


Hong Kong

REDUCE (no change)

Consensus ratings*: Buy 17 Hold 7 Sell 1

Current price: HK\$47.55
 Target price:  HK\$44.60
 Previous target: HK\$43.60
 Up/downside: -6.2%
 CIMB / Consensus: -19.5%

Reuters: 1299.HK
 Bloomberg: 1299 HK
 Market cap: US\$73,887m
 HK\$573,286m

Average daily turnover: US\$154.1m
 HK\$1,195m

Current shares o/s: 12,051m

Free float: 100.0%

*Source: Bloomberg

Key changes in this note

- FY16F VONB decreased by 0.9%.
- FY17F VONB decreased by 3.7%.
- FY18F VONB decreased by 3.6%.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	2.5	0.7	24.5
Relative (%)	-2.1	-6.8	-2.3

Major shareholders	% held
Citigroup	9.0

Analyst(s)



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AIA Group

In anticipation of a buyback

- We expect a US\$1.5bn share buyback to be announced at the FY16 results. Our analysis shows a buyback at current prices only marginally impacts valuations.
- Investor feedback from 2.5 weeks of meetings in Europe & North America indicates expectation of capital management, with a share buyback the most likely possibility.
- We may be past the winter of despair and entering into the spring of hope, but this hope is contingent on a few factors.
- AIA's share price has recently become a play on USDCNY, with the correlation coefficient at -75% since end-Oct 2016, a sharp swing from Jan-Oct 2016's +75%.
- Our TP is increased slightly from HK\$43.60 to HK\$44.60. Maintain Reduce.

Capital management expectations building

We see rising expectations of capital management based on recent investor meetings, with a buyback seen as the most likely possibility. We agree and expect a US\$1.5bn buyback to be announced on 24 Feb 2017, with a number of reasons why we do not expect the scale to be materially larger. This is marginally positive (<1%) to valuations.

Heavy investor interest; HK/China the key source of uncertainty

There was heavy investor interest in AIA during our meetings, with many investors also trying to understand the growth of mainland visitors buying insurance in HK (MVBH), how much of it is protection vs. savings-related, the impact of recent regulatory developments, and whether these developments have been adequately priced in.

Past the winter of despair; entering into the spring of hope?

While we are still concerned about whether consensus is sufficiently conservative in their FY17F value of new business (VONB) growth estimates, and we still think that the VONB outlook is the most uncertain since AIA's IPO, we also believe that we may be past the worst, at least with respect to regulatory developments that could further impact VONB relating to MVBH, which we estimate comprised 15% of group VONB in 1H16.

Hope is contingent on a few factors

These factors include continued US dollar weakness, recent capital outflow measures working to curb outflows, as well as uncertainty clearing up on the impact of these measures on AIA's VONB from MVBH.

AIA's share price has recently become a play on USDCNY

Interestingly, AIA's share price has been strongly inversely correlated to the USDCNY exchange rate since Oct 2016's Unionpay rules (correlation co-efficient of -75%). This is in sharp contrast to the positive correlation from Jan-Oct 2016 (coefficient of +75%).

Great results season track record, especially around 4Q results

We believe we are top-of-consensus for 4Q16's VONB growth at 22% yoy, vs. 8% for consensus, with this driven by forecast MVBH strength, which we do not see repeating in FY17F. As flagged in *Best of times, worst of times; Initiate with Reduce*, 16 Nov 2016, AIA has developed a great track record around the results seasons, with about half of the outperformance over Hang Seng Index coming from the results, and in particular 4Q results (almost five times the outperformance of other quarters).

Target price marginally raised by 2%

Our higher target price was primarily driven by smaller FX variances. Our target price is based on P/EV GGM. See pg. 17 for details on valuations and risks.

Financial Summary	Nov-14A	Nov-15A	Nov-16F	Nov-17F	Nov-18F
Gross Premium (US\$m)					
Investment And Other Income (US\$m)					
Net Premium (US\$m)	17,229	18,812	20,035	22,188	24,875
Net Profit (US\$m)	3,450	2,691	3,918	4,230	4,906
Normalised EPS (US\$)	0.29	0.22	0.33	0.35	0.42
Normalised EPS Growth	22.2%	(22.0%)	45.6%	9.0%	17.2%
FD Normalised P/E (x)	21.40	27.43	18.85	17.29	14.75
P/NB (x)	19.87	16.21	11.43	9.50	6.75
DPS (US\$)	0.06	0.09	0.11	0.13	0.15
Dividend Yield	1.05%	1.46%	1.74%	2.09%	2.50%
P/EV (x)	1.99	1.93	1.76	1.63	1.49
P/BV (x)	2.27	2.37	1.99	1.88	1.73
ROE	12.1%	8.5%	11.5%	11.2%	12.2%
% Change In Normalised EPS Estimates			13.8%	15.7%	26.1%
Normalised EPS/consensus EPS (x)			1.03	1.00	1.04

SOURCE: COMPANY DATA, CIMB FORECASTS

Expect a buyback announcement

But minimal impact on our valuation

Feedback from investors from two and a half weeks of meetings in Europe and North America indicate significant and widespread interest in AIA from existing long-only investors and hedge funds who are active in the stock, as well as potential new investors who are wondering whether to invest. Such widespread interest should not be a surprise, as AIA is one of the most heavily owned stocks within the Asian financial sector, in our view. We have elaborated in detail the nine reasons why investors like the stock in our report titled '*Best of times, worst of times; Initiate with Reduce*' dated 16 Nov 2016.

A sizeable portion of investors we met think that there is a strong possibility of some form of capital management being announced at the upcoming FY16 results on 24 Feb 2017, with a share buyback being the most likely possibility.

We agree and it is now our base case view that AIA could announce a share buyback at its FY16 results on 24 Feb 2017, with the size of such a buyback forecast to be US\$1.5bn. This would equate to 2% of outstanding shares being bought back.

Minimal impact on our valuation from a US\$1.5bn buyback

The impact to our P/EV-based valuation of a US\$1.5bn share buyback is minimal at only +0.2%. There are a few reasons for this.

Firstly, a share buyback conducted at the current share price is not that accretive to valuations. AIA currently trades at 1.9x FY17F P/BV and 1.6x FY17F P/EV. Buying back shares at such multiples therefore is book value per share and embedded value per share (EVPS) dilutive.

Figure 1: Scenario analysis and impact on key metrics

Scenario	1	2	3	4 (base case)	5	6	4 vs. 1 % chg.
Share buyback size (US\$ m)	0	500	1,000	1,500	2,000	3,000	
Debt servicing costs (after tax) (US\$ m)	0	15	29	44	58	88	
Assume share price of (HK\$)	47.50						
USDHKD exchange rate	7.75						
Interest rate cost of financing the buyback	3.5%						
Corporate tax rate	16.5%						
No of shares bought back (mill)	0	82	163	245	326	489	
i.e as a % of the outstanding no. of shares	0.0%	0.7%	1.4%	2.0%	2.7%	4.1%	
FY17 key metrics (US\$)							
EPS	0.36	0.36	0.36	0.36	0.36	0.36	0%
BVPS	3.32	3.30	3.28	3.26	3.23	3.19	-2%
EVPS	3.80	3.79	3.77	3.75	3.74	3.70	-1%
VONB per share	0.25	0.25	0.25	0.25	0.25	0.26	2%
ROE	11.1%	11.1%	11.2%	11.2%	11.2%	11.3%	1%
ROEV	12.3%	12.3%	12.3%	12.3%	12.3%	12.3%	0%
Valuation (HKD)	44.50	44.53	44.56	44.60	44.63	44.69	0.2%
FY18 key metrics (US\$)							
EPS	0.41	0.41	0.42	0.42	0.42	0.42	1%
BVPS	3.59	3.57	3.55	3.53	3.51	3.47	-2%
EVPS	4.16	4.15	4.13	4.12	4.10	4.07	-1%
VONB per share	0.29	0.29	0.30	0.30	0.30	0.30	2%
ROE	11.9%	12.0%	12.1%	12.2%	12.4%	12.6%	3%
ROEV	13.0%	13.1%	13.2%	13.3%	13.5%	13.7%	2%

SOURCES: CIMB ESTIMATES, COMPANY REPORTS

Note that the interest rate on AIA's current senior unsecured fixed rate note issued in Mar 2016 carried an interest rate of 4.5%

This dilution to EVPS thus partially offsets any accretion to return on equity (ROE) and return on embedded value (ROEV), and thus reduces any positive impact to a P/EV Gordon Growth Model (GGM)-based valuation.

Secondly, we compute the sustainable ROEV assumption within our P/EV GGM as a weighted ROEV forecast, with a 45% weighting to FY17F's ROEV, a 45% weighting to FY18F's EV and a 10% weighting to FY19F's ROEV. A share buyback conducted throughout FY17 has minimal impact on our FY17F ROEV, with the impact only more material in FY18F and FY19F (0.3% pt or +2% higher). Our sustainable ROEV assumption embedded within our valuation model thus does not change that much as a result of the buyback.

Having said that, even if we were to use only FY18F ROEV as a basis of our sustainable ROEV assumption within our valuation model, the outcome would only be marginally different. A US\$1.5bn share buyback would still only have a 1% accretive impact to our valuations.

Figure 2: Sensitivity of a P/EV-based valuation to changes in the sustainable ROEV assumption (proxied by FY18F ROEV)

Scenario	1	2	3	4 (base case)	5	6	4 vs. 1 % chg.
Share buyback size (US\$ m)	0	500	1,000	1,500	2,000	3,000	
<i>Gordon Growth model assumptions</i>							
g	1.3%						
COE	8.9%						
Sustainable ROEV assumption	13.0%	13.1%	13.2%	13.3%	13.5%	13.7%	
P/EV based valuation (HK\$)	45.51	45.71	45.91	46.11	46.32	46.74	1%

SOURCES: CIMB ESTIMATES

Another reason why AIA's valuation is not that sensitive to a share buyback is that more than half of AIA's EV comprises the value of in-force, which is essentially a discounted cash flow of business already written and is not impacted by a share buyback.

Even if we were to value AIA using an appraisal value methodology, the impact of a share buyback would not be significant, unless one assumes a very high target new business multiple. At a 5x target new business multiple, the share buyback is actually valuation-dilutive, while at a 10x target new business multiple, a US\$1.5bn share buyback would only increase the valuation by 0.2%.

