

Waterdrop

Shift priority from expansion to balanced growth

Reiterate Rating: BUY | PO: 8.75 USD | Price: 1.51 USD

Balanced growth in the transition time

Waterdrop reported a net loss of RMB1.7bn in 9M21, or RMB477mn in 3Q21, vs. losses at RMB655mn in 2Q21 and RMB139mn in 3Q20. Net operating loss of RMB513mn in 3Q21 improved from RMB815mn in 2Q21 due to the decline in expenses in line with previous company guidance and Waterdrop also guides that the expenses in 4Q21 will “materially reduce” from the 3Q21 level. The operating revenue was RMB779mn, down from RMB863mn in 3Q20 due mainly to the decline in insurance brokerage income, impacted by the new online insurance rules which were implemented in August.

Waterdrop previously focused more on expansion, mainly client acquisition, trying to outpace peers in client size. However, China’s crackdown on the whole internet sector this year and tightening rules on online insurance in August made expansion more difficult and less efficient. Therefore, we expect the management to maintain its new strategy of balanced growth, focusing on both growth and profitability.

We cut our 2021 adjusted net income by 49% due to higher than expected marketing expenses, but raise our 2022-23 adjusted net income by 3-17% due to strategy changes. We consequently cut our PO by 11% to USD8.75. Reiterate Buy as the valuation is undemanding at 0.8x 2022E P/Sales. The current price is a significant underestimate of the role that Waterdrop plays in insurance brokerage sector in China, in our view.

First Year Premium growth remained solid

Compared to the growth of sector health insurance premium at 5% YoY in 9M21, the FYP growth in Waterdrop remained solid at 38% YoY, though the growth decelerated in 3Q21 to zero YoY as the new rules impacted. With lower marketing expenses, the pace of client acquisition was also slower, down 14% YoY, while FYP per consumer rose by 17% YoY, potentially driven by better product mix. Take rate remained largely unchanged at 17% in 3Q21 and we expect that, as retention rates will rise under the new rules, the take rate will also rise in the following quarters.

Estimates (Dec) (CNY)	2019A	2020A	2021E	2022E	2023E
Net Income (Adjusted - mn)	(298)	(291)	(1,571)	(844)	(747)
EPS	(1.74)	(3.90)	(6.22)	(3.98)	(3.76)
EPS Change (YoY)	-98.1%	-124.7%	-59.4%	36.0%	5.5%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	(1.22)	(2.34)	(5.78)	(3.55)	(3.33)
Valuation (Dec)					
P/E	NM	NM	NM	NM	NM
Dividend Yield	0%	0%	0%	0%	0%
EV / EBITDA*	NM	NM	NM	NM	NM
Free Cash Flow Yield*	-10.62%	-21.93%	-59.99%	-36.79%	-34.50%

* For full definitions of *IQmethod*SM measures, see page 6.

30 November 2021

Equity

Key Changes	Previous	Current
(CNY)		
Price Obj.	US\$9.83	US\$8.75

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Stock Data

Price	1.51 USD
Price Objective	8.75 USD
Date Established	30-Nov-2021
Investment Opinion	C-1-9
52-Week Range	1.31 USD-11.77 USD
Mrkt Val / Shares Out (mn)	474 USD / 313.9
Average Daily Value (mn)	0.721 USD
Free Float	20.0%
BofA Ticker / Exchange	WDH / NYS
Bloomberg / Reuters	WDH US / WDH.N
ROE (2021E)	NA
Net Dbt to Eqty (Dec-2020A)	-41.61%

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Refer to important disclosures on page 7 to 9. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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iQprofileSM Waterdrop

