income is higher than expected.

In other words, for investment-type products, deferred income would make insurers' earnings even more pro-cyclical. We take China Life as an example (since it provides the most detailed P&L breakdown). In 2007, investment income rose strongly by 68%, but "increase in deferred income" (as a P&L expense) dropped 15%. On the other hand, in 1H2008, investment income fell 47% yoy, but "increase in deferred income" rose 225% yoy.

DAC amortization

Acquisition cost and commission expenses of long-dated products are deferred, and amortized through the P&L over time. But note DAC appears as an asset on the balance sheet, while deferred income is a liability item.

For insurance contracts, the amortization of DAC is based on a constant percentage of expected premiums.

For investment-type contracts, DAC is amortized at a constant percent of the present value of expected gross profits from the product. As with deferred income, the actual gross profit would replace the original profit estimate at each reporting date, and the deviation from estimates would be reflected on the P&L. For example, when investment income is lower

than previous estimate, the amount of DAC amortized would be lower², hence leading to lower expenses on the P&L. The reverse would hold when actual investment income is higher than expected.

In other words, for investment-type products, DAC amortization helps to smooth out earnings. Again, we take China Life as an example. In 2007, DAC amortization rose 31% as investment income also rose 68%. In 1H2008, DAC amortization fell 29% yoy as investment income fell 47% yoy.

5. Large BV/EV swings as assets are marked to market but liabilities are not

Under IFRS (HK GAAP and China GAAP have similar treatment of investment assets), a significant portion of investment assets have to be marked to market.

Trading assets are marked to market through P&L (and would ultimately flow back to retained earnings on the balance sheet). Available-for-sale assets are marked to market through shareholders' equity. On the other hand, cash/deposits/loans, investment properties and held-to-maturity bonds are carried at cost on the balance sheet. Exhibit 11 shows that ~40%-60% of investment assets are marked-to-market for China insurers.

On the other hand, insurance liabilities are carried at cost. Reserves for insurance contracts are established based on actuarial calculations, and the actuarial assumptions remain unchanged throughout the life of the contracts unless there is a deficiency in the liability adequacy test. Reserves for investment-type insurance contracts are recognized as accumulation of premium deposits less charges plus interest credited (just like bank deposits). Reserves for investment contracts are measured at either amortized cost or, with appropriate designation at inception, at fair value. But note that under existing IFRS framework, insurers are allowed to use a "historical" discount rate rather than a "current market-based" discount rate for insurance liabilities. Hence, insurance liabilities are effectively carried at cost.

As a result, the book value of insurers (P&C and life) is vulnerable to large swings resulting from asset price fluctuations. Exhibit 12 shows that shareholders' equity of China insurers expanded sharply in 2007, but fell significantly in 1H2008. Exhibit 13 shows that, after stripping out the impact of MTM gains/losses, the change in shareholders' equity would have been notably smaller.

By our estimate, investment assets that need to mark to market represent more than 200% of shareholders' equity for China insurers (see Exhibit 11).

EV comprises the "adjusted NAV" and "value of in-force business", and hence the volatility of book value also filters through to the embedded value.

It is worth noting that EV is based on market value, but book value is not completely based on market value since certain investment assets do not need to be marked-to-market according to accounting rules (as explained above). Hence, in computing the EV, the book value needs to be "adjusted" to reflect market value before adding to the "value of in-force business".

² The amortization of DAC involves a "k-factor" which is calculated by dividing the present value of DAC by the present value of expected profit from the contract. When actual profit replaces the original profit estimate at each reporting date, a new k-factor would also be produced. The amount of DAC amortization is then derived by multiplying the k-factor with the actual profit. When investment income falls sharply, the k-factor would increase, but this is often more than offset by the larger decrease in actual profit, hence leading to lower DAC amortization.