Figure 3: The bulk of AIA's embedded value has been its value in force (VIF)

(US\$ m)	FY10	FY11	FY12	FY13	FY14	FY15	1H16
Adjusted net worth	9,524	10,906	13,170	13,462	15,351	15,189	15,689
Value in force (VIF)	15,224	16,333	18,238	20,356	21,802	23,009	24,380
Embedded value (EV)	24,748	27,239	31,408	33,818	37,153	38,198	40,069
Value-in-force as a percentage of EV	62%	60%	58%	60%	59%	60%	61%

SOURCES: CIMB, COMPANY REPORTS

Figure 4: Appraisal value (HK\$) assuming different buyback amounts

New business multiple	Buyback amount (US\$ m)					
	0	500	1,000	1,500	2,000	3,000
5x	43.55	43.51	43.48	43.45	43.41	43.34
6x	45.81	45.79	45.77	45.75	45.74	45.70
7x	48.07	48.06	48.06	48.06	48.06	48.06
8x	50.33	50.34	50.35	50.37	50.38	50.41
9x	52.59	52.61	52.64	52.67	52.70	52.77
10x	54.85	54.89	54.94	54.98	55.03	55.12

SOURCES: CIMB ESTIMATES

Could the size of the share buyback be bigger?

In our view, AIA definitely has the capacity to conduct a much larger share buyback, given that its free surplus (which is the excess of net assets over required assets) was US\$8.2bn at the end of 1H16. The free surplus is the adjusted net worth in excess of the required capital and it represents the level of excess capital that AIA possesses.

Importantly, the size of this free surplus has been increasing over time, as AIA generates more free surplus than it uses to fund new business growth.

Figure 5: AIA's free surplus generation across time (US\$ m)

	FY10	FY11	FY12	FY13	FY14	FY15	1H16
Opening free surplus	4,011	4,992	5,930	6,608	6,727	7,794	7,528
Effect of acquisitions and others	0	0	0	-1,431	-800	0	0
Free surplus post acquisitions and others	4,011	4,992	5,930	5,177	5,927	7,794	7,528
Free surplus generated (including variances such as those on investment returns)	2,107	2,485	2,845	3,786	4,397	2,252	2,315
Free surplus used to fund new business	-958	-1,140	-1,412	-1,510	-1,655	-1,488	-687
Dividends	0	-170	-530	-595	-689	-814	-786
Others	-168	-237	-190	-131	-186	-216	-121
Closing free surplus	4,992	5,930	6,643	6,727	7,794	7,528	8,249

SOURCES: CIMB, COMPANY REPORTS

There are three reasons why we are not forecasting a much bigger share buyback.

Firstly, AIA has traditionally been very conservative in terms of its capital position, and prefers to err on the side of caution with sizeable capital buffers to cushion the impact of any volatility in investment markets. This is a key reason why even though AIA has had strong excess capital buffers since its IPO in October 2010, it has not been active in capital management over and above its ordinary dividend payments.

Even the re-basing of AIA's ordinary final dividend at its FY15 results only saw an additional US\$163m being paid out, which is only a small fraction of the US\$7,528m free surplus it had at the end of FY15.

Secondly, we understand that AIA places great emphasis on ensuring that its credit rating outlook remains strong. AIA currently has an AA- credit rating with S&P and an Aa3 credit rating with Moody's.

Thirdly, another key reason why a share buyback may not be larger is that we believe that AIA wishes to retain the strategic flexibility to take advantage of any acquisition opportunities that may arise.

A quick scan of newsflow indicates two potentially large acquisitions on the horizon. Firstly, there is an "at least" US\$3.3bn acquisition of ANZ's life insurance and wealth management business in Australia, which we believe would give AIA the number one market share position in the Australian market.

Secondly, there is an up-to-US\$3.1bn acquisition of SCB Life in Thailand, which would help AIA address a bancassurance capability gap in that market. With the bancassurance market in Thailand dominated by exclusive partnerships between insurers and banks, we believe that AIA's current bancassurance business in Thailand is relatively sub-scale.

Should AIA actually end up as the eventual acquirer of either or both of these assets, it would want to minimise the risk of an equity capital raising, which may mean a smaller share buyback in 2017.

Figure 6: Details of potential sizable M&A transactions which AIA is said to be involved in, according to newsflow

Potential target	Country	Possible acquisition price as per newsflow (US\$ bn)	Strategic rationale
ANZ life & wealth	Australia	"at least" 3.3	Would result in AIA becoming number one in market share in the Australian market.
SCB Life	Thailand	3.1 (depending on what percentage of SCB Life was sold)	Would allow AIA to make significant in-roads into Thailand's bancassurance channel, where exclusive partnerships between banks and insurers dominate. The scale of AIA's current bancassurance business in Thailand is relatively small.

SOURCES: CIMB, COMPANY DATA, REUTERS

The term "at least" was used by ANZ when stating that its life insurance and wealth asset was for sale

Note that AIA's largest acquisition since its 2010 IPO was ING Malaysia's insurance business at US\$1.73bn, which it announced in October 2012. Its second largest M&A transaction was an upfront payment of US\$800m (with future payments also made during the contract term) to Citibank with respect to

a 15-year bancassurance distribution agreement, which it announced in December 2013.

Why a share buyback and not other capital management measures?

We see three main alternatives of capital management that AIA could employ, given its large free surplus position – a special dividend, an ordinary dividend increase and/or a share buyback.

We see a special dividend as highly unlikely as it does not have any impact on the share price, once it goes ex-dividend.

A rebasing of the level of the ordinary dividend upwards is possible. Indeed, AIA rebased its final ordinary dividend upwards at the FY15 results. The rebasing of the final dividend at the FY15 results effectively saw an additional US\$164m returned to shareholders in FY16. To put this scale in perspective, if the FY15 final dividend had not been rebased, we estimate that AIA would have declared US\$913m in dividends over FY15.

Could a rebasing of the ordinary final dividend happen again at the FY16 results? While it is possible, we think it is unlikely, in our view, as it denotes a continued commitment to future capital payouts in the future. The rebasing of FY15's dividend upwards saw the dividend payout ratio rise from FY14's 22% (a level maintained over FY12-FY14) to 40% in FY15, and we would be surprised to see the dividend payout ratio materially raised yet again, especially since AIA may have believed at FY15 results that a 40% dividend payout ratio was an acceptably sustainable level, and we see little over the last one year that could have changed AIA's mind on this front.

We see a share buyback as the most likely option adopted by AIA, in our view, as it has the advantage of (i) having a direct impact on the share price; (ii) it helps improve leverage and ROEs and ROEVs; and (iii) the pace of the share buyback can be controlled depending on the share price level, where if the share price weakens, the pace of the buyback can be accelerated, and thus potentially cushioning share price downside.

Why now and not previously?

Why wait until the FY16 results on 24 February 2016 to announce a share buyback, and not earlier when AIA's share price fell to as low as HK\$43.30 at the end of December 2016?

We believe that a constraint could have been the fact that AIA's share price only troughed at HK\$43.30 after AIA's financial year end (30 November). It is a possibility that there could have been insider trading issues if AIA had commenced buying back its shares with it in possession of its yet-to-be-published FY16 results.

Other areas of investor feedback

Other areas of feedback from the two and a half weeks of investor meetings in Europe and North America can broadly be categorised into three main areas.

Firstly, the impact of recent regulations and how much of group VONB was at risk from these regulations? To what extent would Unionpay only apply to savings-related and investment-related insurance, and not pure protection, and to what extent could AIA reduce the impact of the regulations by selling pure protection in the form of term life products?

Secondly, what could the impact of AIA's valuation be assuming that VONB from this segment of mainland-visitor-insurance-buyers in Hong Kong fall to zero? How sensitive is AIA's valuation to changes in VONB forecasts given that AIA's share price fell over the last three months, and has the bulk of the downside already materialised?

Lastly, what should one expect for the upcoming FY16 results, to be released on 24 February 2017?

Business at risk from adverse regulations on mainland visitors in HK

We believe that 14% of AIA's FY16F group VONB (estimated to be 15% at 1H16) is at risk from the recently-introduced regulations relating to capital outflows, which could adversely impact FY17F's group VONB. We had written about this segment extensively in our initiation report "*Best of times, worst of times; Initiate with Reduce*" dated 16 November 2016.

Figure 7: AIA's VONB growth forecasts by key regions

	FY13	FY14	FY15	1H16	FY16F	FY17F	FY18F
Group VONB	1,490	1,845	2,198	1,260	2,787	2,954	3,516
HK VONB (mainland-visitor)	56	92	157	183	386	56	62
HK VONB (non-mainland-visitor)	393	501	626	339	808	999	1,213
HK VONB (pension business)	19	26	37	15	43	47	51
Total HK VONB	468	619	820	537	1,236	1,102	1,326
China VONB	166	258	366	278	534	737	958
Other country VONB	1,019	1,115	1,204	553	1,256	1,369	1,533
HK reserve, cap. reqmts & group exp.	-163	-147	-192	-108	-239	-253	-301
y-o-y growth							
Group VONB		24%	19%	31%	27%	6%	19%
HK VONB (mainland-visitor)		66%	70%	193%	146%	-85%	10%
HK VONB (non-mainland-visitor)		27%	25%	31%	29%	24%	21%
HK VONB (pension business)		37%	42%	15%	15%	10%	10%
Total HK VONB		32%	32%	60%	51%	-11%	20%
China VONB		55%	42%	49%	46%	38%	30%
Other country VONB		9%	8%	2%	4%	9%	12%
HK reserve, cap. reqmts & group exp.		-10%	31%	4%	24%	6%	19%

SOURCES: CIMB ESTIMATES, COMPANY REPORTS

How did we arrive at this proportion?

We based our estimates on AIA's disclosure that just over half of its 1H16 annualised new premiums (ANP) and 35% of FY15's ANP in HK were related to mainland visitors buying insurance in HK. We also make the assumption that VONB margins for mainland visitors buying insurance in HK were flat in 1H16 vs. FY15, and that there were slight increases in VONB margins for AIA's non-mainland visitor insurance business over this period.

We then use simultaneous equations to solve the unknown variables to HK's VONB margins for both mainland visitor vs. non-mainland visitor business, and conclude that the VONB margins of mainland visitor business were less than half its non-mainland visitor business (35.0% vs. 72.9%).

Data from HK's Office of the Commissioner of Insurance (OCI) also supports our conclusion that the VONB margins of AIA HK's mainland visitor business are significantly lower than its non-mainland visitor business, especially since they appear to be less protection-related, and shorter duration compared to the non-mainland visitor business in HK.