Key Income Statement Data (Dec)	2019A	2020A	2021E	2022E	2023E
(CNY Millions)					
Sales	1,511	3,028	3,279	4,618	6,548
Gross Profit	1,511	3,028	3,279	4,618	6,548
Sell General & Admin Expense	(1,491)	(3,280)	(4,755)	(5,311)	(7,072)
Operating Profit	(194)	(496)	(1,804)	(1,108)	(1,048)
Net Interest & Other Income	16	(117)	39	45	54
Associates	NA	NA	NA	NA	NA
Pretax Income	(179)	(613)	(1,765)	(1,063)	(994)
Tax (expense) / Benefit	(143)	(50)	(50)	(50)	(50)
Net Income (Adjusted)	(298)	(291)	(1,571)	(844)	(747)
Average Fully Diluted Shares Outstanding	264	284	314	314	314

Key Cash Flow Statement Data

Net Income	(321)	(664)	(1,815)	(1,113)	(1,044)
Depreciation & Amortization	0	0	0	0	0
Change in Working Capital	NA	NA	NA	NA	NA
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	0	0	0	0	0
Cash Flow from Operations	(321)	(664)	(1,815)	(1,113)	(1,044)
Capital Expenditure	NA	NA	NA	NA	NA
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	NA	NA	NA	NA	NA
Shares Issue / (Repurchase)	NA	NA	NA	NA	NA
Cost of Dividends Paid	NA	NA	NA	NA	NA
Cash Flow from Financing	NA	NA	NA	NA	NA
Free Cash Flow	(321)	(664)	(1,815)	(1,113)	(1,044)
Net Debt	(1,294)	(1,323)	(1,403)	(1,554)	(1,648)
Change in Net Debt	NA	NA	NA	NA	NA

Key Balance Sheet Data

Property, Plant & Equipment	21	29	32	38	45
Other Non-Current Assets	73	144	166	206	246
Trade Receivables	252	540	702	912	1,095
Cash & Equivalents	1,294	1,323	1,403	1,554	1,648
Other Current Assets	915	2,670	3,362	4,477	5,202
Total Assets	2,556	4,705	5,664	7,187	8,236
Long-Term Debt	NA	NA	NA	NA	NA
Other Non-Current Liabilities	180	253	349	416	495
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	874	1,271	2,490	4,281	4,786
Total Liabilities	1,054	1,525	2,840	4,697	5,281
Total Equity	1,502	3,180	2,824	2,490	2,955
Total Equity & Liabilities	2,556	4,705	5,664	7,187	8,236

iQ^{method} SM - Bus Performance*

Return On Capital Employed	-14.4%	-3.4%	-41.7%	-23.9%	-20.3%
Return On Equity	NM	NM	NM	NM	NM
Operating Margin	-14.9%	-18.4%	-60.9%	-26.3%	-17.2%
EBITDA Margin	-11.3%	-4.1%	-47.5%	-18.2%	-11.5%

iQ^{method} SM - Quality of Earnings*

Cash Realization Ratio	NM	NM	NM	NM	NM
Asset Replacement Ratio	NA	NA	NA	NA	NA
Tax Rate (Reported)	NM	NM	NM	NM	NM
Net Debt-to-Equity Ratio	-86.2%	-41.6%	-49.7%	-62.4%	-55.8%
Interest Cover	NA	NA	NA	NA	NA

Key Metrics

* For full definitions of iQ^{method} SM measures, see page 6.

Company Sector

Insurance - Multi-line

Company Description

Waterdrop is the 2nd largest online insurance distribution platform in China. It distributes both short-term and long-term insurance products for insurers via its insurance marketplace. Waterdrop also owns Waterdrop Medical Crowdfunding, the largest online medical crowdfunding platform in China.

Investment Rationale

We have a Buy rating on Waterdrop. We believe the growth outlook of online insurance, especially health insurance in China is promising and Waterdrop is well positioned for future growth with clear strategy in diversified product mix, strong execution and improving profitability. We expect Waterdrop to gain market share over the long term from insurance brokers, online platforms, and traditional insurers with improving retention rates and margin.

