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China | Insurance

Ping An Insurance Group (2318 HK)

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Don't bank on it

+ Capital deficiency

Ping An Bank (PAB) is raising fresh capital when its book value is trading below par. It is depending on cheap preferred equity from the parent for most of the capital raise, indicating that the company is simply running low on cash.

+ NPLs building

If PAB were to account for NPLs cleanly, it would not meet minimum coverage requirements. What's more, recent media reports suggest that the extent of NPLs may be far worse than even Special Mention Loans would indicate.

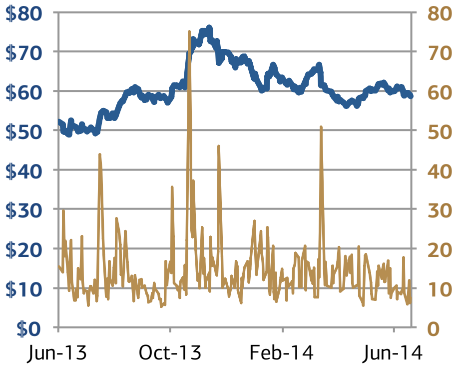
+ Property agency

Ping An has launched an e-commerce real estate platform, Ping An Housing, to compete with the likes of Soufun and Leju. The signature product appears to be a way to make developer loans off balance sheet.

+ Reiterate SELL, maintain PT of HKD 50.66

We maintain our PT of HKD 50.66, based on a multiple of book value.

Ping An (2318 HK) one-year share price in HKD (blue) and volume (gold, in mln shares)



Source: Bloomberg, July 21, 2014

Ping An Insurance Gp. (2318 HK)

Price	HKD 58.20
Rating	**Sell**
Price Target	**HKD 50.66**
Difference	**13%**
Market Cap	HKD 420.3 bln
Simple Moving Avg.	9.0 mln
P/E	13.1x

Source: Bloomberg, July 21, 2014

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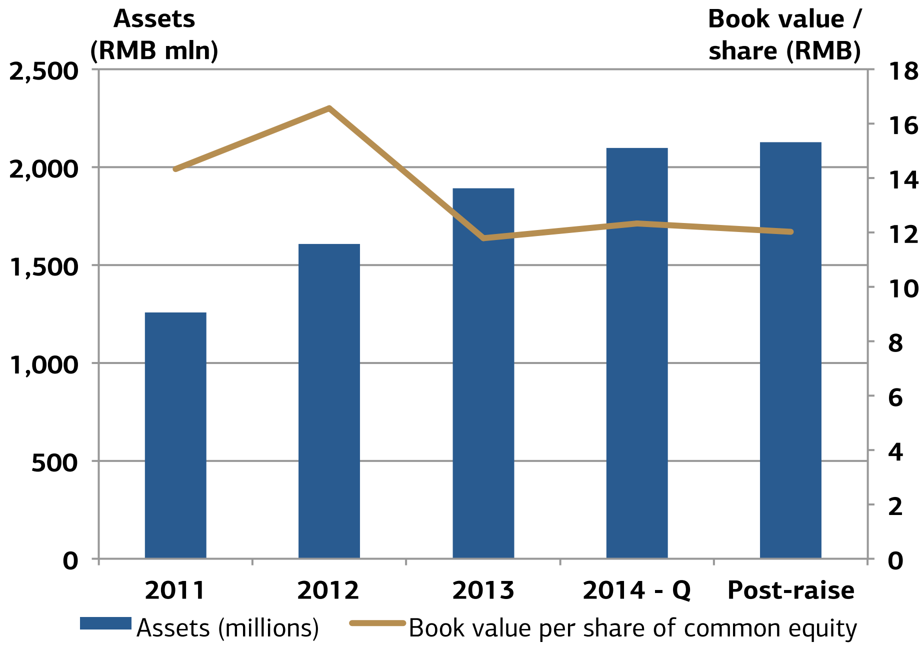
White Elephant

On Tuesday, Ping An's 59%-owned subsidiary Ping An Bank announced plans to raise RMB 30 bln, of which RMB 20 bln will be in preferred equity and RMB 10 bln in common.[1] It is an interesting deal. Banks that are supposedly earning an ROE of 16.58% do not often issue equity when their stock is trading under 80% of book value. Furthermore, 50-60% of the preferred shares and 45-50% of the common will be purchased by the parent, in cash. The preferred dividend has not yet been decided upon, but will not exceed PAB's average return on assets for the last two years, in other words 0.9%.

PAB is raising money with its stock trading at 80% of book value; the deal smacks of desperation.