Figure 8: Estimated VONB data for AIA's HK business-mainland vs. non-mainland

(US\$ m)	FY13	FY14	FY15	1H16
VONB of mainland customers in HK	56	92	157	183
VONB of non-mainland customers in HK	393	501	626	339
VONB of pension business	19	26	37	15
y-o-y growth				
VONB of mainland customers in HK	66%	70%	193%	
VONB of non-mainland customers in HK	27%	25%	31%	
VONB of pension business	37%	42%	15%	
% mix				
VONB of mainland customers in HK	12%	15%	19%	34%
VONB of non-mainland customers in HK	84%	81%	76%	63%
VONB of pension business	4%	4%	5%	3%

SOURCES: CIMB, COMPANY REPORTS

Figure 9: Estimated ANP and VONB margins for AIA's HK business-mainland vs. non-mainland

(US\$ m)	FY13	FY14	FY15	1H16
ANP of mainland customers in HK (US\$ m)	159	263	448	524
ANP of non-mainland customers in HK (US\$ m)	622	689	815	464
y-o-y growth				
ANP of mainland customers in HK (US\$ m)	66%	70%	193%	
ANP of non-mainland customers in HK (US\$ m)	11%	18%	29%	
% mix of ANP				
ANP of mainland customers in HK (US\$ m)	20%	28%	35%	53%
ANP of non-mainland customers in HK (US\$ m)	80%	72%	65%	47%
VONB margins of mainland customers in HK				
	35.0%	35.0%	35.0%	
VONB margins of non-mainland customers in HK				
	72.7%	76.8%	72.9%	

SOURCES: CIMB, COMPANY REPORTS

Why we believe mainland visitor insurance purchases in HK could be capital-outflow-related

While we do agree that buying insurance policies in HK can be more attractive to mainland customers than buying insurance policies on the mainland for a variety of reasons, we believe that a significant part of the growth of this segment could be capital-outflow-related (and hence savings-related) since September 2015, as opposed to protection-related.

There are three reasons for such a belief.

Firstly and most importantly, the growth rate of this segment went exponential from September 2015, with the growth rate of new business premiums (annualised premium equivalent [APE] weighted) accelerating from 43% yoy in September 2015 to 123% yoy in September 2016 (Figure 11). This growth rate is a marked shift upwards compared to past years and in our view, can only be explained by a triggered event.

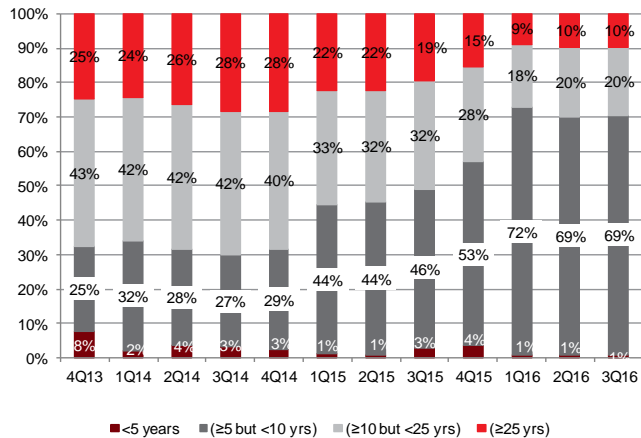
We believe that this triggering event could be the unexpected 2% devaluation of the CNY in August 2015, which may have led to a significant increase of CNY depreciation expectations going forward and for ways to hedge against such a depreciation. Mainland visitor purchases of insurance in HK was seen as one such way.

Secondly, the shift of AIA's sales towards shorter duration policies, in our view, indicates that they are more likely to be savings-related, rather than protection-related.

AIA's mainland visitor insurance sales in HK seem to be more heavily concentrated in the premium duration of five years to 10 years. Its non-mainland visitor insurance sales are more heavily weighted towards premiums payable over 10 years and above.

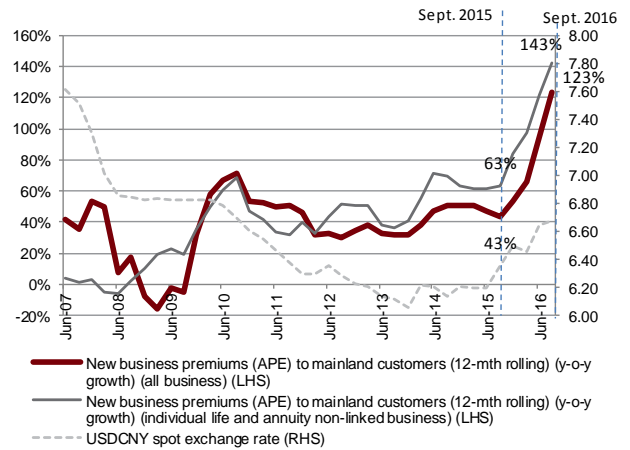
This view is based on an analysis of the premium duration structure of AIA's new regular premium business (Figure 10). Note the rapid shift towards new insurance business with premium duration of 5-10 years, with this portion rising from 44% of total annualised premiums (new business) in 2Q15 to 69% in 3Q16. This rapid shift in premium duration coincides with the rapid growth of mainland visitor business in HK (Figure 11).

Figure 10: Premium duration structure of AIA's regular premiums (new business) of its HK individual life business (quarterly data)



SOURCES: CIMB, COMPANY REPORTS

Figure 11: Growth of new business premiums (annualised premium equivalent [APE] weighted) to mainland customers vs. the US\$/Rmb exchange rate



SOURCES: CIMB, OCI, BLOOMBERG

Lastly, for AIA HK's regular premium business, we estimate that the average case size of its mainland visitor business is about four times larger than its non-mainland visitor business (Figure 12 and 13). Similarly, for AIA HK's single premium business, we estimate that the average case size of its mainland visitor business is three times larger than its non-mainland visitor business. These suggest that the mainland visitors could be buying their insurance policies more for the cash values (i.e. for investment policies) than for protection, even though these policies are critical illness-related (which we understand the bulk of AIA's policies are).

Figure 12: Average case size for AIA's policies (offshore customers) (HK\$) by payment-type

	Single premium	Non-single premium	APE-weighted
2014	13,706,408	56,199	71,711
2015	9,640,963	66,681	74,847
1H16	5,029,393	87,667	92,357
9M16	5,425,734	86,358	91,120

SOURCES: CIMB, OCI

Figure 13: Average case size for AIA's policies (onshore customers) (HK\$) by payment-type

	Single premium	Non-single premium	APE-weighted
2014	865,538	17,819	104,373
2015	983,314	19,085	117,417
1H16	1,653,028	21,117	186,419
9M16	1,472,499	21,397	168,647

SOURCES: CIMB, OCI

How much does the VONB impact AIA's valuation?

Sensitivity analysis shows that a 5% pt change in the VONB growth rate for FY17F would swing a P/EV Gordon Growth Model (GGM) valuation by 3%.

Figure 14: Sensitivity of our P/EV-based valuation to changes in FY17F's VONB growth forecast

FY17F VONB growth assumptions=>	0%	1%	2%	3%	4%	5%	6% (base case)	10%	15%	20%
P/EV based valuation (HK\$)	42.75	43.05	43.36	43.67	43.98	44.29	44.60	45.83	47.37	48.92
% change from base case	-4%	-3%	-3%	-2%	-1%	-1%	0%	3%	6%	10%

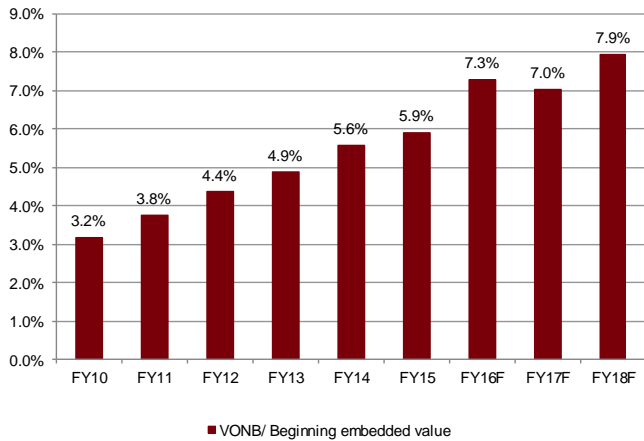
SOURCES: CIMB ESTIMATES

The relatively low sensitivity of AIA's valuation to the VONB is due to the fact that VONB only comprises a small proportion of the EV, with this ratio at only 7.3% in FY16F. Thus, changes to the VONB only has minimal changes to the numerator of the ROEV, and hence minimal changes to the ROEV (which determines the target P/EV multiple in a GGM).

It would thus appear, at first glance, that AIA's valuation is not that sensitive to changes in VONB and investors should not overly focus on this metric. Having said that, we argue that the actual share price sensitivity of AIA to changes in its VONB growth outlook could be greater than the sensitivity that is fundamentally computed using a valuation model, for two reasons.

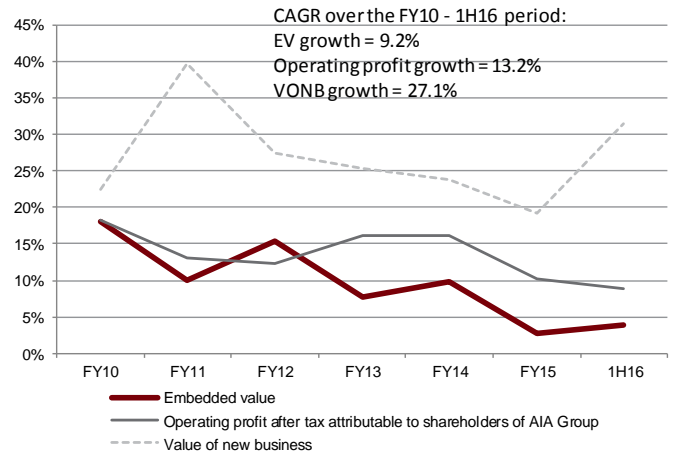
Firstly, we argue that AIA’s P/EV multiple re-rating across time, where it rose from a low of 1x forward P/EV in October 2011 to a peak of 2.1x in April 2015 (Figure 33) was driven by superior VONB growth and beats in consensus VONB, and not by superior operating profit growth or EV growth. VONB growth over the FY10 – 1H16 period was at 27.1% CAGR, which is significantly higher than the 13.2% CAGR for operating profit or 9.2% CAGR for EV growth. Not to mention that operating profit growth and EV growth is relatively non-volatile and easier-to-predict with fewer investors focusing on these metrics.

Figure 15: VONB gearing relative to embedded value for AIA across time



SOURCES: CIMB ESTIMATES, COMPANY REPORTS

Figure 16: Growth rate yoy of key financial metrics



SOURCES: CIMB, COMPANY REPORTS

Secondly, VONB is the most visible performance metric that AIA’s highlights and investors focus on. VONB is consistently the first metric that AIA highlights when it puts out its result releases. It is also the most important metric that buy side investors focus on, in our view.

These factors could lead to AIA’s share price being more sensitive to changes in the VONB outlook than valuation models suggest.

