

n/a

China Insurance Sector

Zhong An: Overview of a Chinese Insurtech Unicorn

The first fintech/insurtech IPO in HK

Zhong An (Not Listed) is a leading fintech/insurtech company in China focusing on innovative insurance products and solutions. On 30 Jun, the insurer filed its Application Proof with no disclosure on IPO size or valuation. According to *Reuters*, it is expected to raise ~USD1.5b in proceeds. Its CNY5.8b Series A fundraising in Jun 2015 implied a group valuation of CNY29.8b (USD4.4b) or 2016 PBR of 4.3x vs PICC P&C's 1.6x. In this report, we provide an initial overview of Zhong An's operations, product mix, top-line growth, profitability, B/S risk and capital strength. Note that MKE is not involved in Zhong An's IPO distribution.

An ecosystem-oriented product and service provider

Zhong An is China's largest Internet-only insurer focusing on innovative scenario-based products. It develops and integrates insurance policies into ecosystem platforms (i.e. lifestyle consumption, travel, consumer finance, health and auto) to ensure a customer-centric purchase experience. Its unique focus on high-frequency micro transactions (avg size: CNY0.9) allows it to reach a large customer base (c492m) and address the unmet demand by traditional insurers. It has also started to offer technology solutions, such as cloud-based applications, Al-backed data services and blockchain services to business partners and insurers.

Shifting away from shipping return policies

Zhong An's total GWP (gross written premium) achieved 107% CAGR in 2014-16 and it continued to grow by 89% YoY in 5M17. Unlike a typical Chinese P&C player that generates ~70-80% of GWP from auto insurance, its product mix is heavily skewed towards non-auto insurance. GWP for shipping return insurance declined by 8% in 2016 due to the rise in competition. But Zhong An reduced its reliance on such business to 35% in 2016 from 77% in 2014 as it explored the growth potential of non-shipping return policies (GWP +250% CAGR in 2014-16), particularly in the health and travel accident segments.

Profitability metrics weak during expansion stage

Zhong An's combined ratio ranged from 105-127% in 2014-16, and management expects underwriting losses to continue due to the erosion of its operating expenses (expense ratio = 63% in 2016 vs 35% in 2014) amid rising commissions paid to ecosystem partners. It will face more cost pressure if competition intensifies, especially when its largest partner/shareholder Alibaba (BABA US | BUY | TP USD167)/Ant Financial start to build up their own insurance franchise.

Further, the insurer's high exposure to funds and stocks (22% as of Dec16; highest among peers) and WMPs and trusts (20%; similar to NCI's level) could raise B/S concerns. It has the lowest net investment yield among peers (1.8% vs peers' 4.2-6.0% in 2016). This could be partly due to its preference for trading stocks vs investing in high-dividend equities.

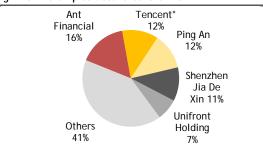
Not Listed

Share Price

Analyst

Ning Ma, CFA (852) 2268 0672 ningma@kimeng.com.hk

Fig 1: Ownership structure before IPO



Source: Company data. *Held by its Tencent Computer System

Fig 2: Valuation implied by Series A fundraising

(CNYm)	2014	2015	2016
Book value	1,021	6,898	6,859
GWP	794	2,283	3,408
Net profit	37	44	9
P/B (x)	29.2	4.3	4.3
P/GWP (x)	37.5	13.0	8.7
P/E (x)	805	673	3,177

Source: Company data

Fig 3: Financial metrics

	2014	2015	2016
GWP grow th	6130%	188%	49%
- Shipping return	5982%	112%	-8%
- Non shipping return	6687%	444%	125%
Net profit grow th	na	20%	-79%
Net investment yield	2.2%	1.7%	1.8%
Gross investment yield	7.3%	12.6%	1.7%
Loss ratio	73.4%	68.5%	42.0%
Expense ratio	35.2%	58.1%	62.7%
Combined ratio	108.6%	126.6%	104.7%
ROA	3.12%	0.9%	0.1%
ROE	3.70%	1.1%	0.1%
Core ratio*	715%	805%	723%
Comprehensive ratio*	715%	805%	723%

Source: C-ROSS reports, company data. *C-SI figures in 2014

Valuation summary (as of 6 July 2017)

		J (,	. ,																
				Last			PB (x)		Р	/EV (x)		EV	growth	#	٧	/NB (x)		VNB	growth	#
Name	Ticker	Rating	TP	price	Upside	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E I	FY18E
China Life	2628 HK	HOLD	26.50	24.05	10%	2.06	1.98	1.85	0.93	0.82	0.70	7%	16%	17%	(0.9)	(2.3)	(3.8)	57%	20%	18%
Ping An	2318 HK	BUY	57.00	54.35	5%	2.32	2.09	1.83	1.40	1.20	1.00	25%	19%	19%	5.0	2.3	0.0	49%	27%	23%
CPIC	2601 HK	BUY	38.50	32.30	19%	1.99	1.93	1.66	1.07	0.94	0.74	13%	16%	16%	0.9	(0.7)	(2.9)	57%	24%	21%
PICC Group	1339 HK	HOLD	3.30	3.52	-6%	1.08	1.06	0.96	0.95	0.92	0.82	10%	15%	14%	(2.0)	(2.5)	(6.1)	47%	14%	15%
PICC P&C	2328 HK	SELL	11.00	14.50	-24%	1.61	1.46	1.30	na	na	na	na	na	na	na	na	na	n/a	na	na
NCI	1336 HK	BUY	46.50	42.10	10%	1.99	1.88	1.72	0.91	0.78	0.65	17%	19%	19%	(1.1)	(2.7)	(4.2)	30%	22%	18%
CTIH	966 HK	BUY	25.00	19.86	26%	1.39	1.29	1.16	0.70	0.62	0.54	9%	12%	15%	(3.4)	(3.9)	(4.6)	50%	21%	20%
AIA Group	1299 HK	BUY	61.00	55.60	10%	2.47	2.27	2.10	2.05	1.83	1.63	10%	12%	12%	16.1	12.0	8.6	25%	18%	19%

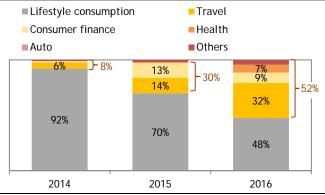
Source: Company data, Bloomberg, Maybank Kim Eng. #FY16 EV/VNB growth for Chinese insurers are underlying growth ex. C-ROSS impact and EV assumption changes

Fig 4: Zhong An is the largest Internet-only insurer in China

Internet-only insurers	Key business partners	Licence approval date	2016 GWP (CNYm)
Zhong An	Alibaba, Ctrip, Ping An	Oct-13	3,408
Taikang Online P&C	Taikang Insurance Group, DXY	Nov-15	675
Yi An P&C	Yinzhijie (a fintech firm)	Feb-16	222
An Xin P&C	Honganonline (a fintech firm)	Dec-15	75
Total			4,380

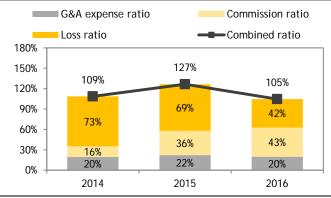
Source: Company data, CIRC, Oliver Wyman

Fig 6: It is diversifying sales by tapping more ecosystems*



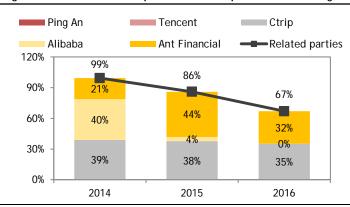
Source: Company data. *Zhong An's GWP breakdown by ecosystems

Fig 8: Weak combined ratio due to high commission expenses



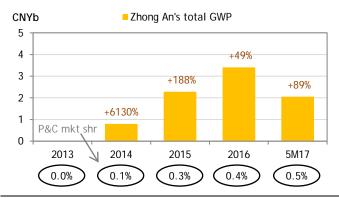
Source: Company data

Fig 10: % of commissions paid to related parties remain high*



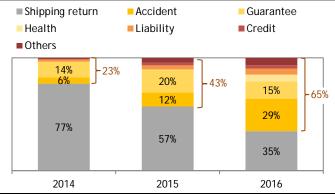
Source: Company data. *Commissions incl. consulting fees and service charges