Exhibit 11: For insurers, many investment assets have to be marked to market either through P&L or balance sheet

Breakdown of investment assets by accounting treatment

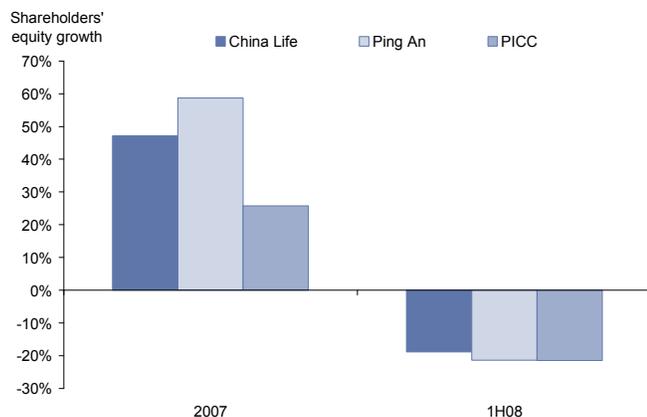
	As of 1H2008				
	China Life	China Pacific	Ping An	PICC	CIH
Investment asset breakdown (Rmb mn)					
Marked to market	412,754	102,689	238,920	42,109	35,232
Through P&L	29,986	1,684	61,121	5,437	4,406
Trading bonds	16,922	520	32,566	2,469	497
Trading equities	13,064	1,164	28,434	2,968	3,909
Derivative financial assets	0	0	121	0	0
Through shareholders' equity	382,768	101,005	177,799	36,672	30,826
Available-for-sale bonds	282,342	64,760	122,560	31,489	25,988
Available-for-sale equities	100,426	36,245	55,239	5,183	4,838
At cost	435,656	169,527	226,404	34,768	21,495
Cash and deposits and loans	221,470	107,121	93,384	30,465	10,366
Held-to-maturity bonds	214,186	62,406	129,343	3,780	11,039
Investment properties	0	0	3,677	523	89
Total investment assets	848,410	272,216	465,324	76,877	56,726
Memo:					
Shareholders' equity	166,738	50,237	87,928	20,485	6,967
Key ratios					
Equity investments as % of total investment assets	13%	14%	18%	11%	15%
Trading assets as % of total investment assets	4%	1%	13%	7%	8%
Available-for-sale assets as % of total investment assets	45%	37%	38%	48%	54%
Total marked-to-market assets as % of total investment assets	49%	38%	51%	55%	62%
Total marked-to-market assets as % of shareholders' equity	248%	204%	272%	206%	506%

Note: Figures for China Pacific are based on China GAAP, while other companies are based on HK GAAP/IFRS.

Source: Company data, Goldman Sachs Research estimates.

Exhibit 12: Sharp swings in book value, as investment assets are marked to market but insurance liabilities not

Yoy growth of shareholders' equity for China insurers in 2007 and 1H2008

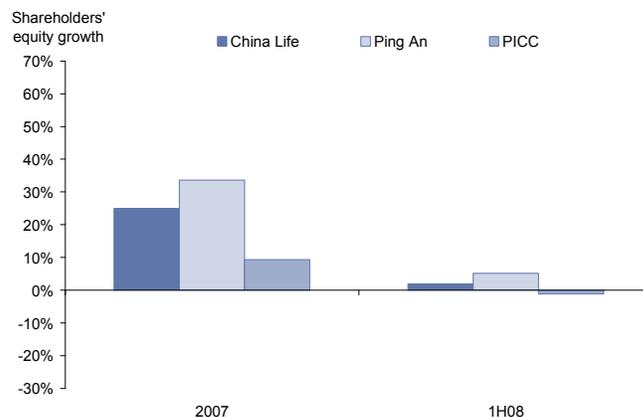


Note: The figures above exclude A-share IPO proceeds.

Source: Company data, Goldman Sachs Research estimates.

Exhibit 13: Stripping out the effect of MTM gains/losses, the changes in book value are notably more modest

Yoy growth of shareholders' equity ex-MTM gains/losses for China insurers in 2007 and 1H2008



Note: The figures above exclude A-share IPO proceeds and net change in accumulated unrealized gains/losses.

China Life relatively more defensive, PICC most cyclically geared

Exhibit 14: China Life has lower earnings-sensitivity to investment returns than peers

Earnings sensitivity to total investment yields, based on 2009E estimates

	Ping An			China Life			PICC		
	Investment yield	Net profit (Rmb mn)	% change in net profit	Investment yield	Net profit (Rmb mn)	% change in net profit	Investment yield	Net profit (Rmb mn)	% change in net profit
Investment yield - 1.0pp	3.47%	14,346	-9%	4.64%	30,739	-8%	3.67%	413	-57%
Investment yield - 0.5pp	3.97%	15,025	-4%	5.14%	31,996	-4%	4.17%	681	-28%
Base case	4.47%	15,703	0%	5.64%	33,253	0%	4.67%	950	0%
Investment yield + 0.5pp	4.97%	16,382	4%	6.14%	34,510	4%	5.17%	1,218	28%
Investment yield + 1.0pp	5.47%	17,060	9%	6.64%	35,767	8%	5.67%	1,487	57%

Note: The above exercise does not take into account the impact of investment income on DAC and deferred income.