Finally, a lot of investors were interested in understanding the outlook, both in the near term and the long term. It was widely agreed that AIA was a quality stock with well-liked management that had an established track record of delivering superior shareholder value across time. Accordingly, there were a number of long-only investors in Europe and North America we met who were wondering when the right time was to invest in AIA.

Figure 17: Share price / index performances of AIA, Prudential and major benchmark indices

	Absolute performance		Relative performance			
	AIA	Pru	vs. HSI	vs. MSCI Asia ex Jap.	vs. MSCI EM	vs. MSCI World
Dec-11	11%	-8%	31%	30%	32%	21%
Dec-12	25%	53%	2%	6%	9%	11%
Dec-13	29%	55%	26%	28%	33%	8%
Dec-14	11%	4%	10%	11%	15%	9%
Dec-15	8%	-1%	15%	19%	24%	12%
Dec-16	-6%	-15%	-7%	-9%	-13%	-12%
Feb-17	8%	1%	1%	0%	0%	4%

SOURCES: CIMB, COMPANY REPORTS

A results beat versus consensus... again!

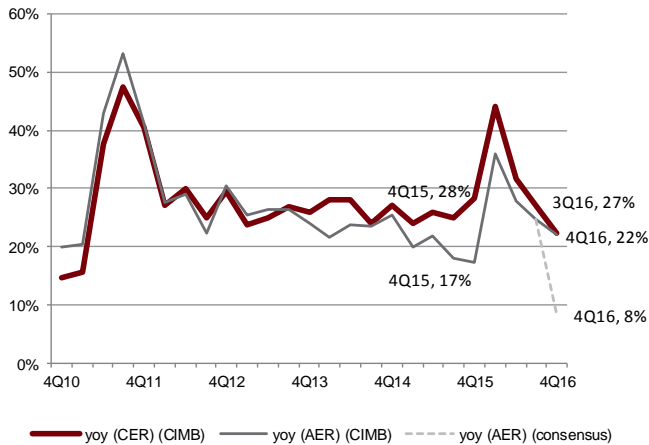
What should investors expect for the upcoming FY16 results on 24 Feb. 2017?

We are top-of-consensus for our VONB estimate, and forecast an FY16F VONB growth of 27%. As AIA has already reported its 9M16 results, this implies that we are expecting a 22% VONB growth in 4Q16.

We understand that consensus is forecasting 23% yoy VONB growth for FY16F, which implies only 8% yoy. To put things in perspective, an 8% yoy growth rate

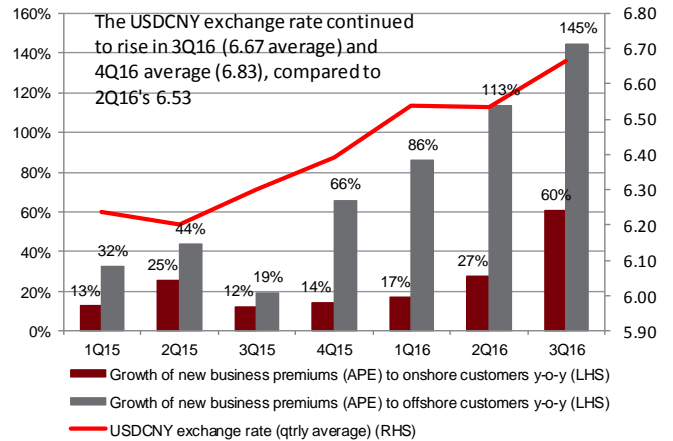
would be the lowest VONB growth rate since its listing. We see such a record-low growth rate as extremely improbable, and are thus significantly ahead of 4Q16 consensus numbers.

Figure 18: VONB growth yoy (Constant Exchange Rates [CER] and Actual Exchange Rates [AER]) (CIMB vs. consensus)



SOURCES: CIMB ESTIMATES, COMPANY

Figure 19: Growth of new business premiums (APE) to customers (onshore vs. offshore) compared to USDCNY



SOURCES: CIMB, OCI

What is driving our higher-than-consensus VONB forecast?

There are three reasons.

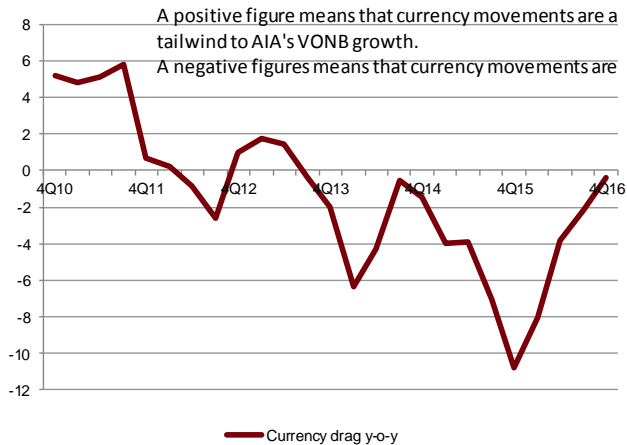
Firstly, and most importantly, we believe that we are much more bullish than consensus on the VONB growth mainland visitor segment in Hong Kong, which has been the main growth driver of AIA's group VONB growth over the last year. For example, the VONB of mainland visitors buying insurance in Hong Kong grew 193% yoy in 1H16 according to our estimates, significantly outstripping group VONB growth of 31% yoy.

We do not think that yoy growth of this mainland visitor segment slowed in September and October 2016 (i.e. the first two months of AIA's 4Q16). In fact, the growth rate may even have accelerated yoy, thus leading to policymakers feeling it necessary to impose a ban on payments via Unionpay cards for insurance in HK at the end of October 2016. The rules banning the use of Unionpay cards for mainland visitors to buy savings-related or investment-related in Hong Kong only thus impacted one month of AIA's 4Q16 results.

It should be stressed that should AIA beat consensus VONB estimates due to the strength of mainland visitor purchases of insurance in HK, questions could be raised about the sustainability of such VONB strength. This is because of the uncertain outlook for this segment in light of the tougher outlook following stricter regulations in recent months. As such, these questions of sustainability may see consensus choosing not to revise up their FY17F, FY18F and FY19F forecasts by the amount of the VONB beat.

A second reason is that for the first time since 3Q13, we do not expect any currency drag on VONB growth. In other words, we expect 4Q16's VONB growth on an actual exchange rates (AER) basis to be the same as VONB growth on a constant exchange rates (CER) basis. This is due to CNY and PHP currency weakness being offset by THB, SGD, MYR, AUD, IDR and KRW strength.

Figure 20: Currency drag on VONB yoy growth (% pts)



SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Figure 21: Currency change yoy of selected Asian currencies (period average) and the drag on AIA's group VONB

	HKD	THB	SGD	MYR	CNY	KRW	AUD	IDR	PHP	Weighted average
1Q13	-0.2%	-3.1%	-3.7%	-1.2%	-1.5%	-5.5%	-0.2%	6.7%	-5.7%	-1.8%
2Q13	0.0%	-4.9%	-1.0%	-0.3%	-2.1%	-2.4%	0.8%	5.6%	-4.1%	-1.4%
3Q13	0.0%	-1.3%	0.4%	1.5%	-3.7%	-1.8%	11.5%	7.3%	2.7%	0.4%
4Q13	0.0%	2.3%	2.0%	4.7%	-2.7%	-3.1%	10.6%	19.0%	4.9%	2.0%
1Q14	0.0%	8.2%	3.0%	7.4%	-2.6%	-1.1%	16.8%	24.9%	9.5%	4.1%
2Q14	-0.1%	10.0%	1.1%	6.4%	0.5%	-5.9%	10.5%	17.8%	8.2%	3.7%
3Q14	-0.1%	3.3%	-1.5%	-0.4%	1.1%	-9.3%	-1.7%	15.7%	0.6%	0.6%
4Q14	0.0%	3.1%	2.2%	2.1%	0.4%	-0.6%	6.3%	5.7%	2.6%	1.6%
1Q15	0.0%	0.2%	5.5%	7.9%	2.5%	3.1%	11.1%	4.2%	-0.4%	2.4%
2Q15	0.0%	1.4%	7.6%	11.7%	0.0%	4.8%	18.7%	13.8%	0.1%	3.4%
3Q15	0.0%	7.1%	9.7%	21.1%	0.9%	12.1%	25.3%	14.7%	4.2%	6.0%
4Q15	-0.1%	10.3%	10.3%	30.9%	3.8%	9.1%	23.5%	15.6%	4.6%	7.5%
1Q16	0.2%	9.7%	5.9%	20.3%	4.9%	9.1%	12.7%	9.3%	6.6%	5.5%
2Q16	0.1%	7.2%	0.8%	10.1%	4.7%	6.5%	3.9%	1.6%	4.7%	3.0%
3Q16	0.1%	1.5%	-1.3%	4.6%	6.2%	-0.4%	-0.7%	-2.1%	2.7%	1.6%
4Q16	0.1%	-2.2%	-1.8%	-1.9%	6.1%	-2.4%	-5.8%	-5.7%	3.5%	0.4%
1Q17	-0.2%	-1.1%	1.1%	4.4%	5.9%	-1.6%	-4.0%	-2.6%	4.9%	1.3%

SOURCES: CIMB, BLOOMBERG, COMPANY REPORTS

Positive figures denote that the USD is appreciating against the Asian currencies, ie a drag on group VONB of AIA (YoY currency change (period average))

The last reason why we think consensus' 4Q16's VONB growth of only 8% yoy is way too low is AIA's track record around results seasons.

As we highlighted in a previous report, AIA has an enviable track record around results seasons. A trading strategy of buying five days before it reports its results and selling five days after its results (i.e. a ten day window) for every single results seasons since its IPO would have delivered a cumulative absolute return of 88%.

After adjusting for market movements (proxied using the Hang Seng Index [HSI]), AIA's cumulative outperformance over the HSI over this 10-day window since its IPO is 61% pt.

With AIA having delivered an overall 121% pt of outperformance over the HSI since just before it reported its first set of results, its results season outperformance of 61% pt comprise just over half (51%) of AIA's overall outperformance over the HSI.

Such an enviable track record around results season is almost always due to better-than-consensus VONB. In our view, AIA has traditionally beat consensus expectations for VONB by about 3% pt over 1Q-3Q. The beat is much greater in 4Q, where the full year (FY) beat tends to be about 3%pt, with consensus sell side estimates seemingly consistently not properly taking into account the already disclosed 9M figures.