Fig 5: It has a small market share despite its strong growth



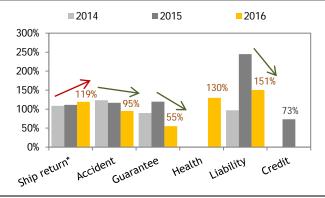
Source: Company data, CIRC

Fig 7: Reducing its reliance on shipping return insurance*



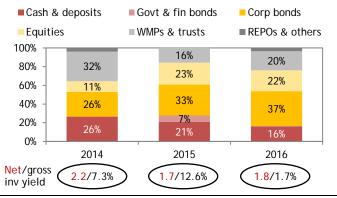
Source: Company data. *Zhong An's GWP breakdown by product types

Fig 9: Shift to non-ship. return policies with better margins



Source: Company data. *Also incl. other segments

Fig 11: Aggressive asset mix and low net investment yield



Source: Company data



1. Financial summary

P&L (FYE Dec; CNYm)	2014	2015	2016	2017E	2018E	SEGMENT (FYE Dec)	2014	2015	2016	2017E	2018E
GWP	794	2,283	3,408	-	-	GWP growth					
- Shipping return	613	1,298	1,194	-	-	Shipping return	5982%	112%	-8%	-	-
- Non shipping return	181	985	2,214	=		Non shipping return	6687%	444%	125%	-	-
NEP & fees	712	1,921	3,225	-	-	- Accident	na	537%	247%	-	-
Net claims	(523)	(1,316)	(1,355)	-	-	- Merchant guarantee	3986%	316%	14%	-	-
Net commissions*	(111)	(691)	(1,380)	-	-	- Health	na	102854%	1432%	-	-
G&A expenses	(142)	(439)	(664)	-	-	- Liability	na	408%	128%	-	-
Underwriting expenses	(775)	(2,447)	(3,400)	-	_	- Credit insurance	na	1192%	99%	-	-
Underwriting profit	(63)	(525)	(174)	-	-	- Cargo	na	na	278%	-	-
Investment income	90	561	140	-	-	- Household property	1049439%	641%	-54%	-	-
Other Income	15	27	47	-	-	- Others	na	1627%	177%	_	-
Finance Costs	(6)	(3)	(0)	-	-	Total	6130%	188%	49%	-	-
Associates & JVs	Ó	Ó	Ó	_	-	GWP mix					
Pretax profit	37	60	13	-		Shipping return	77%	57%	35%	_	_
Income tax	0	(15)	(4)	_	_	Non shipping return	23%	43%	65%	_	_
MI & pref. share div	0	0	0	_	_	- Accident	6%	12%	29%	_	_
Net profit	37	44	9			- Merchant guarantee	14%	20%	15%	_	_
'*Incl. consulting & service			,			- Health	0%	1%	6%		
mer. consuming & service	. 1003					- Liability	2%	4%	5%		
B/S (FYE Dec; CNYm)	2014	2015	2016	2017E	2018E	- Credit insurance	1%	2%	3%	-	-
Cash & deposits	342	1,623	1,401	2017	2010E		0%	2 <i>%</i> 1%	2%	-	-
•	342 0			-	-	- Cargo				-	-
Associates & JVs		0	7 270	-	-	- Household property	1%	1%	0%	-	-
Other investments	948	6,086	7,279			- Others	0%	2%	4%		
Total investments	1,290	7,709	8,681	-	-	Combined ratio	100 70		440.00		
Intangibles	12	40	149	-	-	Shipping return*	108.7%	111.3%	119.3%	-	-
Other assets	68	320	502	-		Non shipping return*	105.3%	140.0%	96.0%	-	-
Total assets	1,369	8,069	9,332	-	-	Total	107.9%	123.0%	105.1%	-	-
						*MKE estimates					
Policy reserves	123	618	1,371	-	-						
Borrowings & REPOs	140	2	283	-	-	INVEST. MIX (FYE Dec)	2014	2015	2016	2017E	2018E
Other liabilities	86	551	820	-		Low risk	26%	28%	16%	-	-
Total liabilities	349	1,171	2,473	-	-	Cash & deposits	26%	21%	16%	-	-
						Government bonds	0%	4%	0%	-	-
Shareholders' equity	1,021	6,898	6,859	-	-	Financial bonds	0%	3%	0%	-	-
Other equity instrument	0	0	0	-	-	Moderate risk	26%	33%	37%	-	-
Minority interests	0	0	0	-	-	Corporate bonds	26%	33%	37%	-	-
Total equity	1,021	6,898	6,859	-	_	Policyholders' loans	0%	0%	0%	_	_
	, -	,	,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,			Debt schemes	0%	0%	0%	_	-
KEY METRICS (FYE Dec)	2014	2015	2016	2017E	2018E	Investment properties	0%	0%	0%	_	_
GWP growth	6130%	188%	49%	-		High risk	47%	39%	46%	_	
NEP & fees growth	na	170%	68%	_	_	Funds & stocks	11%	23%	22%	_	_
Net investment yield	Hu	17070	0070				1 1 70				_
,	2 2%	1 7%	1 8%	_	_	Unlisted equities*	Λ%	Λ%	11%		-
Gross investment vield	2.2% 7.3%	1.7% 12.6%	1.8% 1.7%	-	-	Unlisted equities* WMPs & trusts	0% 32%	0% 16%	0% 20%	-	_
Gross investment yield	7.3%	12.6%	1.7%	-	-	WMPs & trusts	32%	16%	20%	-	-
Loss ratio (% NEP)	7.3% 73.4%	12.6% 68.5%	1.7% 42.0%	-	- - -	WMPs & trusts REPOs & others				-	-
Loss ratio (% NEP) Expense ratio (% NEP)	7.3% 73.4% 35.2%	12.6% 68.5% 58.1%	1.7% 42.0% 62.7%	- - -	-	WMPs & trusts	32%	16%	20%	- - -	-
Loss ratio (% NEP) Expense ratio (% NEP) Combined ratio (% NEP)	7.3% 73.4% 35.2% 108.6%	12.6% 68.5% 58.1% 126.6%	1.7% 42.0% 62.7% 104.7%	-	- - - -	WMPs & trusts REPOs & others *Incl. associates & JVs	32% 4%	16% 0%	20% 3%	20175	20105
Loss ratio (% NEP) Expense ratio (% NEP)	7.3% 73.4% 35.2%	12.6% 68.5% 58.1%	1.7% 42.0% 62.7%	-	-	WMPs & trusts REPOs & others *Incl. associates & JVs SOLVENCY (FYE Dec)	32% 4% 2014*	16% 0% 2015	20% 3% 2016	2017E	2018E
Loss ratio (% NEP) Expense ratio (% NEP) Combined ratio (% NEP) Net profit growth	7.3% 73.4% 35.2% 108.6% na	12.6% 68.5% 58.1% 126.6% 20%	1.7% 42.0% 62.7% 104.7% -79%	- - -	- - - -	WMPs & trusts REPOs & others *Incl. associates & JVs SOLVENCY (FYE Dec) Core ratio	32% 4% 2014* 715%	16% 0% 2015 805%	20% 3% 2016 723%	2017E	2018E
Loss ratio (% NEP) Expense ratio (% NEP) Combined ratio (% NEP) Net profit growth DUPONT (FYE Dec)	7.3% 73.4% 35.2% 108.6% na	12.6% 68.5% 58.1% 126.6% 20%	1.7% 42.0% 62.7% 104.7% -79%	-	-	WMPs & trusts REPOs & others *Incl. associates & JVs SOLVENCY (FYE Dec) Core ratio Comprehensive ratio	32% 4% 2014*	16% 0% 2015	20% 3% 2016	2017E	2018E
Loss ratio (% NEP) Expense ratio (% NEP) Combined ratio (% NEP) Net profit growth DUPONT (FYE Dec) NEP / assets	7.3% 73.4% 35.2% 108.6% na 2014 60.1%	12.6% 68.5% 58.1% 126.6% 20% 2015 40.7%	1.7% 42.0% 62.7% 104.7% -79% 2016 37.1%	- - -	- - - -	WMPs & trusts REPOs & others *Incl. associates & JVs SOLVENCY (FYE Dec) Core ratio	32% 4% 2014* 715%	16% 0% 2015 805%	20% 3% 2016 723%	2017E	2018E - -
Loss ratio (% NEP) Expense ratio (% NEP) Combined ratio (% NEP) Net profit growth DUPONT (FYE Dec) NEP / assets Pretax profit margin	7.3% 73.4% 35.2% 108.6% na 2014 60.1% 5.1%	12.6% 68.5% 58.1% 126.6% 20% 2015 40.7% 3.1%	1.7% 42.0% 62.7% 104.7% -79% 2016 37.1% 0.4%	- - -	- - - -	WMPs & trusts REPOs & others *Incl. associates & JVs SOLVENCY (FYE Dec) Core ratio Comprehensive ratio	32% 4% 2014* 715%	16% 0% 2015 805%	20% 3% 2016 723%	2017E - -	2018E - -
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Loss ratio (% NEP) Expense ratio (% NEP) Combined ratio (% NEP) Net profit growth DUPONT (FYE Dec) NEP / assets Pretax profit margin - Underwriting margin - Investments / NEP - Others / NEP Effective tax rate	7.3% 73.4% 35.2% 108.6% na 2014 60.1% 5.1% -8.9% 12.6% 1.4% -1.1%	12.6% 68.5% 58.1% 126.6% 20% 2015 40.7% 3.1% -27.3% 29.2% 1.2% 25.7%	1.7% 42.0% 62.7% 104.7% -79% 2016 37.1% 0.4% -5.4% 4.4% 1.4% 28.0%	- - - 2017E - - - - -	- - - -	WMPs & trusts REPOs & others *Incl. associates & JVs SOLVENCY (FYE Dec) Core ratio Comprehensive ratio	32% 4% 2014* 715%	16% 0% 2015 805%	20% 3% 2016 723%	2017E	2018E - - -
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Loss ratio (% NEP) Expense ratio (% NEP) Combined ratio (% NEP) Net profit growth DUPONT (FYE Dec) NEP / assets Pretax profit margin - Underwriting margin - Investments / NEP - Others / NEP Effective tax rate ROA Leverage (assets / SHF)	7.3% 73.4% 35.2% 108.6% na 2014 60.1% 5.1% -8.9% 12.6% 1.4% -1.1% 3.1% 1.2x	12.6% 68.5% 58.1% 126.6% 20% 2015 40.7% 3.1% -27.3% 29.2% 1.2% 25.7% 0.9% 1.2x	1.7% 42.0% 62.7% 104.7% -79% 2016 37.1% 0.4% -5.4% 4.4% 1.4% 28.0% 0.1% 1.3x	2017E	- - - -	WMPs & trusts REPOs & others *Incl. associates & JVs SOLVENCY (FYE Dec) Core ratio Comprehensive ratio	32% 4% 2014* 715%	16% 0% 2015 805%	20% 3% 2016 723%	2017E	2018E - -