Source: Goldman Sachs Research estimates.

Exhibit 15: China Life has lower earnings-sensitivity to equity investment returns than peers

Earnings sensitivity to equity investment returns, based on 2009E estimates

	Ping An			China Life			PICC		
	Equity investment return	Net profit (Rmb mn)	% change in net profit	Equity investment return	Net profit (Rmb mn)	% change in net profit	Equity investment return	Net profit (Rmb mn)	% change in net profit
Equity return - 2.0pp	4.6%	15,227	-3.0%	7.2%	32,584	-2.0%	8.2%	837	-11.9%
Equity return - 1.0pp	5.6%	15,465	-1.5%	8.2%	32,919	-1.0%	9.2%	893	-6.0%
Base case	6.6%	15,703	0.0%	9.2%	33,253	0.0%	10.2%	950	0.0%
Equity return + 1.0pp	7.6%	15,941	1.5%	10.2%	33,588	1.0%	11.2%	1,006	6.0%
Equity return + 2.0pp	8.6%	16,179	3.0%	11.2%	33,922	2.0%	12.2%	1,063	11.9%

Note: The above exercise does not take into account the impact of investment income on DAC and deferred income.

Source: Goldman Sachs Research estimates.

Exhibit 16: China Life also has lower EV-sensitivity to equity investment MTM gains/losses than Ping An

EV- and BV-sensitivity to equity investment MTM gains/losses, based on 2009E estimates

	China Life			Ping An			PICC		
	Equity gains recognized in EV as % of total equity investments	2009E EV per share (HK\$)	% change in EV	Equity gains recognized in EV as % of total equity investments	2009E EV per share (HK\$)	% change in EV	Equity gains recognized in BVPS as % of total equity investments	2009E BVPS (HK\$)	% change in BVPS
Base case - 2pp	-2.0%	10.63	-0.8%	-2.0%	21.59	-1.1%	-2.0%	2.10	-0.8%
Base case - 1pp	-1.0%	10.67	-0.4%	-1.0%	21.71	-0.6%	-1.0%	2.11	-0.4%
Base case	0.0%	10.72	0.0%	0.0%	21.84	0.0%	0.0%	2.12	0.0%
Base case + 1pp	1.0%	10.76	0.4%	1.0%	21.96	0.6%	1.0%	2.13	0.4%
Base case + 2pp	2.0%	10.81	0.8%	2.0%	22.09	1.1%	2.0%	2.13	0.8%

Source: Goldman Sachs Research estimates.

China Life relatively more defensive than peers

While China insurers are inherently pro-cyclical, on a relative basis, we think China Life is more defensive than its peers.

We estimate China Life has the lowest earnings-sensitivity among peers to both total investment yields and equity investment returns (see Exhibits 14 and 15).

We also estimate China Life has lower EV-sensitivity to equity investment MTM gains/losses than Ping An (see Exhibit 16).

We believe these reflect China Life's more conservative investment strategies:

- Less exposure to equity investments and stronger focus on bonds/deposits (see Exhibit 17).
- Less trading-oriented with its equity investments, since close to 90% of its equity investments are available-for-sale as opposed to trading (see Exhibit 18).
- Cautious/conservative stance on overseas investments (no investments in subprime-stricken overseas companies so far; the investment in VISA was profit-making).
- Still accumulated unrealized gains, not losses, sitting on its balance sheet as of 1H2008, versus accumulated unrealized losses for other China insurers (see Exhibit 18).
- Consistently low exposure to trading assets which need to be marked-to-market through the P&L, both bonds and equity investments (see Exhibits 19 and 20).
- Steadily rising fixed income returns (Exhibit 21), reflecting China Life's focus on deposits and bond investments.

As a result, China Life has achieved steadier investment performance than other insurers over time (Exhibit 22).

Meanwhile, China Life does not have exposure to other volatile/cyclical businesses, such as securities and P&C insurance.