Figure 22: AIA's share price performance (absolute and relative) around result dates

	AIA absolute share price reaction				AIA relative share price reaction (vs. HSI)			
	t= -1 to t= +1	t= -3 to t= +3	t= -5 to t= +5	Share price change on the day only	t= -1 to t= +1	t= -3 to t= +3	t= -5 to t= +5	Share price change on the day only
4Q10	4%	5%	4%	6%	4%	5%	5%	4%
1Q11	4%	7%	7%	3%	5%	8%	9%	3%
2Q11	4%	6%	5%	3%	5%	5%	6%	4%
3Q11	-1%	0%	6%	-2%	-2%	-2%	1%	-1%
4Q11	2%	10%	10%	3%	3%	9%	10%	3%
1Q12	1%	1%	-1%	0%	0%	1%	-3%	0%
2Q12	0%	2%	-3%	0%	-2%	-2%	-3%	-2%
3Q12	-1%	-2%	1%	0%	-1%	-2%	-2%	0%
4Q12	2%	5%	6%	4%	3%	5%	9%	4%
1Q13	3%	4%	6%	1%	1%	1%	0%	1%
2Q13	-1%	3%	8%	0%	-1%	0%	5%	0%
3Q13	5%	5%	5%	4%	4%	5%	6%	3%
4Q13	-2%	0%	2%	0%	-1%	1%	-1%	-1%
1Q14	6%	4%	2%	3%	5%	2%	2%	4%
2Q14	0%	5%	5%	1%	-1%	-1%	0%	0%
3Q14	-2%	-2%	-1%	-1%	-1%	-2%	0%	-1%
4Q14	0%	6%	10%	0%	0%	6%	11%	0%
1Q15	2%	1%	-1%	-1%	1%	-4%	-2%	-1%
2Q15	0%	0%	-1%	-2%	1%	3%	2%	-1%
3Q15	5%	2%	5%	3%	3%	1%	2%	3%
4Q15	-1%	1%	10%	1%	1%	2%	4%	2%
1Q16	5%	6%	3%	2%	4%	5%	3%	3%
2Q16	-2%	0%	-2%	-1%	-2%	-1%	-1%	-1%
3Q16	-2%	-3%	-1%	1%	-1%	-1%	1%	0%
Total	32%	65%	88%	30%	26%	45%	61%	25%
AIA's outperf. since just before 1st set of results					121%	121%	121%	121%
Outperf. (just before its 1st set of results to today) (% pts)					22	37	51	21

SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

What is even more noteworthy is that the bulk of the 61% pt of outperformance over the HSI during the results season has come when AIA reports its full-year results (i.e. the 4Q results). 37% pt of the outperformance over the HSI comes in 4Q, with "only" 8% pt each in 1Q, 2Q and 3Q. In other words, 4Q's outperformance contributed 60% of the overall outperformance every year. This is particularly amazing given that the VONB for the first nine months of every year is already known before AIA reports its full-year results.

Figure 23: AIA's share price performance (absolute and relative) around result dates (by quarter)

	AIA absolute share price reaction				AIA relative share price reaction (vs. HSI)			
	t= -1 to t= +1	t= -3 to t= +3	t= -5 to t= +5	Share price change on the day only	t= -1 to t= +1	t= -3 to t= +3	t= -5 to t= +5	Share price change on the day only
1Q	20%	23%	17%	8%	16%	12%	8%	9%
2Q	2%	14%	14%	2%	0%	5%	8%	1%
3Q	4%	1%	15%	6%	1%	-1%	8%	4%
4Q	5%	27%	42%	14%	9%	29%	37%	12%
Total	32%	65%	88%	30%	26%	45%	61%	25%
Pct of year's perf. in 4Q	17%	41%	48%	47%	35%	64%	60%	47%

SOURCES: CIMB, COMPANY REPORTS, BLOOMBERG

Why still maintain a Reduce rating?

So where to from here?

The key reasons why we decided to initiate on AIA on a Reduce rating in mid-November were fourfold.

Firstly, we believed that we were entering into the worst year for VONB growth since AIA's listing, and consensus VONB growth for FY17F looked too high in our view, given our lowest-of-consensus VONB growth forecast.

Secondly, not only did we have the lowest VONB growth forecast, but importantly, we were uncertain whether we would need to revise our lowest-of-

consensus VONB growth downwards. This was because the regulatory outlook was highly uncertain, and for the first time since AIA's IPO, we were of the view that AIA was less in control of its future VONB growth rate. We believed that this uncertainty could weigh on its share price and make it more difficult to continue its historical track record of outperformance.

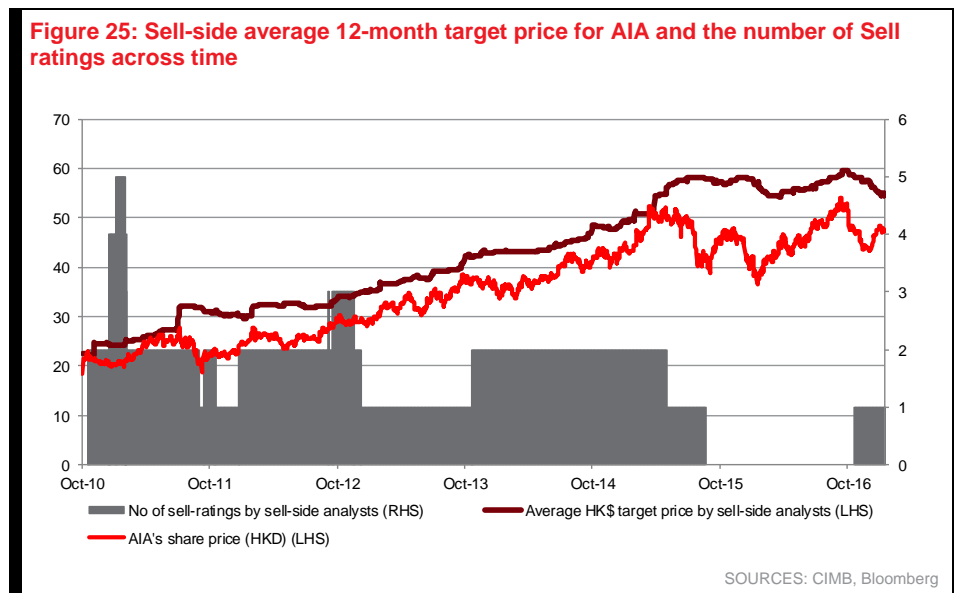
Figure 24: List of measures impacting HK insurance purchases by mainland customers in HK (Feb. – Oct 2016)

Date	Measure that could impact mainland visitor insurance purchases	AIA's share price impact	
		Absolute	(± 3 days) Relative to HSI index
3-Feb-16	A US\$5,000 limit per transaction for card payments to buy insurance via Unionpay terminals is said to be strictly enforced, with this to be implemented from 4th Feb. 2016. There was no mention of a cap on the number of transactions that could be done.	-6.7%	-7.2%
5-Feb-16	The US\$5,000 limit per transaction for card payments to buy insurance offshore has been extended from Unionpay to Visa, Mastercard and other international credit cards, according to SAFE. SAFE clarified that it had placed insurers in the "limited" merchants category in line with the nation's capital account controls. The regulator will also "closely monitor" cardholders and insurers in situations where cards have been swiped multiple times.	-6.7%	-4.0%
12-Mar-16	PBOC bans the use of cross-border electronic payment channels (e.g. All-in-pay) for purchase of HK life insurance and investment life insurance. These platforms will still be permitted for the purchase of overseas insurance policies covering personal accidents, medical and transportation, with a cap of Rmb30,000.	2.2%	0.9%
22-Apr-16	CIRC warns customers that there are risks with the buying of insurance in HK. These include the risks that the policies are not covered by mainland law, that the dividends are uncertain, that there are exchange rate risks, and that there are policy risks, as purchase of life insurance in HK belongs to transactions under the capital account, which is subject to foreign exchange control. Policyholders also risk being unable to make timely premium payments if foreign exchange payment policies change.	5.0%	5.3%
13-Jun-16	21st Century Business Herald reports that the CIRC has recently visited AIA, Metlife, Pru and other foreign insurance JVs, as well as some insurance intermediaries to investigate whether there have been any illegal insurance sales or promotions.	-4.9%	1.1%
8-Jul-16	The Office of Commissioner of Insurance (OCI) in HK sends a letter to insurers in HK, asking them to get mainland customers buying insurance in HK to sign a statement which has the factors and risks to be considered when taking out long term insurance policies in Hong Kong.	2.1%	-0.7%
18-Jul-16	CIRC issues a notice about strengthening the regulation of illegal sales of offshore insurance on the mainland, where local bureaus and intermediaries are asked to investigate illegal sales of insurance on the mainland.	4.6%	1.4%
29-Oct-16	Unionpay releases a statement stating that (i) its credit cards and debit cards will not be allowed to be used to buy insurance in HK, other than accident, travel and medical insurance; (ii) It will also strictly enforce the rule that each insurance transaction for the above three mentioned business insurance types cannot exceed US\$5,000; (iii) it will tighten other requirements on overseas insurance merchants, including accurate use of merchant-identification code, insurance merchant training and abnormal checks, as well as inspections of insurance merchants. Unionpay's recent monitoring on overseas insurance merchants had shown a surge in single-card uses for multiple transactions at the same merchants.	-9.5%	-6.3%

SOURCES: CIMB, OCI, CIRC, SAFE, Uniopay, PBOC, 21st Century Business Herald

Thirdly, our analysis of how investors have generated returns from investing in AIA indicated that about half of their cumulative outperformance versus the Hang Seng Index (HSI) since AIA's IPO came from a ten-day window around every time AIA reported its results. If we were unsure about the ability of AIA to beat consensus estimated for VONB in FY17F, then logically it would be much more difficult for AIA's to continue to beat benchmark indices.

Lastly, we could not reconcile this highly uncertain and challenging outlook with the fact that there were no sell recommendations on the stock, indicating a level of bullishness that we did not feel back in November.



Hence, from that perspective, we decided to initiate coverage on AIA with a Reduce rating.

We still elect to maintain our Reduce rating, although we are a bit less bearish than we were back in November. The US\$ has unexpectedly weakened in 2017 YTD, and regulations pertaining to capital outflows seem to be working, which could mean a lesser likelihood of adverse regulations going forward, that could negatively impact AIA's share price.

This is important as while we were bearish on the regulatory outlook back in November 2016, even we were surprised at the pace and the intensity of the regulations being released to address capital outflows as well as mainland visitors buying insurance in HK.

On that front, we do believe that we are past the winter of despair and entering into the spring of hope, to use Charles Dickens's terminology. Such hope is contingent on a few factors

These factors include continued US\$ weakness (or at least reduced US\$ strength), recent capital outflow measures working to curb outflows, as well as uncertainty clearing up on the impact of these measures on AIA's mainland visitor business in HK.