Source: Company data



2. Company background

The leading insurtech company with a short operating history

Founded in Oct 2013, ZhongAn Online P&C Insurance Company is a leading fintech/insurtech company in China focusing on innovative ecosystem-oriented insurance products and solutions through various scenario-based settings. Zhong An is one of China's four Internet-only insurers to obtain a licence from the CIRC to sell insurance products online without being required to set up physical branches. It was the first company to receive an Internet insurance licence, more than two years earlier than the other three Internet-only insurers in China.

Fig 12: Zhong An - major developments

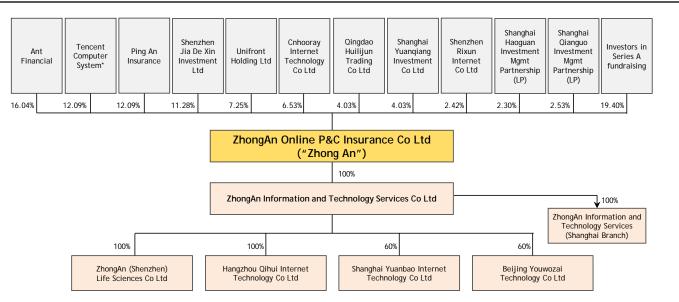
Date	Events
Oct-13	Was founded by nine shareholders with a registered capital of CNY1b; started operation in Nov.
Apr-14	Launched its proprietary online technology platform Wujieshan (无界山).
Nov-14	Sold ~100m policies within a week during the Double 11 Shopping Festival.
May-15	Obtained CIRC's approval to sell auto insurance products and provide insurance information services.
Jun-15	Completed its Series A fundraising with total proceeds of CNY5.8b (-241m shares at CNY24/share).
Nov-15	Cooperated with Ping An to launch the first online-to-offline (O2O) auto brand Baobiao Auto Insurance (保骉车险).
Apr-16	Launched Baobei Open Platform (保贝计划), which connects consumer finance platforms with its FI partners.
May-16	Established ZhongAn Information and Technology Services Co Ltd.
Aug-16	Launched a mid-range insurance product Personal Clinic Policy (尊享e生).
Nov-16	Released the ZhongAn Tech brand to promote and develop the use of blockchain, Al and other new technologies.
Dec-16	Served over 492m customers since inception; had 245 product terms approved by CIRC.

Source: Company data

Strong background of the key founding shareholders, aka, the "Three Ma"

Zhong An is well known for the strong background of its key founders, who are collectively called the "Three Ma": Jack Ma of Ant Financial, Pony Ma of Tencent and Mingzhe Ma of Ping An. In Jun 2015, Zhong An completed its Series A fundraising with five investors and raised CNY5.8b. After the Series A fundraising and prior to the pending HK IPO, Ant Financial, Tencent and Ping An hold ~16%, ~12% and ~12% stake in Zhong An, respectively.

Fig 13: Shareholding structure of Zhong An prior to the pending HK IPO



Source: Company data. *Tencent Computer System is a subsidiary of Tencent (700 HK | Not Rated)



Large customer base, but small premium scale

According to global management consultant Oliver Wyman, Zhong An ranked as the largest insurer in China in terms of the number of customers served (cumulatively 492m) and the number of policies sold (cumulatively 7.2b) as of Dec 2016. Besides, Zhong An was also the largest Internet-only insurer in China with a total GWP of CNY3.4b in 2016.

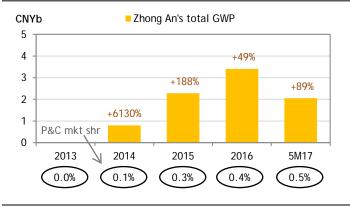
Fig 14: Zhong An is the largest Internet-only insurer in China

Internet-only insurers	Key business partners	Licence approval date	2016 GWP (CNYm)
Zhong An	Alibaba, Ctrip, Ping An	Oct-13	3,408
Taikang Online P&C	Taikang Insurance Group, DXY	Nov-15	675
Yi An P&C	Yinzhijie (a fintech firm)	Feb-16	222
An Xin P&C	Honganonline (a fintech firm)	Dec-15	75
Total			4,380

Source: Company data, CIRC, Oliver Wyman

Zhong An's total GWP achieved 107% CAGR in 2014-16 and it continued to grow at 89% YoY in 5M17. Although the insurer has the largest customer base in China, it had only 0.5% P&C market share in 2016 vs the top three P&C players' (i.e. PICC, Ping An and CPIC) combined 64% market share. This is primarily due to Zhong An's unique focus on high-frequency micro transactions. We calculate that Zhong An's average policy size is only CNY0.90, which is much smaller than any typical insurance policy sold by the traditional players.

Fig 15: Zhong An is still small in terms of premium scale...



Source: Company data

Fig 16: ... as it focuses on high-frequency micro transactions

Cumulative numbers	Oct13 to Dec16
Total GWP (CNYm)	6,498
Number of policies sold (m)	7,200
Number of customers served* (m)	492
GWP per policy (CNY)	0.90
GWP per customer (CNY)	13.21

Source: Company data. *Incl. both policyholders & the insured



3. Business model

Ecosystem-oriented insurance products for different scenarios

Zhong An partners with leading ecosystem providers and develops innovative products under different scenario-based settings. The insurer integrates its products into its ecosystem partners to ensure a customer-centric purchase experience. As Zhong An designs products based on scenarios, this allows it to reach a large customer base and address the previously unmet customer demands.