To be balanced, we note that China Life has a much larger exposure to bancassurance business than Ping An. In 1H08, bancassurance accounted for about half of China Life's premiums, versus about 13% for Ping An (including deposits). Bancassurance are typically investment-type products with low margin and high reliance on investment spreads, and are often more volatile than the agency business. As a result, we believe China Life will likely have more volatile premium growth than Ping An.

That said, we believe the suboptimal business mix of China Life also suggests room for margin pickup, as the company gradually shifts its focus to the agency channel and improves its agency productivity over time. We also believe the still-low margin renders China Life more geared to investment liberalization in China, which should help improve both the duration matching and investment return for China Life in the longer term.

Exhibit 17: We believe China Life has more conservative investment strategies than peers, as reflected by its strong focus on fixed income and less exposure to trading assets

Breakdown of investment assets for China insurers

	As of 1H2008				
	China Life	China Pacific	Ping An	PICC	CIH
Investment assets (Rmb mn)					
Cash, deposits and loans	221,470	107,121	93,384	30,465	10,366
Bonds	513,450	127,686	284,469	37,738	37,524
Trading	16,922	520	32,566	2,469	497
Available-for-sale	282,342	64,760	122,560	31,489	25,988
Held-to-maturity	214,186	62,406	129,343	3,780	11,039
Equities	113,490	37,409	83,794	8,151	8,747
Trading	13,064	1,164	28,555	2,968	3,909
Available-for-sale	100,426	36,245	55,239	5,183	4,838
Investment properties	0	0	3,677	523	89
Total investment assets	848,410	272,216	465,324	76,877	56,726
Memo: Shareholders' equity	166,738	50,237	87,928	20,485	6,967
As % of total investment assets					
By asset class					
Cash, deposits and loans	26%	39%	20%	40%	18%
Bonds	61%	47%	61%	49%	66%
Equities	13%	14%	18%	11%	15%
Investment properties	0%	0%	1%	1%	0%
By accounting treatment					
Marked-to-market	49%	38%	51%	55%	62%
Trading assets (through P&L)	4%	1%	13%	7%	8%
Available-for-sale assets (through B/S)	45%	37%	38%	48%	54%
At cost (held-to-maturity)	51%	62%	49%	45%	38%

Note: Figures for China Pacific are based on China GAAP, while other companies are based on HK GAAP/IFRS.

Source: Company data, Goldman Sachs Research.

Exhibit 18: China Life has a more conservative equity investment strategy – most equity investments are available-for-sale and there are still unrealized gains sitting on the balance sheet

Equity investment breakdown and accumulated unrealized gains/losses for China insurers, as of 1H2008

	Based on China GAAP			Based on HK GAAP			
	China Life	China Pacific	Ping An	China Life	Ping An	PICC	CIH
Equity investments that mark to market through book value							
Equity investments - 1H2008	120,471	37,409	101,555	113,490	83,673	8,151	8,747
Trading equities	13,064	1,164	42,914	13,064	28,434	2,968	3,909
Available-for-sale (AFS) equities	100,124	36,055	55,087	100,426	55,239	5,183	4,838
Longterm stake investments	7,283	190	3,554				
Total investment assets - 1H2008	855,391	272,216	518,152	848,410	465,324	76,877	56,726
AFS equities and longterm stakes as % of total equity investments	89%	97%	58%	88%	66%	64%	55%
AFS equities and longterm stakes as % of total investment assets	13%	13%	11%	12%	12%	7%	9%
Equities as % of total investment assets	14%	14%	20%	13%	18%	11%	15%
Buffer for future investment income							
Accumulated unrealized gains in book value - 1H2008	1,818	(7,187)	(9,787)	1,730	(9,791)	(1,133)	(573)
Total equity investments - 1H2008	120,471	37,409	101,555	113,490	83,673	8,151	8,747
Accumulated unrealized gains as % of AFS equities and longterm stakes	1.7%	-19.8%	-16.7%	1.7%	-17.7%	-21.9%	-11.8%
Accumulated unrealized gains as % of total equity investments	1.5%	-19.2%	-9.6%	1.5%	-11.7%	-13.9%	-6.5%

Source: Company data, Goldman Sachs Research.