Figure 26: List of measures impacting HK insurance purchases by mainland customers in HK & other capital outflows (Nov/ Dec)

Date	Measures that could impact mainland visitor insurance purchases & other capital outflows (Nov. & Dec. 2016)	AIA's share price impact	
		Absolute	(± 3 days) Relative to HSI index
15-Nov-16	AIA is reportedly no longer accepting Visa/ Mastercard for insurance purchases by mainlanders in HK.	-3.5%	-1.3%
25-Nov-16	PBOC prohibits the issuance of co-branded/ dual-currency Visa & Mastercard cards by banks in China.	0.2%	-0.3%
2-Dec-16	BOC has begun to sharply limit corporate customers' ability to purchase foreign currency in Shanghai Began at start Dec. 2016 to discourage companies wishing to change yuan into dollars. Those firms which insisted on doing so were told they would be restricted to exchanging a maximum of USD1m. Previously, there had been no restrictions on companies' forex purchases. An official at a mid-sized shareholding bank in Shanghai said the lender had suspended all forex purchases. It was also preventing individuals from transferring foreign currency to their relatives, taking aim at a common workaround to take money overseas.	-4.1%	-4.4%
5-Dec-16	Economic Information Daily reports that there has been a 99.6% fall month-on-month in Nov. 2016 of Unionpay transactions relating to HK insurance purchases. Specifically, overseas insurance purchases paid with UnionPay cards fell to Rmb30m in Nov. from Rmb8.06b in October.	-6.4%	-7.8%
7-Dec-16	Apple Daily reports that from 10 Dec. 2016, mainlanders cannot use Visa/ Mastercard to buy insurance in HK	-3.3%	-2.7%
18-Dec-16	A US\$5,000 limit is officially extended to Visa and Mastercard with respect to buying insurance in HK, and multiples swipes are not allowed.	-0.9%	2.7%
31-Dec-16	State Administration of Foreign Exchange (SAFE) requires extra documentation for people seeking to sell yuan from Jan. 1 2017, while keeping each person's annual \$50,000 allowance unchanged. Individuals still need identification cards to buy foreign exchange at banks within their annual quota, and if the purchase value exceeds annual quotas, they must also provide documents to verify the transaction value. Customers must pledge money won't be used for overseas purchases of property, securities, life insurance or investment-type insurance. Citizens previously didn't have to sign such a pledge. Customers must give a more detailed account of the planned use of funds, e.g. business travel, overseas study, family visits, medical treatment, merchandise trade or purchases of non-investment insurance policies, including the timing, by year and month. Violators of foreign-exchange rules will be added to the currency regulator's watch list, denied forex quota for three years and subjected to anti-money-laundering investigations. Customers must confirm compliance with restrictions on money laundering, tax evasion and underground bank dealings. Customers must also now confirm they aren't lending or borrowing quotas to or from other citizens.	1.1%	-3.0%
31-Dec-16	Daily limit of personal FX purchases is reduced from Rmb200,000 to Rmb50,000. A personal cross border bank transfer limit of Rmb200,000 is also imposed. Individuals with frequent transactions could be put onto the regulator's "watch list" and potentially be penalized. Scrutiny is thus being increased on individual's forex purchases.	1.1%	-3.0%

SOURCES: CIMB, SAFE, PBOC, MEDIA NEWSFLOW

Figure 27: List of measures impacting HK insurance purchases by mainland customers in HK & other capital outflows in 2017

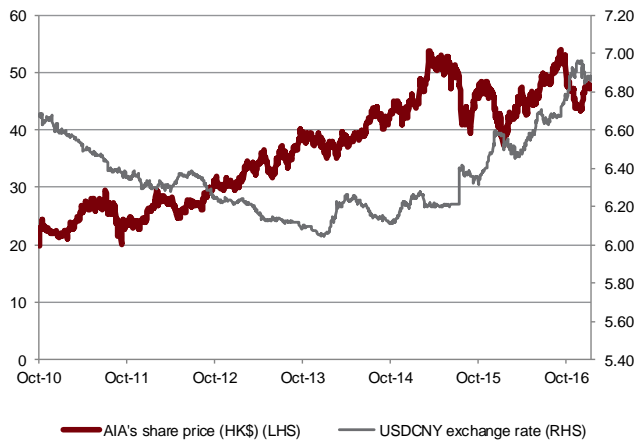
Date	Measures that could impact mainland visitor insurance purchases & other capital outflows (Jan. 2017)	AIA's share price impact	
		Absolute	(± 3 days) Relative to HSI index
1-Jan-17	Implementation of Common Reporting Standards (CRS) comes into effect for HK financial institutions. All mainland customers would have to declare their tax file numbers upon buying any financial product (including insurance) in HK. China then plans to exchange with other countries the financial information of customers from Sep 2018.	n.a.	n.a.
4-Jan-17	Onshore banks are reportedly refusing to accept cheques by HK insurers. Claimants for life insurance or those with profit-sharing and investment-related policies are banned from check exchange at mainland banks. Insurance agents from AXA said checks to clients are not honored in BOC's mainland outlets starting from Jan. 2017.	4.7%	1.2%
11-Jan-17	Reuters reports that banks have been set limits by SAFE on banks currency transaction volumes, and have to turn business away if they exceed these limits. They cannot disclose the oral instructions by SAFE about these restrictions. SAFE had also been verbally telling banks since at least late Nov 2016 that it would vet all cross-border money transfers worth US\$5m or more, down from US\$50m. SAFE also tells banks not to publish negative research on the yuan. They also told the banks to interview clients to make sure the forex deals were not for fake transactions, or else face punishment. SAFE is reportedly quietly choking programmes designed to open overseas markets to Chinese investors. Even where institutional investors have been granted quotas to invest overseas, they are finding it increasingly difficult to exchange yuan into another currency.	3.7%	2.7%
23-Jan-17	Regulators bar bankers from making net renminbi outflows. According to the Financial Times, some banks in Shanghai must "import" Rmb100 for every Rmb100 they allow a client to remit overseas, ensuring no net outflows of the Chinese currency. Shanghai-based banks had been allowed to remit Rmb160 overseas for every Rmb100 they brought back into China. In Beijing, banks must import Rmb100 for every Rmb80 they remit overseas on behalf of clients, thus ensuring a net inflow. SAFE has instructed banks not to inform clients why their overseas remittances are being rejected and is checking their net renminbi flows on a weekly basis, compared with every month previously.	1.5%	0.3%
25-Jan-17	China Merchants Bank tightens rules for mainlanders opening Hong Kong accounts. From Feb. 1, applicants for account opening at CMB's HK branches must have assets at the bank averaging Rmb5m each day over the past 3 months, a 100-fold rise from Rmb50,000 previously. This follows tighter rules set by Citi (HK) in late-2016 for mainlanders opening accounts in HK.	1.1%	-0.8%

SOURCES: CIMB, VARIOUS REGULATORS, NEWSFLOW

US\$ weakness or at least not-an-overly-strong US\$ can be important as it impacts policy risk with respect to AIA's share price. This is because an overly strong US\$ against the CNY could once again entrench CNY depreciation expectations in the minds of mainland customers, potentially leading to greater capital outflows and again potentially leading to more adverse regulations being announced by China's policymakers.

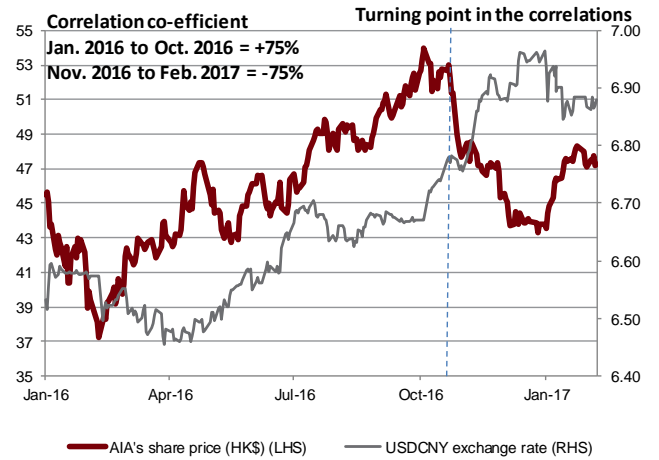
We find it extremely interesting that AIA's share price has recently become a play on USDCNY. The correlation may be co-incidental, but AIA's share price has been strongly inversely correlated to the USDCNY exchange rate since rules were introduced banning the use of Unionpay cards in HK by mainland customers to purchase investment or savings-related insurance at end-Oct 2016 (correlation co-efficient of -75%). This is in sharp contrast to the positive correlation from the start to 2016 to end Oct. 2016 (correlation coefficient of +75%).

Figure 28: A strong correlation between AIA's share price and the USDCNY exchange rate only become apparent from start-2016



SOURCES: CIMB, BLOOMBERG

Figure 29: Sharp turnaround in the direction of the correlation between AIA's share price and the USDCNY exchange rate



SOURCES: CIMB, BLOOMBERG

Finally, as we highlighted in a recent report *'Paying the price of uncertainty'* dated 8 December 2016, the level of uncertainty may remain high in the very near term and will only start to clear up at the 1Q17 results at end-April 2017, when we have the first clean quarter of AIA's VONB post the Unionpay ban.

Figure 30: The timeline of uncertainty: Key dates to watch for Timeline of uncertainty

Date	Comments
Jan./ Feb. 2017	To see if the US\$50,000 FX conversion limit is reduced, and to obtain more clarity on what new regulations could be released that could impact AIA's mainland visitor insurance business in HK.
24 Feb. 2017	AIA's FY16 results: to assess how much of its VONB could be at risk should mainland visitors' insurance purchases in HK completely dry up (we had estimated 15% of group VONB in our Nov report).
Mid-Mar. 2017	Release of HK's insurance industry 4Q16 statistics: To assess the impact of a two-month Unionpay ban on industry insurance purchases by mainland visitors in HK.
End-Apr. 2017	AIA's 1Q17 results: to assess its full quarter impact of the Unionpay ban.
End-May 2017	Release of HK's insurance industry 1Q17 statistics: To assess the full-quarter impact on industry insurance purchases by mainland visitors in HK of regulations released in 4Q16.
End-Jul. 2017	AIA's 2Q17 results: To assess the full-quarter impact to AIA of regulations released in 1Q17.

SOURCES: CIMB

Valuation and risks

We have made minor changes to our VONB and EV forecasts and consequently, our valuation and target price.

In light of the weaker-than-expected US\$ in 2017 YTD, we have slightly reduced the negative foreign exchange variances within our EV forecast, thus boosting our EV forecasts over the FY17F-18F period. We still expect the US\$ to appreciate against Asian currencies over the FY17F-18F forecast period, though the strength of the expected currency appreciation is less than previously forecast.