Besides, access to ecosystem partners' extensive user data allows Zhong An to identify potential customers and analyse their online behaviours and consumption patterns to adjust product strategies, adopt dynamic pricings, offer automated claim-settlement services and ensure effective risk management.

provider Customer data e.g. PBOC, Sesame Credit, Qian Hai Zheng Xin Product Distribution Leading ecosystem Insurance policy #1 Innovate Integrate Distribute Open platform Big data analytics Vertical/long-tail Insurance policy #2 ecosystem partners Customers 众安保险 Offline ecosystem Insurance policy #3 partners Al/machine learning Blockchain Insurance policy #N Direct sales

Fig 17: Zhong An's ecosystem-oriented product innovation and distribution

Source: Company data

Zhong An currently operates in five major ecosystems, namely lifestyle consumption, travel, consumer finance, health and auto. As it already has an established cooperation with the leading ecosystem providers, it has started to extend its partnership into long-tail, vertical and offline ecosystem partners.

Fig 18: Zhong An's five major ecosystems

Ecosystems	Avg policy size (2016)	Key ecosystem partners	Flagship products	Major competitors
Lifestyle consumption (e-com. & consumer electronics)	CNY0.5	Taobao, Tmall, Xiaomi, SF Express, Weidian (微店), Chuchujie (楚楚街), SanPower PC Mall, Jiyoujia (极有家) and Mobike (摩拜单车)	Shipping return policy for merchants /buyers (退货运费险/任性退), merchant guarantee policy (商家保证金保险), phone accident policy (手机意外险) and screen crack policy (碎屏险)	PICC, Cathay, Huatai
Travel	CNY23.7	Ctrip, Qunar, Alitrip, Tongcheng, China Eastern, Air China and Spring Airlines	Flight accident and delay policy (航意航延险)	Ping An, TK.com, Sunshine
Consumer finance	CNY13.0	China Telecom, Zhaocaibao (招财宝), Mogujie (蘑菇街), Meilishuo (美丽说) and Fenqile (分期乐)	Baobei Open Platform (保贝计划), Orange Baitiao (甜橙白条) and Mashanghua (马上花)	Taikang, PICC, Yi An
Health	CNY393.2	Omron, We Doctor (微医), Mi Band (小米手环), Ledongli (乐动力), WeChat and Tencare Doctor Tang (糖大夫)	Pesonal clinic policy (尊享e生), group health insurance plan, walk to wellness policy (步步保) and diabetes policy (糖小贝)	Ping An, An Xin
Auto	CNY37.2	Ping An, Didi Chuxing, Xiaomi, WeChat, Tuhu (途虎) and Changʻan Motors	Baobiao Auto Insurance (保骉车险)	PICC, Ping An, CPIC, Huatai

Source: Company data



Fig 19: Tmall partnership - shipping return policy



Source: Tmall website

Fig 20: Ctrip partnership - flight accident and delay policy



Source: Ctrip website

Fig 21: Xiaomi partnership - phone accident policy



Source: Xiaomi website



Technology solutions business still in early development stage

In addition to the insurance product offerings, Zhong An has also started to offer technology solutions to business partners and other insurance companies through its recently established (i.e. Jul 2016) subsidiary, ZhongAn Technology. Zhong An Technology currently develops and offers three series of technology solution services: 1) the S Series of insurance and financial applications; 2) the X Series of intelligent data services; and 3) the T Series of blockchain services.

In 2016, Zhong An invested CNY214m in R&D, equivalent to 6.3% of 2016 total GWP vs 2.8% in 2014-15. Management expects to incur substantial R&D expenses and capex for ZhongAn Technology. In the long run, management expects this business to be the new growth driver for Zhong An, and the increase in R&D expenses is likely to be partially offset by scale and better operating efficiency.

Fig 22: Zhong An Technology's technology solutions

	E-commerce platforms (launched in 1017)	Help insurers and agents to quickly establish online sales channels, incl. official homepages, mobile apps, e-commerce and WeChat platforms, etc.
S Series cloud-based applications	Insurance core systems (development stage)	Develop cloud-based core systems for insurance providers.
	Finance core systems (development stage)	Develop cloud-based core systems for financial service providers.
	X-Model (launched in Mar-17)	Help insurers conduct data analysis and develop customised risk mgmt models.
	X-Decision (launched in May-17)	Help insurers make transactional decisions based on data analysis provided by X-Data and X-Model, such as approval of customer loan applications.
X Series Al-backed	X-Man (to launch in Aug-17)	Help insurers analyse their customer data to create customer profiles.
data services	Customer Service Chatbot (launched in Nov-16)	Analyse customer questions to provide relevant and useful responses; help reduce customer service staff cost.
	Facial recognition (launched)	Help achieve remote identity verification, which enhances security in online financial transactions.
	Other platform-level products	Intelligent development tools and intelligent infrastructure services such as X-Flow, X-Antifraud and X-Custmade (launched in Apr-17 to Jun-17).
	Ti-Capsule (launched in Aug-16)	Store important or sensitive data such as EMR or privacy information. All documents stored are tamper-resistant and do not drop-out in any situation.
T Series Internet	Ti-Sun (launched in Dec-16)	Provide an unique smart identity for all users in the system containing their digitalised attributes and assets, which helps facilitate KYC and AML checks.
security platform	Ti-GlassHouse (launched in May-17)	Provide the ability to digitalise off-chain assets such as points or insurance products to Anlink's blockchain system.
	Ti-Packet (launched in May-17)	Allow signing parties to enter an agreement by certified electronic signatures and blockchain authorisation, which ensures the agreement to be non-amendable.

Source: Company data



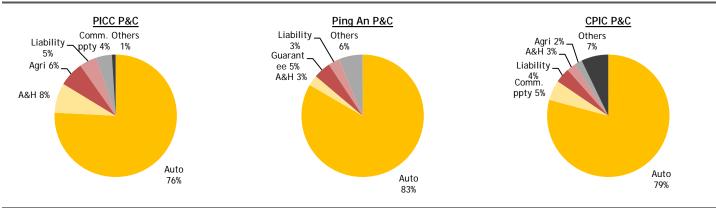
4. Product mix and growth

Different product mix vs traditional P&C leaders

Unlike traditional P&C leaders that generate the majority of their total GWP from auto insurance (76-83% in 2016), Zhong An's product mix is heavily skewed towards non-auto insurance, with shipping return insurance making up the largest part of its premium income (35% in 2016), followed by accident insurance (29%) and guarantee insurance (15%).

Fig 23: Traditional P&C leaders mainly sell auto insurance

2016 GWP mix of the top three P&C insurers in China



Source: Company data, Maybank Kim Eng

Reducing reliance on shipping return insurance

Growth in Zhong An's total GWP slowed down from 188% in 2015 to 49% in 2016, dragged by shipping return insurance (-8% in 2016 vs +112% in 2015). The decline in sales of shipping return insurance was likely due to: 1) increased competition from other market players; and 2) Zhong An's shift towards other product categories with greater growth potential, such as accident and health insurance.