Exhibit 19: China Life has consistently had low exposure to trading equities

Trading equities as % of total equity investments

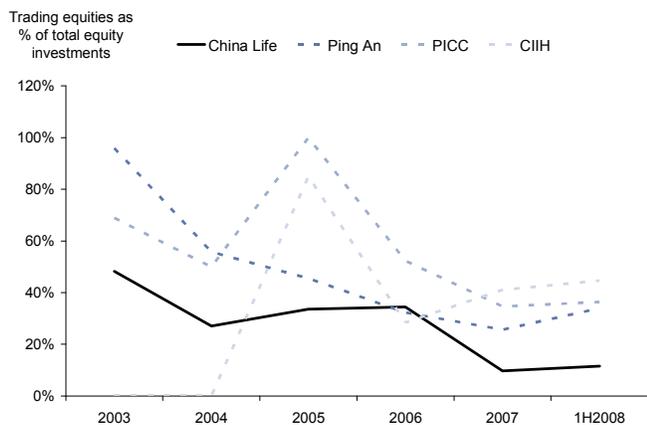
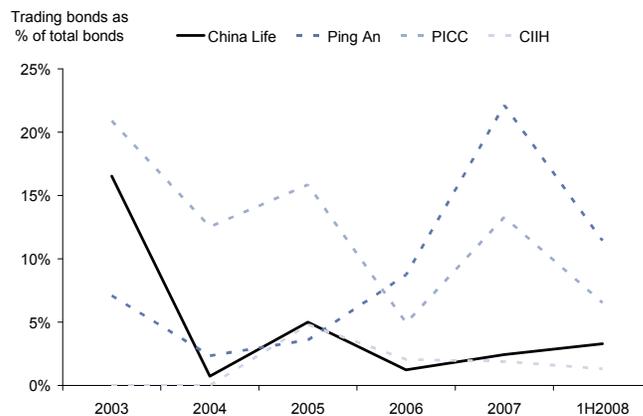


Exhibit 20: China Life has consistently had low exposure to trading bonds

Trading bonds as % of total bond investments



Source: Company data, Goldman Sachs Research estimates.

Exhibit 21: China Life’s more conservative investment strategies lead to steadily rising net investment yields...

Net investment yields (ex-realized and unrealized gains; mainly reflecting deposit/bond income) of China insurers

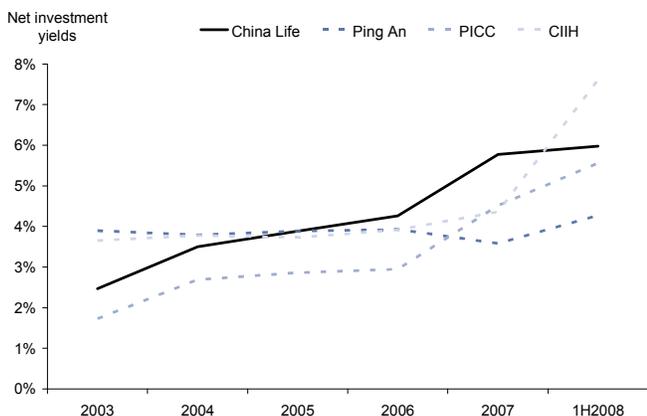
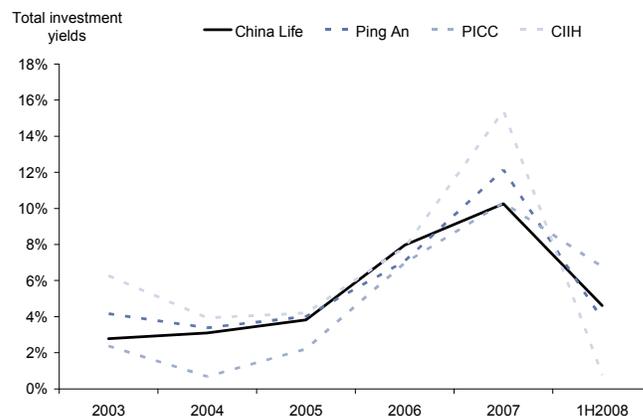


Exhibit 22: ...in turn making China Life’s overall investment performance less volatile than peers

Total investment yields of China insurers



Source: Company data, Goldman Sachs Research estimates.

Ping An more pro-cyclical than China Life

We believe Ping An’s diversified financial services model should create good cross-selling synergies and help unlock value of excess capital in the longer term. We continue to hold a positive view on Ping An management’s ability to execute.