Figure 31: AIA's embedded value across time

(US\$ m)	FY10	FY11	FY12	FY13	FY14	FY15	FY16F	FY17F	FY18F
Opening EV	20,966	24,748	27,239	30,565	33,018	37,153	38,198	41,997	44,317
Value of new business	667	932	1,188	1,490	1,845	2,198	2,787	2,954	3,516
Expected return on EV	1,846	2,029	2,192	2,389	2,635	2,698	2,829	3,133	3,369
Operating experience variance	-104	165	140	114	188	274	215	108	54
Operating assumption changes	3	-21	-29	10	-80	-26	-34	-26	-19
Finance costs on medium term notes	0	0	0	-26	-53	-76	-100	-100	-100
EV operating profit	2,412	3,105	3,491	3,977	4,535	5,068	5,697	6,069	6,819
Investment return variance	1,073	-297	933	345	720	-1,804	-470	3	-3
Effect of change in economic assumptions	-333	-26	-105	429	122	145	0	0	0
Other non operating variances	-150	18	-113	-154	23	369	97	0	0
Total EV profit	3,002	2,800	4,206	4,597	5,400	3,778	5,323	6,072	6,816
Dividends	0	-170	-530	-595	-689	-814	-1,124	-1,352	-1,589
Other capital movements	0	-89	-42	11	-14	-12	0	-1,500	0
Effect of changes in exchange rates	780	-50	535	-760	-562	-1,907	-400	-900	-900
Closing EV	24,748	27,239	31,408	33,818	37,153	38,198	41,997	44,317	48,644
Number of shares	12,044	12,044	12,044	12,044	12,045	12,048	12,051	11,809	11,812
EV per share	2.05	2.26	2.61	2.81	3.08	3.17	3.48	3.75	4.12

SOURCES: CIMB ESTIMATES, COMPANY REPORTS

We also have made slight changes to our VONB forecasts, given that regulatory developments have been more adverse than previously expected when we published our initiation report on 16 November 2016.

We now forecast VONB yoy growth of 27% in FY16F (was 28% previously), 6% in FY17F (was 9% previously), while leaving our FY18F VONB growth forecast unchanged at 19%.

Figure 32: Key valuation assumptions used in valuing AIA

	Valuation assumptions
Cost of equity	8.9%
Terminal growth rate	1.3%
ROEV (weighted average of FY17-FY19, with a stronger weighting to earlier years)	13.0%
Target P/EV	1.5x
FY17F EVPS (USD)	3.75
i.e. FY17F EVPS (HKD)	29.08
USDHKD exchange rate	7.75
Hence target price (HKD)	44.60
Current share price (HKD)	47.55
Upside/ downside	-6%
FY17F VONB per share (USD)	0.25
i.e. FY17F VONB per share (HKD)	1.94
Implied target new business multiple	8.0x

SOURCES: CIMB ESTIMATES

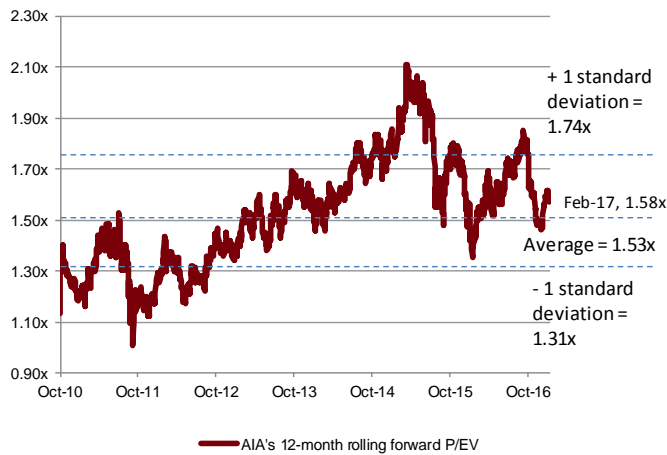
We have also factored in a US\$1.5bn share buyback, which as we argued earlier in this report, has a marginally positive impact on AIA's valuation.

We value AIA using the Gordon Growth model to derive a target P/EV multiple, with a cost of equity (COE) assumption of 8.9%, a terminal growth rate ('g') assumption of 1.3%, and a return on embedded value (ROEV) assumption of 13.0% (derived from a weighted average ROEV over the next three years) (previously 12.6%).

This gives a target P/EV multiple of 1.5x. We then apply this target multiple to our FY17F EV per share estimate of US\$3.8 (see Figure 28 for details on how this was derived). Assuming an US\$/HK\$ exchange rate of 7.75, we derive a target price of HK\$44.60 (previously \$43.60). Our target price also equates to an implied target new business multiple of 8.0x FY17F VONB.

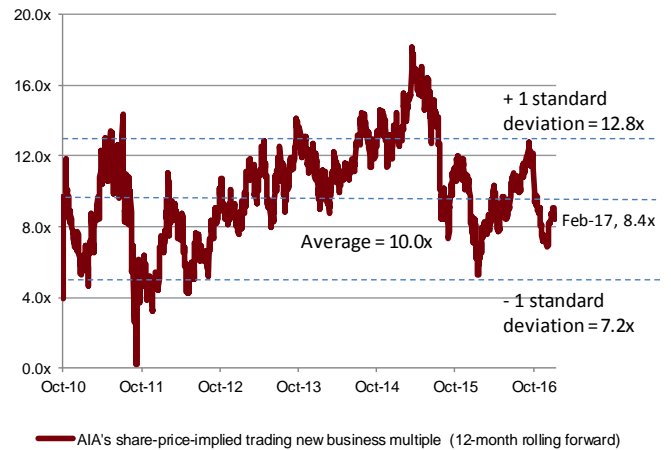
Our target P/EV multiple of 1.5x is in line with AIA's average forward P/EV multiple (on a 12-month rolling basis) of 1.5x since it was listed in Oct 2010. Our implied target new business multiple of 8.0x is slightly below the average share-price-implied new business multiple of 8.4x, since it was listed in Oct 2010.

Figure 33: AIA's 12-month rolling forward P/EV across time



SOURCES: CIMB ESTIMATES, COMPANY REPORTS, BLOOMBERG

Figure 34: AIA's share-price-implied trading new business multiple (12-month rolling forward) across time



SOURCES: CIMB ESTIMATES, COMPANY REPORTS, BLOOMBERG

Key upside risks to our call are 1) significant strengthening of Asian currencies (especially the Rmb, THB, S\$, RM, Rp and Php) against the US\$, as a substantial portion of AIA's VONB is derived in these currencies; 2) no additional regulations are issued which seek to control capital outflow from China via mainland visitors buying insurance in HK; 3) the company's results exceed investor expectations throughout FY17; and 4) a potentially rapid rise in global interest rates. We estimate that a 50bp rise in interest rates would lead to a 3.1% increase in AIA's valuation.

Figure 35: Interest rate sensitivity on AIA's valuation from changes in interest rates

Impact if interest rates rise on 1H16's VONB	
1H16 VONB (US\$ m)	1,260
50bp increase in interest rates	8%
50bp decrease in interest rates	-9%
<hr/>	
1h16 EV (US\$ m)	40,069
50bp increase in interest rates	0.2%
50bp decrease in interest rates	-0.3%
<hr/>	
Current trading new business multiple (11 Nov.)	9.6x
Hence percentage impact to AIA's valuation from:	
50bp increase in interest rates	3.1%
50bp decrease in interest rates	-3.8%

SOURCES: CIMB estimates, COMPANY REPORTS

Figure 36: Financial statements of AIA

(Year-end 30 November)	2014A	2015A	2016F	2017F	2018F
Profit & Loss (US\$m)					
Net premium	17,229	18,812	20,035	22,188	24,875
Investment income	5,352	5,645	6,124	6,625	7,533
Total Revenue	22,581	24,457	26,159	28,812	32,408
Insurance-related expenses	17,119	18,524	19,635	21,640	24,146
Other operating-related expenses	1,972	2,049	2,192	2,442	2,714
Underwriting income	3,490	3,884	4,333	4,730	5,548
Share of P/L from associates	14	0	0	0	0
Operating profit/(loss)	3,504	3,884	4,333	4,730	5,548
Operating profit after tax (OPAT)	2,925	3,229	3,602	3,932	4,613
OPAT attrib to shareholders of AIA Group	2,910	3,209	3,580	3,908	4,584
Non operating items	540	(518)	338	322	322
Net profit after tax	3,450	2,691	3,918	4,230	4,906
Balance sheet (US\$m)					
Assets					
Investment assets (excluding unit linked)	124,801	126,435	141,509	156,216	172,452
Investment assets (including unit linked)	20,974	19,794	20,753	21,758	22,812
Other assets	23,214	23,529	25,397	27,412	29,588
Total assets	168,989	169,758	187,658	205,386	224,851
Liabilities					
Insurance contract liabilities	113,202	115,969	125,613	139,211	152,040
Investment contract liabilities	7,937	7,116	6,760	6,422	6,101
Borrowings	2,934	3,195	3,515	3,866	4,253
Other liabilities	12,139	12,056	14,344	17,066	20,304
Total liabilities	136,212	138,336	150,231	166,565	182,698
Net assets	32,777	31,422	37,427	38,821	42,153
Share capital	13,962	13,971	13,980	12,489	12,498
Reserves	-5,838	-9,146	-5,988	-5,988	-5,988
Retained profits	24,343	26,294	29,074	31,946	35,237
Total shareholders' equity	32,628	31,422	37,427	38,821	42,153
Equity attributable to shareholders	32,467	31,119	37,066	38,447	41,747

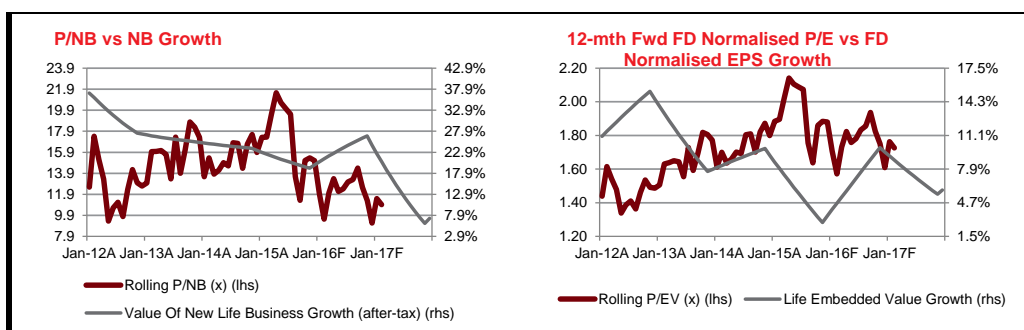
SOURCES: CIMB ESTIMATES, COMPANY REPORTS