Fig 24: Zhong An's GWP breakdown in 2014-16

(CNYm)	2014	2015	2016	2015 YoY%	2016 YoY%	Remarks
Shipping return	613	1,298	1,194	112%	-8%	Shifted focus to other products with more growth potential
Non-shipping return	181	985	2,214	444%	125%	Broadened product offering and ecosystem partnerships
- Accident	44	283	982	537%	247%	Increased # of travel partners; deepened existing partnerships
- Guarantee	109	453	518	316%	14%	Served to improve e-commerce merchants' liquidity
- Health	0	13	205	102854%	1432%	Launched more new products
- Liability	16	81	185	408%	128%	Consisted of logistics liability and phone accident insurance
- Credit	4	52	103	1192%	99%	Served consumer finance ecosystem
- Cargo	0	16	59	na	278%	Purchased by e-commerce merchants/shoppers
- Household property	5	34	15	641%	-54%	Included products such as phone screen crack policy
- Others	3	53	147	1627%	177%	n/a
Total GWP	794	2,283	3,408	188%	49%	Growth was offset by sales decline in shipping return policy

Source: Company data

Fig 25: Major market players in Taobao/Tmall shipping return insurance

Zhong An	Huatai P&C	PICC P&C
China Life P&C	Taikang Online P&C	Taiping General Insurance

Source: Taobao website, Maybank Kim Eng

Thanks to Zhong An's effort in broadening product offerings and ecosystem partnerships, GWP growth momentum from non-shipping return insurance remained strong in 2016 (125% vs 444% in 2015). As a result, GWP contribution from shipping return insurance plunged to 35% in 2016 from 77% in 2014, whereas contribution from accident insurance surged to 29% in 2016 from 6% in 2014. We observe similar growth trends in the GWP contribution from non-lifestyle consumption ecosystems (rose to 52% in 2016 from 8% in 2014), particularly from travel ecosystems (rose to 32% in 2016 from 6% in 2014).

Fig 26: Diversifying sales by tapping more ecosystems Zhong An's GWP breakdown by ecosystems

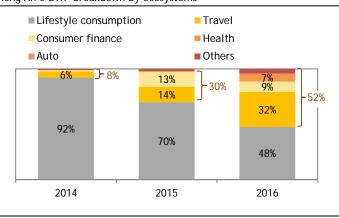
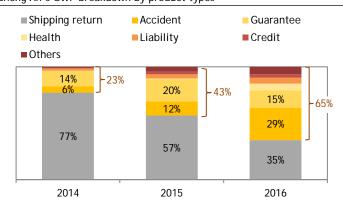


Fig 27: Reducing reliance on shipping return policies Zhong An's GWP breakdown by product types

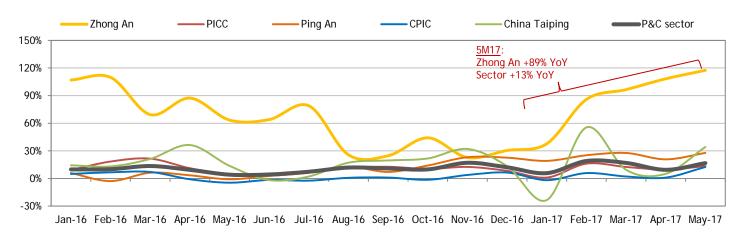


Source: Company data Source: Company data

GWP growth momentum recovered in 2017 YTD

Zhong An achieved 89% YoY GWP growth in 5M17, well above the P&C sector's 13% YoY growth. According to the company, such strong growth was driven by the significant increase in health, consumer finance and travel ecosystems, as it continued to expand and penetrate each of these ecosystems. This could further reduce its reliance on shipping return insurance.

Fig 28: Zhong An's GWP growth momentum recovered in 2017 YTD



Source: CIRC, Maybank Kim Eng

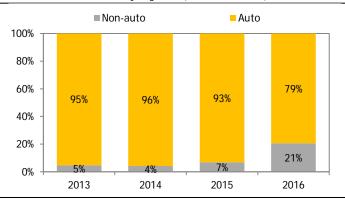


Challenges in scaling up auto insurance business

Auto insurance still dominates the online P&C market in China, with a 79% market share in terms of 2016 GWP. Zhong An could quickly boost its premium scale if it could successfully tap into this market. However, there are three major challenges that the insurer will face in this product segment:

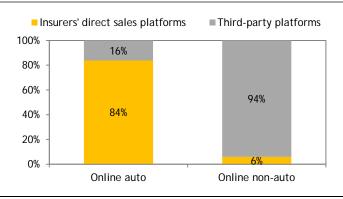
First, the online auto market is largely dominated by traditional P&C players. In 2016, insurers' direct sales platforms (PC + mobile) already accounted for 84% of the total online auto GWP. This could make it difficult for newcomers to enter the market.

Fig 29: Auto insurance still dominates online P&C market... Online P&C market share by segment (in terms of GWP)



Source: Insurance Association of China

Fig 30: ... and it is largely occupied by traditional players Online P&C market share by platform type (in terms of GWP)



Source: Insurance Association of China

Second, the second-round auto pricing reform in Jun 2017 will put pressure on premium rates. As online channel's price discount vs offline could remain low, this will discourage customers from making online purchases. Besides, leading players will continue to enjoy economies of scale and thus lower combined ratios vs the sector.

Fig 31: P&C insurers could offer auto insurance products at maximum 14% lower prices in the second-round reform (report)

	2016 market share*	No-claim discount** (A)	Underwriting factor (B)	Channel factor (C)	Overall pricing*** (A x B x C)	Change in floor pricing
Region A	76%	0.60-2.00	0.85-1.15	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.43-2.65 New: 0.38-2.65	-12%
Region B	17%	0.60-2.00	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.43-2.65 New: 0.34-2.65	-22%
Henan	4%	0.60-2.00	Old: 0.85-1.15 New: 0.80-1.15	Old: 0.85-1.15 New: 0.75-1.15	Old: 0.43-2.65 New: 0.36-2.65	-17%
Shenzhen	3%	0.60-2.00	Old: 0.75-1.15 New: 0.70-1.25	Old: 0.75-1.15 New: 0.70-1.25	Old: 0.34-2.65 New: 0.29-3.13	-13%
Overall	100%					-14%

Source: CIRC, Maybank Kim Eng. *Based on P&C GWP; **Xiamen and Beijing use wider NCD of 0.40-3.00; ***Excl. traffic violation factor in calculation for simplicity.

Third, Zhong An has only recently received CIRC approval to expand its auto business into 12 more regions, according to <u>media reports</u>. Geographical restrictions could limit its growth.

Fig 32: Operating regions of Zhong An's auto insurance business

Date	Events
May-15	Obtained CIRC's approval to sell auto insurance in five regions, including Heilongjiang, Shandong, Guangxi, Chongqing, Shanxi and Qingdao.
Mar-17	Received CIRC's approval to expand its auto insurance business into 12 more regions, including Guangdong, Shenzhen, Jiangxi, Xiamen, Henan, Anhui, Jiangsu, Zhejiang, Hebei, Tianjin, Beijing and Shanghai.

Source: Media reports



5. Underwriting profitability

High commission expenses put pressure on combined ratio

Given Zhong An's short operating history and small operating scale, its profitability is weaker than peers. Its combined ratio ranged from 105-127% in 2014-16 vs 96-99% for top three P&C players in 2016. Management expects the combined ratio to continue to be above 100% amid significant increase in operating expenses, driven by rising commissions (including consulting fees and service charges paid to ecosystem partners) to support expansion and for deepening cooperation with existing partners.

Fig 33: Zhong An's combined ratio remains high...

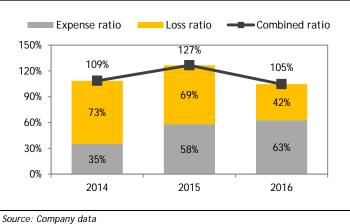
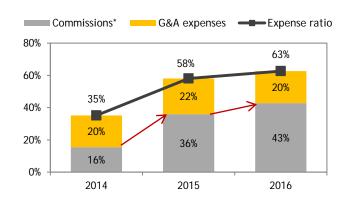


Fig 34: ... with rising expense ratio amid higher commissions



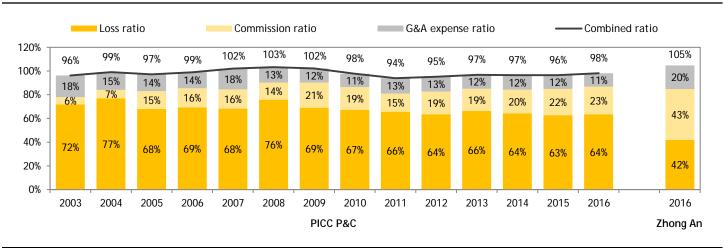
Source: Company data. *Commissions incl. consulting fees and service charges

. .