We also believe the extent of pro-cyclicality is not significantly different between Ping An and China Life, since their product mix is not structurally different (“spread products” are still the key product) and both insurers face the same capital markets domestically. After all, our estimated earnings-/EV-sensitivities to investment yields for Ping An are not significantly different from those for China Life.

That said, **we still believe Ping An is relatively more pro-cyclical than China Life, given Ping An's more aggressive investment mix/strategies:**

- Stake investment in Fortis, which is still plagued by subprime woes (but which could see sharp rebound in earnings as and when the subprime problems ease/recover in the longer term).
- Higher exposure to equity investments (including Fortis) than peers (see Exhibit 17).
- More trading-oriented with its equity investments, with higher share of available-for-sale equities than China Life (see Exhibit 18).
- More exposure to trading assets, both bonds and equities (see Exhibit 17).
- More exposure to investment assets that need to be marked-to market (relative to total investment assets and shareholders' equity; see Exhibit 11)

Reflecting the above, we estimate Ping An's revenue base has been more reliant on investment income, and the share of investment income in revenue has also been more volatile over time, compared with China Life (see Exhibit 23). Ping An's book value and EV have also been more impacted by MTM gains/losses than China Life (on both the way up and on the way down; see Exhibit 24).

We also point to Ping An's exposure to other cyclical businesses, including securities (5%-9% of pretax profit in 2007 and 1H2008) and P&C (3%-13% of pretax profit in 2007 and 1H2008), which would also add to earnings volatility, in our view.

Exhibit 23: Despite its more diversified revenue, Ping An has been more reliant on investment income, and the share of investment revenue has also been more volatile
Retained investment income as % of total net revenue

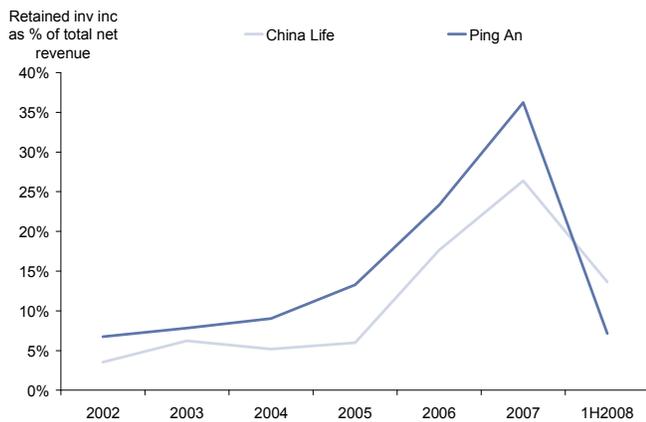
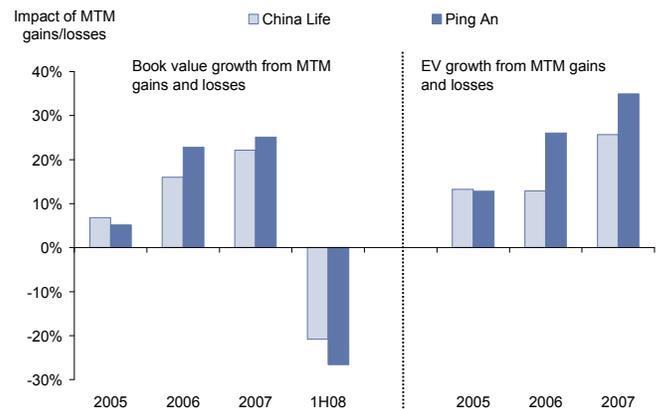


Exhibit 24: Ping An's book value and EV have also been more impacted by MTM gains/losses, reflecting its more aggressive investment strategies
Impact of MTM gains/losses on the growth of BV and EV



Note: Retained investment income equals investment income less policyholder dividends and interest credited to investment contracts.

Source: Company data, Goldman Sachs Research.