Stock Data

Price to Book Value

NA





Price objective basis & risk

Waterdrop (WDH)

Our PO is at USD8.75 per ADR. We use P/Sales to value Waterdrop and to compare the valuation to its peers and similar companies in China and the U.S., mainly 1) online platform companies similar to Waterdrop's business model, focusing on distribution, 2) online healthcare and medical companies which provide health and medical services, targeting similar client groups like Waterdrop and 3) online insurers and distributors in the U.S.. The average P/S multiple of the comps is at 3.4x 2023E and the average topline growth in 2021-22E is at 41%.

Downside risks are 1) regulatory risks to limit the growth or cap commission rates, 2) competitors grow faster or cut prices to get market share, 3) faster than expected increase of client acquisition costs.

Upside risks are 1) stronger than expected premium growth, 2) retention rate improvement better than expected, 3) higher mix of organic traffic in client acquisition.

Analyst Certification

I, Michael Li, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.



Greater China - Financials Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Agricultural Bank of China	ACGBF	1288 HK	Winnie Wu
	Agricultural Bank Of China-A	XACNF	601288 CH	Winnie Wu
	AIA Group Limited	AAIGF	1299 HK	Michael Li
	Bank Of China	BACHF	3988 HK	Winnie Wu
	Bank Of China -A	BACZF	601988 CH	Winnie Wu
	Bank of Ningbo	XBINF	002142 CH	Emma Xu
	BOC Hong Kong Holdings Ltd	BNKHF	2388 HK	Winnie Wu
	Chailease	XCAHZ	5871 TT	Brooksley Kang
	China Construction Bank	CICHF	939 HK	Winnie Wu
	China Construction Bank -A	XCTBF	601939 CH	Winnie Wu
	China Everbright Bank	CEBCF	6818 HK	Winnie Wu
	China Galaxy Securities Co Ltd	CGXYF	6881 HK	Michael Li
	China International Capital Corporation	CNICF	3908 HK	Michael Li
	China Life Insurance	LFC	LFC US	Michael Li
	China Life Insurance	CILJF	2628 HK	Michael Li
	China Merchants Securities	XMRKF	600999 CH	Michael Li
	China Merchants Securities	XCJRF	6099 HK	Michael Li
	China Minsheng Banking Corp Ltd	CGMBF	1988 HK	Winnie Wu
	China Minsheng Banking Corp Ltd -A	CMAKF	600016 CH	Winnie Wu
	China Pacific Insurance Group	CHPXF	2601 HK	Michael Li
	China Pacific Insurance Group	XQJNF	601601 CH	Michael Li
	China Renaissance	CSCHF	1911 HK	Michael Li
	Chongqing Rural Commercial Bank	COGQF	3618 HK	Winnie Wu
	CITIC Limited	CTPCF	267 HK	Ronald Leung, CFA
	CITIC Securities	CIHF	6030 HK	Michael Li
	CTBC FHC	CTFHF	2891 TT	Brooksley Kang
	E.Sun FHC	ESUFF	2884 TT	Brooksley Kang
	Guotai Junan International	GUOTF	1788 HK	Michael Li
	Guotai Junan Securities	XGUOF	2611 HK	Michael Li
	Guotai Junan Securities-A	XOQOF	601211 CH	Michael Li
	Haitong International	HNGFF	665 HK	Michael Li
	Haitong Securities	HTNGF	6837 HK	Michael Li
	Haitong Securities -A	XHTSF	600837 CH	Michael Li
	HKEX	HKXCF	388 HK	Michael Li
	HSBC	XHSBF	5 HK	Alastair Ryan
	HSBC -A	HSBC	HSBC US	Alastair Ryan
	Huatai Securities	XHTLF	601688 CH	Michael Li
	Huatai Securities	HUATF	6886 HK	Michael Li
	Ind & Comm BK	IDCBF	1398 HK	Winnie Wu
	Ind & Comm BK -A	XIKNF	601398 CH	Winnie Wu
	Lufax Holding	LU	LU US	Winnie Wu
	New China Life	NWWCF	1336 HK	Michael Li
	Noah Holdings Limited	NOAH	NOAH US	Emma Xu
	Ping An Insurance	PIAIF	2318 HK	Michael Li
	Ping An Insurance	XPSPF	601318 CH	Michael Li
	PSBC	PSBKF	1658 HK	Winnie Wu
	StanChart	XCHBF	2888 HK	Alastair Ryan
	Waterdrop	WDH	WDH US	Michael Li
	ZhongAn Online P&C Insurance	ZZHGF	6060 HK	Michael Li
NEUTRAL				
	Cathay FHC	XCIF	2882 TT	Brooksley Kang
	CITIC Securities -A	CIISF	600030 CH	Michael Li
	Fubon FHC	FUISF	2881 TT	Brooksley Kang
	GF Securities	GFSEZ	1776 HK	Michael Li
	GF Securities	XMPQF	000776 CH	Michael Li
	Mega FHC	MGFNF	2886 TT	Brooksley Kang
	Ping An Bank	XPABY	000001 CH	Emma Xu
	Shin Kong FHC	SKFHF	2888 TT	Brooksley Kang
UNDERPERFORM				
	Bank of Comm	BKCF	3328 HK	Winnie Wu
	Bank Of Communications Co-A	XNCTF	601328 CH	Winnie Wu
	Bank of E Asia	BKEAF	23 HK	Winnie Wu
	Bank of E Asia-A	BKEAY	BKEAY US	Winnie Wu