A question mark on the future loss ratio trend

Zhong An's loss ratio improved significantly to 42% in 2016 from 73% in 2014. Room for further improvement would depend on: 1) how fast the insurer can scale up its operations to achieve economies of scale in risk diversification and customer data accumulation; and 2) how accurate its untested proprietary actuarial model is in pricing insurance risks. As Zhong An and other listed Chinese insurers share little similarity in product mix and design, it could be difficult for investors to gauge the normalised level of Zhong An's loss ratios.

Fig 35: Combined ratio comparison - Zhong An vs PICC P&C

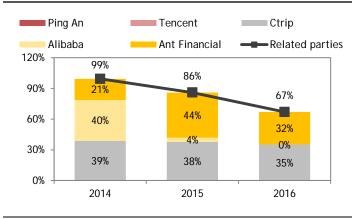


Source: Company data, Maybank Kim Eng

Risk of direct competition with the largest ecosystem partner/shareholder

As Zhong An does not own exclusive distribution rights on its ecosystem partners' platforms, its commission expenses will face more pressure if market competition intensifies. In 2016, 67% of Zhong An's total commission expenses were paid to related parties (32% to Ant Financial and 35% to Ctrip). As Alibaba/Ant Financial are building up their own insurance franchise through various investments and partnerships, there is risk that Zhong An will face more direct competition from its largest ecosystem partner and shareholder.

Fig 36: Zhong An's reliance on Ant Financial is still high Commissions paid to related parties as % of total commissions



Source: Company data

Fig 37: Alibaba/Ant Financial are building their own franchise Alibaba/Ant Financial's major insurance investments/partnerships



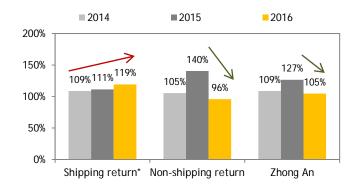
Source: Company data, media reports, CIRC

*Collectively controlled by Alibaba, AliHealth and Yunfeng Group

Improved profitability in non-shipping return insurance

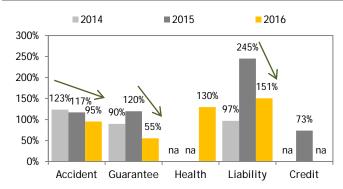
We estimate Zhong An's historical combined ratios by product using its China GAAP results. We observe a deteriorating trend in its shipping return insurance combined ratio in 2014-16, which was likely due to increased commission expenses amid competition. On the other hand, the combined ratio of the non-shipping return insurance segment improved sharply in 2016, mainly driven by: 1) the steady improvement in accident insurance profitability; and 2) significantly lower combined ratios in guarantee and liability insurance. The question here is whether the latter was a one-off distortion or it's sustainable in the future.

Fig 38: Zhong An's combined ratios by product segments



 $\textit{Source: Company data, Maybank Kim Eng estimates.} \quad {}^{\star} \textit{Incl. other small segments}$

Fig 39: Its combined ratios of non-shipping return products



Source: Company data, Maybank Kim Eng estimates



6. Investments and B/S risk

Aggressive asset allocation could be investors' concerns

Zhong An has a relatively more aggressive portfolio asset allocation strategy, with 84% allocation to moderate to high-risk assets as of Dec 2016 vs its Chinese peers' 55% on average. Its bond portfolio consists of nearly all corporate bonds, with very limited allocation to lower-risk government and financial bonds. Zhong An's high exposure to funds and stocks (22%; highest among peers) and WMPs and trusts (20%; similar to NCI's level) could also raise concerns about its balance-sheet risks.

Fig 40: Zhong An's asset allocation vs its Chinese peers (Dec 2016)

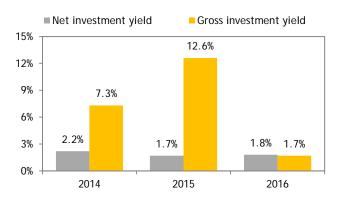
	China Life	Ping An Insur	Ping An Group	CPIC	PICC Group	PICC P&C	NCI	СТІН	Average	Zhong An
Low risk	47%	51%	48%	41%	32%	38%	39%	40%	45%	16%
Cash & deposits	24%	17%	18%	16%	18%	25%	14%	16%	19%	16%
Govt bonds	17%	17%	15%	10%	2%	3%	9%	11%	13%	0%
Financial bonds	6%	17%	16%	15%	12%	9%	16%	14%	13%	0%
Moderate risk	27%	25%	24%	36%	31%	26%	20%	34%	26%	37%
Corp bonds	20%	12%	11%	25%	16%	17%	11%	11%	15%	37%
Policy loans	4%	3%	2%	3%	0%	0%	4%	6%	3%	0%
Debt schemes	3%	7%	10%	7%	13%	7%	5%	13%	8%	0%
Invest properties	0%	2%	1%	1%	1%	1%	1%	4%	1%	0%
High risk	26%	24%	28%	23%	37%	37%	41%	26%	28%	46%
Funds & stocks	10%	9%	8%	8%	15%	15%	11%	7%	9%	22%
Unlisted equities*	8%	6%	6%	3%	13%	12%	6%	6%	7%	0%
WMPs & trusts	6%	8%	6%	7%	8%	9%	20%	3%	7%	20%
REPOs & others	2%	1%	9%	6%	0%	0%	4%	9%	4%	3%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

 $Source: \ Company \ data, \ Maybank \ Kim \ Eng \ estimates. \ \ ^{1} Including \ associates \ \& \ JVs$

Volatile investment results; lowest net investment yield among peers

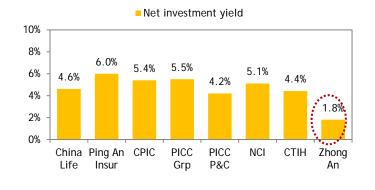
Zhong An's high reliance on stock capitalised gains also led to its volatile investment results. Gross investment yield fell to only 1.7% in 2016 from 12.6% in 2015 due to weak A-share market performance. Zhong An's net investment yield was the lowest among peers in 2016 (1.8% vs peers' 4.2-6.0%). This could be partly due to its preference for trading stocks vs investing in high-dividend equities.

Fig 41: Zhong An's investment yields (2014-16)



Source: Company data

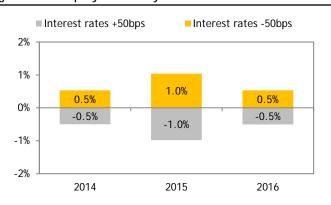
Fig 42: Zhong An's 2016 net investment yield vs peers



Source: Company data, Maybank Kim Eng

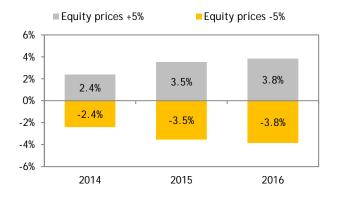
The illustrations below show Zhong An's sensitivity to interest rates/equity prices:

Fig 43: Total equity sensitivity to interest rates...



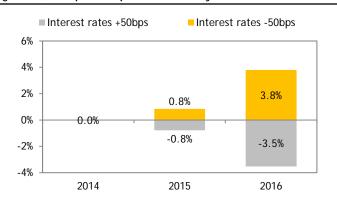
Source: Company data

Fig 45: Total equity sensitivity to equity prices...



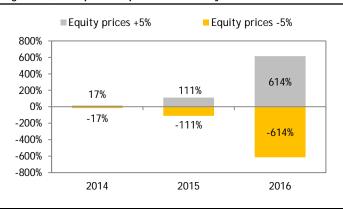
Source: Company data

Fig 44: ..., and pre-tax profit sensitivity



Source: Company data

Fig 46: ..., and pre-tax profit sensitivity

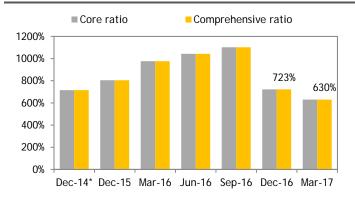


Source: Company data

7. Capital strength

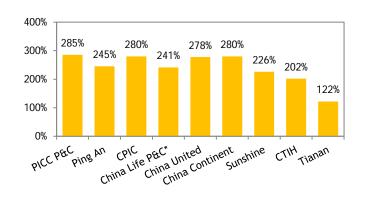
Zhong An has a strong capital position with both the C-ROSS core and comprehensive solvency ratios at over 600% during Dec-15 to Mar-17, significantly above the regulatory minimum level of 100%. The insurer's capital position is also well above other leading P&C insurers in China. The proceeds from the pending HK listing should further strengthen Zhong An's capital position.