If Ping An is recapitalizing its banking subsidiary despite diluting shareholders and at virtually no return to the parent, it is reasonable to suspect that the bank is running out of capital. Since 2011, PAB assets have grown at a CAGR of 17.5%, while, after the raise; book value per share will have declined at a CAGR of roughly 5%.

Chart 1. PAB assets vs. book value per share



Source: Company filings

[1] http://news.xinhuanet.com/fortune/2014-07/16/c_126758307.htm

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If it were to account for its NPLs cleanly—without growth in "special mention loans" booked as NPLs—Ping An would already have broken CBRC statutory coverage requirements. Reserving for those loans to bring it into compliance would leave Ping An with a deficiency in core capital.

Clean accounting of NPLs would put PAB significantly below statutory coverage requirements.

Table 1. PAB NPL coverage ratio

	2014 Q1	2014 (Adjusted)	Statutory requirement
NPLs	8,105	32,221	n/a
Loan loss reserve	-16,335	-16,335	n/a
Coverage ratio	202%	51%	150%

Source: Company filings, J Capital Research estimates, CBRC

A Chinese proverb comes to mind: "Pulling on your coat lapels shows the holes in your elbows"[2]—i.e., you can patch up one shortfall but only at the expense of exposing another.

Prior to this raise, PAB was likely beginning to feel desperate. Headquarters, presumably acting on the CBRC's behest, has threatened the branches with a crackdown on rolling over loans.[3] Moreover, all the banks have been under pressure to bring shadow-banking assets back onto balance sheet. Without a bailout, this would have crushed PAB.

More to come

Recent media reports suggest the Special Mention Loans already recorded may be the least of Ping An's problems: as yet completely unreported NPLs seem poised to skyrocket. The 21st Century Business Daily quoted an insider in the Chongqing Branch of Ping An Bank as saying, "we've so far only reported RMB 299 mln in NPLs to HQ, in reality . . . NPLs have already reached RMB 1.4 bln."[4]

What's in it for the parent?

So what does the parent get, other than an investment that yields less than a term deposit? Given the scale of the investment, we think it likely that Ping An is preparing to pretty up its insurance balance sheet as well.

[2] For our Sinophones: "捉襟见肘"

[3] http://english.caixin.com/2014-06-25/100695417.html

[4] http://finance.caijing.com.cn/20140715/3620476.shtml

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Since early this year, the CIRC has been increasingly warning about risk in Debt Invest Plans (DIPs),[5] a kind of investment product that allows insurers to lend to LGFVs and property developers. Ping An has by far the most exposure, with DIPs to the tune of 45% of its total equity as of 2013. The prospect of a crackdown on DIPs no doubt has made Ping An jittery. But with a PAB newly flush with capital, Ping An will be able to use the bank's balance sheet to roll-over, at par, debt securities currently on the insurance balance sheet.

At present, this is just a hypothesis—we will have to see how the balance sheet progresses over the rest of 2014.

Ping An Housing

Ping An's foray into e-commerce has largely gone unnoticed in the West, but its housing vertical, a competitor to companies like Soufun and E-House Holdings, has been up and running since May.

The website markets properties in the first- and second-hand markets, and also organizes buying groups for residential properties. But most striking of all is its promotion: buy a house, and you get to invest up to RMB 200,000 in its "haofangbao" product, yielding 14% a year.

Ping An's property portal seems like little more than a channel to make developer loans.

Source: http://xf.pinganfang.com/sh/main/detail.id.10.html

Haofangbao is apparently a structured product: part money market fund, part "rebate." The money that the client uses to purchase the WMP goes into a money market fund yielding roughly 5-6%, while

[5] http://finance.21cbh.com/2014/5-29/2OMDA1OTFfMTE4MjU2OA.html

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rebates from the cost of the unit fund the remaining 6-8% and are paid over time by the developer.[6]

There is no economic difference between a rebate and a loan—they are both cash in today in exchange for cash out tomorrow. Automakers, electronics marts, and washing machine companies like to offer rebates because they act as zero-interest working capital loans.

But Ping An Housing rebates are *8% project loans*—and ones that are guaranteed by Ping An. That is, of course, identical to developer lending, for it makes no difference to the cash flows whether funding is accounted for as "loans" or "rebates payable." Once again, Ping An is increasing its developer exposure.

Valuation

We first toggle down Ping An's asset value based on our estimate of eventual NPLs, and then assign it a multiple of book value.

Risks

The mini-stimulus in infrastructure spending and monetary loosening in the form of relending and pledged supplementary lending facilities could create more abundant liquidity for PAB, and raise fair values of Ping An Insurance's marketable securities.

[6] http://finance.21cbh.com/2014/xintuo_69/1192616.html

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