Figure 37: Key financial data

(Year-end 30 November)	2014A	2015A	2016F	2017F	2018F
Summary					
EPS (US\$)	0.29	0.22	0.33	0.36	0.42
Operating EPS (US\$)	0.29	0.32	0.36	0.40	0.47
PE ratio (x) (oper. EPS)	19.7	18.4	16.8	15.3	12.9
EPS growth (%)	22.2%	-22.0%	45.6%	9.0%	17.2%
DPS (US\$)	0.06	0.09	0.11	0.13	0.15
Dividend yield (%)	1.1%	1.5%	1.6%	1.9%	2.2%
Issued shares (m)	12,045	12,048	12,051	11,809	11,812
BVPS (US\$)	2.70	2.58	3.08	3.26	3.53
P/B (x)	2.14	2.31	1.98	1.87	1.73
EV per share (US\$)	3.08	3.17	3.48	3.75	4.12
Growth of EV per share	10%	3%	10%	8%	10%
ROEV	14.7%	5.0%	12.9%	12.3%	13.3%
Price/EV (x)	1.87	1.88	1.75	1.62	1.48
VoNB per share (US\$)	0.15	0.18	0.23	0.25	0.30
Growth of VONB per share	24%	19%	27%	8%	19%
Implied new business (NB) multiple	17.6	15.4	11.3	9.4	6.6
Ratio and growth analysis					
ROA	2.2%	1.6%	2.2%	2.2%	2.3%
ROE	12.1%	8.5%	11.5%	11.2%	12.2%
Payout ratio	22.4%	40.0%	32.8%	35.9%	36.9%
Growth in net earned premium	8.6%	9.2%	6.5%	10.7%	12.1%
Growth in operating profit after tax & minorities	16.1%	10.3%	11.6%	9.2%	17.3%
Asset portfolio mix	100%	100%	100%	100%	100%
- Fixed interest assets	84%	85%	85%	85%	85%
- Equity securities & interest in investment funds	10%	10%	10%	10%	10%
- Others	5%	5%	5%	5%	5%
Average investment income yield	5.1%	4.5%	4.8%	4.7%	4.8%
Insurance-related expense ratio	75.8%	75.7%	75.1%	75.1%	74.5%
Operating expense ratio	8.7%	8.4%	8.4%	8.5%	8.4%
Growth of operating profit after tax and minorities	16.1%	10.3%	11.6%	9.2%	17.3%
Net profit after tax and minorities	22.2%	-22.0%	45.6%	7.9%	16.0%

SOURCES: CIMB ESTIMATES, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(US\$m)	Nov-14A	Nov-15A	Nov-16F	Nov-17F	Nov-18F
Revenue	17,229	18,812	20,035	22,188	24,875
Total Claims and Changes in Reserves	(17,119)	(18,524)	(19,635)	(21,640)	(24,146)
Acq. Costs/Other Underwriting Exp.					
Total Underwriting Result	(1,862)	(1,761)	(1,791)	(1,895)	(1,984)
Investment Income on Tech Reserve	5,352	5,645	6,124	6,625	7,533
Insurance Profit / (Loss)	3,490	3,884	4,333	4,730	5,548
Total Other Technical Income	14	0	0	0	0
Total Other Revenues	0	0	0	0	0
Total Operating Costs	0	0	0	0	0
Other Technical Income / (Loss)					
Depreciation And Amortisation	0	0	0	0	0
Operating Profit	3,504	3,884	4,333	4,730	5,548
Pretax Income/(Loss) from Assoc.	0	0	0	0	0
Post-Tax Oper. Earnings - Life/Other Biz					
Head Office Costs					
Non-Operating Income/(Expense)	0	0	0	0	0
Net Interest Income	0	0	0	0	0
Investment Income on Shareholders Fund					
Other Income	540	(518)	338	322	322
Exceptional Items					
Pre-tax Profit	4,044	3,366	4,671	5,052	5,870
Taxation	(579)	(655)	(731)	(798)	(936)
Consolidation Adjustments & Others					
Exceptional Income - post-tax					
Profit After Tax	3,465	2,711	3,941	4,254	4,934
Minority Interests	(15)	(20)	(22)	(24)	(29)
Preferred Dividends					
Special Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Preference Dividends (Australia)					
Net Profit	3,450	2,691	3,918	4,230	4,906

Operating Ratios

	Nov-14A	Nov-15A	Nov-16F	Nov-17F	Nov-18F
Premium Retention Ratio (life & Health)					
Benefits Ratio (life & Health)	(99.4%)	(98.5%)	(98.0%)	(97.5%)	(97.1%)
Acquisition Expense Ratio (life & Health)	0%	0%	0%	0%	0%
Admin Expense Ratio (life & Health)	0%	0%	0%	0%	0%
Total Expense Ratio (life & Health)	11.4%	10.9%	10.9%	11.0%	10.9%
Policyholder Dividends Ratio (life & Health)	0%	0%	0%	0%	0%
Combined Underwriting Ratio (life & Health)	(87.9%)	(87.6%)	(87.1%)	(86.5%)	(86.2%)
Underwriting Profit Margin (life & Health)	(10.8%)	(9.4%)	(8.9%)	(8.5%)	(8.0%)
Operating Profit Margin (life & Health)	20.3%	20.6%	21.6%	21.3%	22.3%

SOURCE: CIMB RESEARCH, COMPANY DATA

BY THE NUMBERS... cont'd

Balance Sheet

(US\$m)	Nov-14A	Nov-15A	Nov-16F	Nov-17F	Nov-18F
Fixed Assets					
Intangible Assets	0	0	0	0	0
Other Long Term Assets	168,989	169,758	187,658	205,386	224,851
Total Non-current Assets	168,989	169,758	187,658	205,386	224,851
Total Cash And Equivalents	0	0	0	0	0
Trade Debtors					
Other Current Assets	0	0	0	0	0
Total Current Assets	0	0	0	0	0
Creditors - Direct & Reinsurance Business					
Provision For Claims Outstanding	113,202	115,969	125,613	139,211	152,040
Other Current Liabilities	0	0	0	0	0
Total Current Liabilities	113,202	115,969	125,613	139,211	152,040
Total Long-term Debt	2,934	3,195	3,515	3,866	4,253
Hybrid Debt - Debt Component					
Other Liabilities	20,076	19,172	21,104	23,488	26,405
Total Non-current Liabilities	23,010	22,367	24,619	27,354	30,658
Total Technical & Other Provisions	0	0	0	0	0
Total Liabilities	136,212	138,336	150,231	166,565	182,698
Shareholders' Equity	32,467	31,119	37,066	38,447	41,747
Minority Interests	161	303	361	374	406
Total Equity	32,628	31,422	37,427	38,821	42,153
Life Embedded Value	37,153	38,198	41,997	44,317	48,644

Key Ratios

	Nov-14A	Nov-15A	Nov-16F	Nov-17F	Nov-18F
Net Premium Growth	8.6%	9.2%	6.5%	10.7%	12.1%
Operating Profit Growth (Life & Health)	13.7%	10.8%	11.6%	9.2%	17.3%
Value Of New Life Business Growth (after-tax)	23.8%	19.1%	26.8%	6.0%	19.0%
Life Embedded Value Growth	9.86%	2.81%	9.95%	5.52%	9.76%
Pre-tax Margin	23.5%	17.9%	23.3%	22.8%	23.6%
Net Profit Margin	20.0%	14.3%	19.6%	19.1%	19.7%
Effective Tax Rate	14.3%	19.5%	15.6%	15.8%	15.9%
Net Dividend Payout Ratio	NA	NA	NA	NA	NA
Return On Average Assets	2.19%	1.60%	2.21%	2.16%	2.29%
Net Gearing	8.29%	9.31%	8.66%	9.14%	9.24%
Financial Leverage	5.54	5.33	5.24	5.21	5.36
Equity / Assets	19.2%	18.3%	19.8%	18.7%	18.6%

Key Drivers

	Nov-14A	Nov-15A	Nov-16F	Nov-17F	Nov-18F
Industry gross premium grth (%)	N/A	N/A	N/A	N/A	N/A
Gross Premium Growth (%)	8.6	9.2	6.5	10.7	12.1
Gross Premium Mkt share (%)	N/A	N/A	N/A	N/A	N/A
Claims Ratio (%)	75.8	75.7	75.1	75.1	74.5
Net Commission Ratio (%)	8.7	8.4	8.4	8.5	8.4
Net Premium Market Share (%)	N/A	N/A	N/A	N/A	N/A
Management Expense Ratio (%)	N/A	N/A	N/A	N/A	N/A

SOURCE: CIMB RESEARCH, COMPANY DATA

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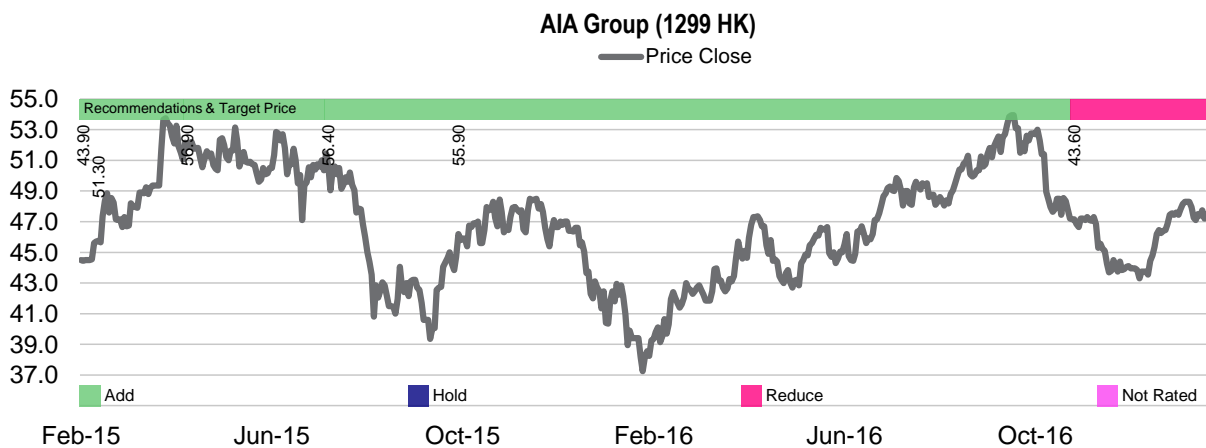
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Add	58.4%	5.4%
Hold	29.6%	1.4%
Reduce	11.6%	0.4%

Spitzer Chart for stock being researched (2 year data)



Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2016, Anti-Corruption 2016.

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