Fig 47: Zhong An's C-ROSS solvency ratio



Source: Company data, C-ROSS reports. *C-SI figures for 4Q14

Fig 48: C-ROSS comprehensive solvency ratio (Mar-17)



Source: Company data, Maybank Kim Eng. *40% owned by China Life



8. Valuation

On 30 Jun, Reuters <u>reported</u> that Zhong An plans to raise USD1.5b in its HK IPO, citing people familiar with the plans. However, the insurer's Application Proof filing does not provide disclose on its potential fundraising size or valuation.

In Jun 2015, the insurer completed its Series A fundraising with total proceeds of CNY5.8b, which implied a group valuation of CNY29.8b (USD4.4b) or 2016 PBR of 4.3x vs PICC P&C's 1.6x based on our calculation:

Fig 49: Zhong An's valuation implied by Series A fundraising

Investors	No. of shares (m)	Consideration (CNYm)	Ownership
Morgan Stanley Asia Securities Products LLC	31	738	2.48%
CICC Securities (HK) Limited	31	750	2.52%
CDH Avatar, L.P.	62	1,488	5.00%
Keywise ZA Investment	61	1,469	4.93%
Equine Forces Limited Partnership	55	1,331	4.47%
Series A investors - total	241	5,775 (A)	19.40% (B)
Zhong An's Implied valuation (A / B)		29,775	

Source: Company data

Fig 50: Zhong An's valuation multiple implied by Series A fundraising

(CNYm)	2014	2015	2016
Book value	1,021	6,898	6,859
GWP	794	2,283	3,408
Net profit	37	44	9
P/B (x)	29.2	4.3	4.3
P/GWP (x)	37.5	13.0	8.7
P/E (x)	805	673	3,177

Source: Company data, Maybank Kim Eng



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Sadiq CURRIMBHOY

Regional Head, Research & Economics (65) 6231 5836 sadiq@maybank-ke.com.sg

WONG Chew Hann, CA

Regional Head of Institutional Research (603) 2297 8686 wchewh@maybank-ib.com

ONG Seng Yeow

Regional Head of Retail Research (65) 6231 5839

ongsengyeow@maybank-ke.com.sg

TAN Sin Mui

Director of Research

(65) 6231 5849 sinmui@kimeng.com.hk

ECONOMICS

Suhaimi ILIAS
Chief Economist
Malaysia | Philippines
(603) 2297 8682 suhaimi_ilias@maybank-ib.com

CHUA Hak Bin Regional Thematic Macroeconomist (65) 6231 5830 chuahb@maybank-ke.com.sq

LEE Ju Ye

Singapore (65) 6231 5844 leejuye@maybank-ke.com.sg

Tim LEELAHAPHAN Thailand

(66) 2658 6300 ext 1420 tim.l@maybank-ke.co.th

Saktiandi SUPAAT

Head, FX Research (65) 6320 1379 saktiandi@maybank.com.sg

STRATEGY

Sadiq CURRIMBHOY

Global Strategist

(65) 6231 5836 sadiq@maybank-ke.com.sg

Willie CHAN

Hong Kong / Regional

(852) 2268 0631 williechan@kimeng.com.hk

WONG Chew Hann, CA Head of Research (603) 2297 8686 wchewh@maybank-ib.com

• Strategy

Desmond CH'NG, ACA

(603) 2297 8680 desmond.chng@maybank-ib.com • Banking & Finance

LIAW Thong Jung (603) 2297 8688 tjliaw@maybank-ib.com • Oil & Gas Services- Regional

ONG Chee Ting, CA (603) 2297 8678 ct.ong@maybank-ib.com • Plantations - Regional

Mohshin AZIZ (603) 2297 8692 mohshin.aziz@maybank-ib.com
• Aviation - Regional • Petrochem

YIN Shao Yang, CPA (603) 2297 8916 samuel.y@maybank-ib.com • Gaming - Regional • Media

TAN Chi Wei, CFA (603) 2297 8690 chiwei.t@maybank-ib.com • Power • Telcos

WONG Wei Sum, CFA

(603) 2297 8679 weisum@maybank-ib.com Property

LEE Yen Ling (603) 2297 8691 lee.yl@maybank-ib.com • Building Materials • Glove • Ports • Shipping

(603) 2297 8612 ivan.yap@maybank-ib.com
• Automotive • Semiconductor • Technology

Kevin WONG

(603) 2082 6824 kevin.wong@maybank-ib.com
• REITs • Consumer Discretionary

LIFW Wei Han

(603) 2297 8676 weihan.I@maybank-ib.com Consumer Staples

Adrian WONG

(603) 2297 8675 adrian.wkj@maybank-ib.com • Constructions • Healthcare

(603) 2297 8687 jade.tam@maybank-ib.com • Media • Building Materials

TEE Sze Chiah Head of Retail Research

(603) 2082 6858 szechiah.t@maybank-ib.com

Nik Ihsan Raja Abdullah, MSTA, CFTe

July 7, 2017

nikmohdihsan.ra@maybank-ib.com

HONG KONG / CHINA

Howard WONG Head of Research (852) 2268 0648

howardwong@kimeng.com.hk

Strategy
 Oil & Gas - Regional

Benjamin HO (852) 2268 0632 benjaminho@kimeng.com.hk Consumer & Auto

Christopher WONG

(852)2268 0652 christopherwong@kimeng.com.hk
• HK & China Properties

Jacqueline KO, CFA

(852) 2268 0633 jacquelineko@kimeng.com.hk
• Consumer Staples & Durables

Ka Leong LO, CFA (852) 2268 0630 kllo@kimeng.com.hk • Consumer Discretionary & Auto

Mitchell KIM

(852) 2268 0634 mitchellkim@kimeng.com.hk
• Internet & Telcos

Ning MA, CFA (852) 2268 0672 ningma@kimeng.com.hk

Ricky NG CFA

(852) 2268 0689 rickyng@kimeng.com.hk • Regional Renewables • HK & China Properties

Sonija LI, CFA, FRM (852) 2268 0641 sonijali@kimeng.com.hk • Gaming

Stefan CHANG, CFA (852) 2268 0675 stefanchang@kimeng.com.hk

Technology - Regional

Tony Ren, MBA, CFA (852) 2268 0640 tonyren@kimeng.com.hk • Healthcare & Pharmaceutical

Jigar SHAH Head of Research

(91) 22 6623 2632 jigar@maybank-ke.co.in

• Strategy • Oil & Gas • Automobile • Cement

(91) 22 6623 2607 vishal@maybank-ke.co.in

· Banking & Financials

Neerav DALAL

(91) 22 6623 2606 neerav@maybank-ke.co.in Software Technology • Telcos

Vishal PERIWAL

(91) 22 6623 2605 vishalperiwa@maybank-ke.co.in

Infrastructure

SINGAPORE

Neel SINHA Head of Research (65) 6231 5838 neelsinha@maybank-ke.com.sg

Strategy
 SMID Caps - Regional

CHUA Su Tye (65) 6231 5842 chuasutye@maybank-ke.com.sg • REITs

Derrick HENG, CFA (65) 6231 5843 derrickheng@maybank-ke.com.sg

• Transport • Property • REITs (Office)

John CHEONG, CFA (65) 6231 5845 johncheong@maybank-ke.com.sg • Small & Mid Caps • Healthcare

NG Li Hiang (65) 6231 5840 nglihiang@maybank-ke.com.sg

INDONESIA

Isnaputra ISKANDAR Head of Research (62) 21 8066 8680 isnaputra.iskandar@maybank-ke.co.id