PICC most cyclically geared

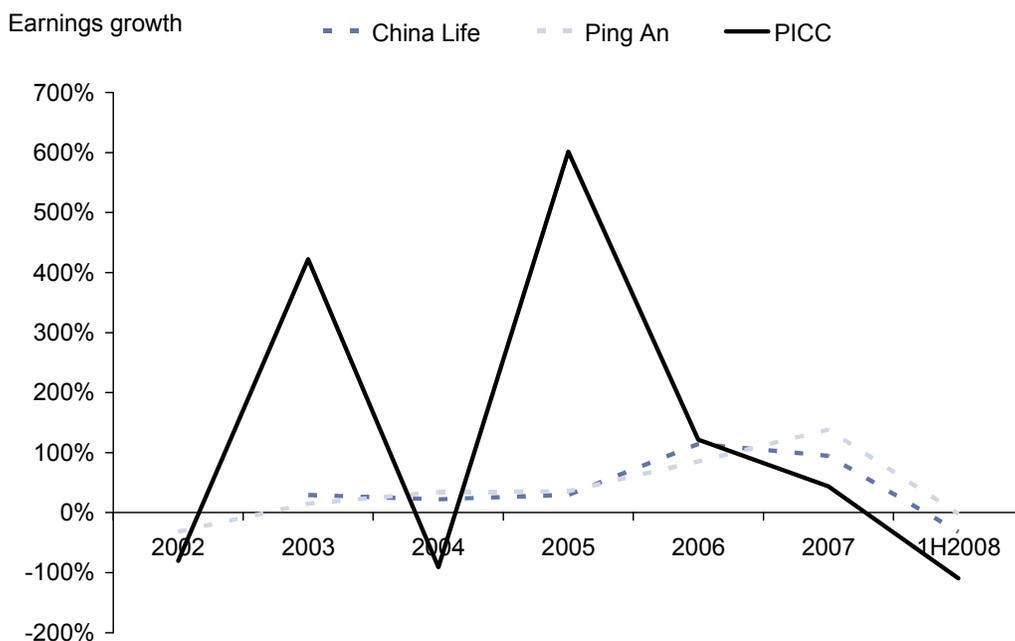
We believe PICC is still fundamentally challenged due to ongoing pricing and commission pressure in the P&C insurance sector, and cost pressure for PICC (e.g. catch-up in salary increase, network build out, losses on premium receivables).

On the other hand, we believe PICC is the most pro-cyclically geared among peers. We estimate PICC has the highest earnings-sensitivity to both total investment yields and equity investment returns (see Exhibits 14 and 15). In our view, this is mainly due to PICC's thin underwriting profitability and the non-participating nature of most P&C products.

Note PICC's earnings progression has been notably more volatile than China Life and Ping An (see Exhibit 25).

Exhibit 25: PICC has notably more volatile earnings progression over time, reflecting its pro-cyclicality and weak underwriting business

Yoy earnings growth for China insurers



Source: Company data, Goldman Sachs Research.

Fundamentally positive, but not time for beta yet; prefer China Life

We stay fundamentally positive on the secular prospects of life insurers, and would accumulate on dips in general, given the still-low insurance penetration, strong income growth, ongoing investment liberalization and capital market reform in China.

That said however, we are not yet prepared for the “time for beta and market rebound” call, given a still murky macro outlook.

To make an outright positive call, we would need to see clear signs of moderating inflation (including PPI) and a soft landing, and/or policy easing in China, which we believe are key to a sustainable A-share recovery and hence insurers' earnings/EV growth recovery.

China Life is our top pick for relative defensiveness and good underlying growth (23% NBV CAGR through 2009E). We also see less event risk with China Life (e.g. no capital-raising overhang, less risk of growth-dilutive overseas M&As) vis a vis Ping An.

We remain cautious on PICC due to underwriting challenges resulting from premium rate declines and cost pressure. We reiterate our Sell rating and 12-m TP of HK\$3.2 (based on 1.5X 2009E BVPS).

Exhibit 26: Valuation of China insurers

Ticker	Stock rating	Curr	Share price 9/3/2008	P/EV (X)			NBM (X)			P/B (X)			P/E (X)			Div yield		
				2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	2010E	2008E	2009E	
H-share insurers																		
China Life (H)	2628.HK	Neutral	HKD	28.95	3.30	2.70	2.33	31.3	22.6	17.1	4.04	3.20	2.72	27.2	20.5	17.0	1.0%	1.3%
Ping An (H)	2318.HK	Neutral	HKD	55.30	3.05	2.53	2.25	27.3	19.3	15.1	4.36	3.43	2.88	27.6	21.6	17.7	0.9%	1.3%
PICC (H)	2328.HK	Sell	HKD	4.33							2.25	2.05	1.93	(37.8)	42.4	25.2	0.0%	0.8%
A-share insurers																		
China Life (A)	601628.SS	Neutral	Rmb	24.39	3.23	2.82	2.43	30.4	24.1	18.4	3.95	3.34	2.83	25.5	20.7	17.8	1.1%	1.3%
Ping An (A)	601318.SS	Neutral	Rmb	43.79	2.81	2.48	2.20	24.1	18.7	14.6	4.01	3.36	2.83	24.4	20.5	17.4	1.0%	1.4%

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Source: Company data, Goldman Sachs Research estimates.

Exhibit 27: Price targets and underlying assumptions for China insurers

Ticker	Stock rating	Curr	Share price 9/3/2008	12-mo Price target	Potential upside/downside	AVPS	Discount rate			3-stage growth model						Target P/EV (X)	Implied NBM (X)	
							Risk-free rate	Adj. risk prem.	Discount rate	1st stage		2nd stage		Terminal stage				
										NBV CAGR	No. of years	NBV CAGR	No. of years	APE CAGR	NBV CAGR			
H-share insurers																		
China Life (H)	2628.HK	Neutral	HKD	28.95	37.0	28%	37.0	5.0%	6.3%	11.3%	21%	3	15%	12	4.0%	4.0%	4.22	43.9
Ping An (H)	2318.HK	Neutral	HKD	55.30	62.0	12%	58.9	5.0%	6.9%	11.9%	20%	3	11%	12	4.0%	4.0%	3.42	32.2
A-share insurers																		
China Life (A)	601628.SS	Neutral	Rmb	24.39	37.8	55%	34.7	5.0%	6.3%	11.3%	21%	3	15%	12	4.0%	4.0%	5.01	54.6
Ping An (A)	601318.SS	Neutral	Rmb	43.79	63.4	45%	54.9	5.0%	6.9%	11.9%	20%	3	11%	12	4.0%	4.0%	4.07	40.8
P&C insurers	Ticker	Stock rating	Curr	Share price	12-mo Price target	Potential upside/downside	Target P/B X BVPS	Discount rate			CAMELOT 3-stage DDM						Target P/B (X)	Implied P/E (X)
								Risk-free rate	Adj. risk prem.	Discount rate	1st stage		2nd stage		Terminal stage			
											Growth	No. of years	Growth	No. of years	ROE	Growth		
PICC (H)	2328.HK	Sell	HKD	4.33	3.2	-26%	3.2	5.0%	6.9%	11.9%	31%	3	7%	12	14.0%	4.0%	1.50	10.7

Our 12-m TPs are based on EV for China Life, SOTP for Ping An, and P/B for PICC. Key risks to our price targets include a sharp fall in the A-share market and a hard landing in China.

Source: Goldman Sachs Research estimates.

Reg AC

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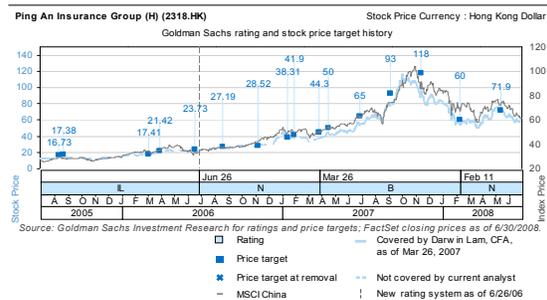
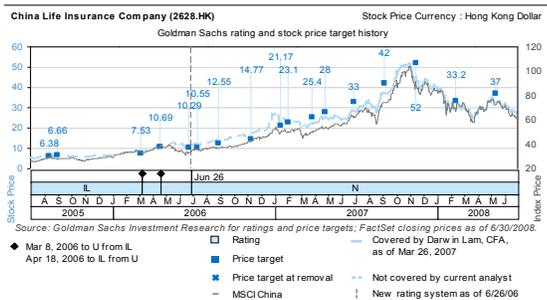
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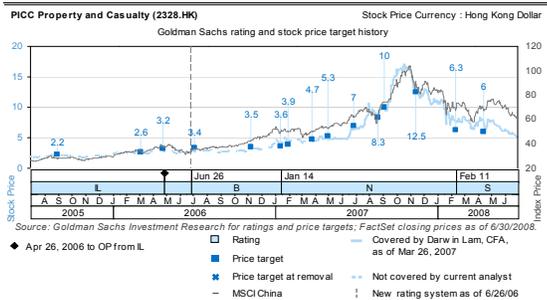
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