• Strategy • Metals & Mining • Cement

Rahmi MARINA

(62) 21 8066 8689

rahmi.marina@maybank-ke.co.id
• Banking & Finance

Aurellia SETIABUDI

(62) 21 8066 8691 aurellia.setiabudi@maybank-ke.co.id · Property

Janni ASMAN

(62) 21 8066 8687 janni.asman@maybank-ke.co.id • Cigarette • Healthcare • Retail

Adhi TASMIN (62) 21 8066 8694 adhi.tasmin@maybank-ke.co.id • Plantations

PHILIPPINES

Minda OLONAN Head of Research (63) 2 849 8840 minda_olonan@maybank-atrke.com Strategy

Lovell SARREAL

(63) 2 849 8841

lovell_sarreal@maybank-atrke.com
• Consumer • Media • Cement

Rommel RODRIGO

(63) 2 849 8839 rommel_rodrigo@maybank-atrke.com • Conglomerates • Property • Gaming

· Ports/ Logistics

Katherine TAN

(63) 2 849 8843 kat_tan@maybank-atrke.com • Banks • Construction

THAII AND Maria LAPIZ Head of Institutional Research

Maria LAPI2 riead of institutional Research Dir (66) 257 0250 | (66) 2658 6300 ext 1399 Maria.l.@maybank-ke.co.th • Strategy • Consumer • Materials • Ind. Estates

Sittichai DUANGRATTANACHAYA (66) 2658 6300 ext 1393 Sittichai.D@maybank-ke.co.th

· Services Sector · Transport

Yupapan POLPORNPRASERT (66) 2658 6300 ext 1395

yupapan.p@maybank-ke.co.th Oil & Gas

Tanawat RUENBANTERNG

(66) 2658 6300 ext 1394 Tanawat.R@maybank-ke.co.th • Banks & Diversified Financials

Sukit UDOMSIRIKUL Head of Retail Research (66) 2658 6300 ext 5090 Sukit.u@maybank-ke.co.th

Surachai PRAMUAI CHAROFNKIT (66) 2658 6300 ext 1470

Surachai.p@maybank-ke.co.th • Auto • Conmat • Contractor • Steel

Suttatip PEERASUB (66) 2658 6300 ext 1430 suttatip.p@maybank-ke.co.th • Media • Commerce

Sutthichai KUMWORACHAI (66) 2658 6300 ext 1400 sutthichai.k@maybank-ke.co.th • Energy • Petrochem

Termporn TANTIVIVAT

(66) 2658 6300 ext 1520 termporn.t@maybank-ke.co.th • Property Jaroonpan WATTANAWONG

(66) 2658 6300 ext 1404 jaroonpan.w@maybank-ke.co.th • Transportation • Small cap

VIETNAM

lien.le@maybank-kimeng.com.vn
• Strategy • Consumer • Diversified

NGUYEN Thi Ngan Tuyen, Head of Retail Research (84) 8 44 555 888 x 8081 tuyen.nguyen@maybank-kimeng.com.vn • Food & Beverage • Oil&Gas • Banking

binh.truong@maybank-kimeng.com.vn • Rubber Plantation • Tyres and Tubes • Oil&Gas

Food & Beverage

LE Hong Lien, ACCA Head of Institutional Research (84) 8 44 555 888 x 8181

THAI Quang Trung, CFA

Deputy Head, Institutional Research (84) 8 44 555 888 x 8180 trung.thai@maybank-kimeng.com.vn • Real Estate • Construction • Materials

LE Nguyen Nhat Chuyen (84) 8 44 555 888 x 8082

chuyen.le@maybank-kimeng.com.vn · Oil & Gas

TRUONG Quang Binh

NGUYEN Thach Lam (84) 8 44 555 888 x 8085

thachlam.nguyen@maybank-kimeng.com.vn
• Utilities

Deputy Head, Retail Research (84) 4 44 555 888 x 8087

TRINH Thi Ngoc Diep (84) 4 44 555 888 x 8208 diep.trinh@maybank-kimeng.com.vn • Technology • Utilities • Construction

NGUYEN Thi Sony Tra Mi (84) 8 44 555 888 x 8084 mi.nguyen@maybank-kimeng.com.vn • Port Operation • Pharmaceutical

thanhlam.nguyen@maybank-kimeng.com.vn
• Technical Analysis

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Malaysia

Maybank Investment Bank Berhad (A Participating Organisation of Bursa Malaysia Securities Berhad) 33rd Floor, Menara Maybank, 100 Jalan Tun Perak, 50050 Kuala Lumpur

Tel: (603) 2059 1888; Fax: (603) 2078 4194

Stockbroking Business: Level 8, Tower C, Dataran Maybank, No.1, Jalan Maarof 59000 Kuala Lumpur

Tel: (603) 2297 8888 Fax: (603) 2282 5136

Philippines

Maybank ATR Kim Eng Securities Inc. 17/F, Tower One & Exchange Plaza Ayala Triangle, Ayala Avenue Makati City, Philippines 1200

Tel: (63) 2 849 8888 Fax: (63) 2 848 5738

South Asia Sales Trading

Kevin Foy Regional Head Sales Trading kevinfoy@maybank-ke.com.sg Tel: (65) 6636-3620 US Toll Free: 1-866-406-7447

Malaysia Joann Lim joann.lim@maybank-ib.com Tel: (603) 2717 5166

Indonesia Harianto Liong harianto.liong@maybank-ke.co.id Tel: (62) 21 2557 1177

New York Andrew Dacey adacey@maybank-keusa.com Tel: (212) 688 2956

Vietnam Patrick Mitchell patrick.mitchell@maybank-kimeng.com.vn Tel: (84)-8-44-555-888 x8080

Singapore

Maybank Kim Eng Securities Pte Ltd Maybank Kim Eng Research Pte Ltd 50 North Canal Road Singapore 059304

Tel: (65) 6336 9090

Hong Kong

Kim Eng Securities (HK) Ltd Level 30, Three Pacific Place, 1 Queen's Road East, Hong Kong

Tel: (852) 2268 0800 Fax: (852) 2877 0104

Thailand

Maybank Kim Eng Securities (Thailand) Public Company Limited 999/9 The Offices at Central World, 20th - 21st Floor, Rama 1 Road Pathumwan, Bangkok 10330, Thailand

Tel: (66) 2 658 6817 (sales) Tel: (66) 2 658 6801 (research)

North Asia Sales Trading

Andrew Lee andrewlee@kimeng.com.hk Tel: (852) 2268 0283 US Toll Free: 1 877 837 7635

Thailand Tanasak Krishnasreni Tanasak.K@maybank-ke.co.th

Tel: (66)2 658 6820

London Scott Kinnear-Nock SKinnear-nock@maybank-ke.co.uk Tel: (44) 207-332-0221

India Manish Modi manish@maybank-ke.co.in Tel: (91)-22-6623-2601

Philippines Keith Roy keith_roy@maybank-atrke.com Tel: (63) 2 848-5288

London

Maybank Kim Eng Securities (London) Ltd PNB House 77 Queen Victoria Street London EC4V 4AY, UK

Tel: (44) 20 7332 0221 Fax: (44) 20 7332 0302

Indonesia

PT Maybank Kim Eng Securities Sentral Senayan III, 22nd Floor JI. Asia Afrika No. 8 Gelora Bung Karno, Senayan Jakarta 10270, Indonesia

Tel: (62) 21 2557 1188 Fax: (62) 21 2557 1189

Vietnam

Maybank Kim Eng Securities Limited 4A-15+16 Floor Vincom Center Dong Khoi, 72 Le Thanh Ton St. District 1 Ho Chi Minh City, Vietnam

Tel: (84) 844 555 888 Fax: (84) 8 38 271 030

New York

Maybank Kim Eng Securities USA Inc 777 Third Avenue, 21st Floor New York, NY 10017, U.S.A.

Tel: (212) 688 8886 Fax: (212) 688 3500

India

Kim Eng Securities India Pvt Ltd 2nd Floor, The International, 16, Maharishi Karve Road, Churchgate Station, Mumbai City - 400 020, India

Tel: (91) 22 6623 2600 Fax: (91) 22 6623 2604

Saudi Arabia

In association with Anfaal Capital Villa 47, Tujjar Jeddah Prince Mohammed bin Abdulaziz Street P.O. Box 126575 Jeddah 21352

Tel: (966) 2 6068686 Fax: (966) 26068787

www.maybank-ke.com | www.maybank-keresearch.com