Greater China - Financials Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	China Cinda Asset Management	CCGDF	1359 HK	Michael Li
	China CITIC Bk	CHBJF	998 HK	Winnie Wu
	China CITIC Bk -A	CHCKF	601998 CH	Winnie Wu
	China Everbright Bank	XCBLF	601818 CH	Winnie Wu
	China Galaxy Securities Co Ltd	XCXYF	601881 CH	Michael Li
	China Industrial Bank Co. Ltd.	INBLF	601166 CH	Winnie Wu
	China Life Insurance	XCNNF	601628 CH	Michael Li
	China MERCH BK	CIHMF	3968 HK	Winnie Wu
	China MERCH BK -A	CIHKF	600036 CH	Winnie Wu
	China Securities Corp	XCUEF	6066 HK	Michael Li
	China Securities Corp	XCSIF	601066 CH	Michael Li
	Everbright Securities	XEBCF	601788 CH	Michael Li
	Everbright Securities	XELEF	6178 HK	Michael Li
	Futu Holdings	FUTU	FUTU US	Emma Xu
	Hang Seng Bk	HSNGF	11 HK	Winnie Wu
	Hang Seng Bk - A	HSNGY	HSNGY US	Winnie Wu
	New China Life	XNWCF	601336 CH	Michael Li
	Orient Securities	XOBNF	600958 CH	Michael Li
	Orient Securities	XONQF	3958 HK	Michael Li
	Shanghai Pudong Dev Bank	SHVPF	600000 CH	Winnie Wu

RVW

	China Huarong Asset Management	CHUAF	2799 HK	Michael Li
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iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Return On Equity

Net Income

Amortization

Operating Margin

Operating Profit

Shareholders' Equity

Earnings Growth

Expected 5 Year CAGR From Latest Actual

Sales

Free Cash Flow

Cash Flow From Operations – Total Capex

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Cash Flow From Operations

Denominator

Net Income

Asset Replacement Ratio

Capex

Depreciation

Tax Rate

Tax Charge

Pre-Tax Income

Net Debt-To-Equity Ratio

Net Debt = Total Debt – Cash & Equivalents

Total Equity

Interest Cover

EBIT

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Current Share Price

Denominator

Diluted Earnings Per Share (Basis As Specified)

Price / Book Value

Current Share Price

Shareholders' Equity / Current Basic Shares

Dividend Yield

Annualised Declared Cash Dividend

Current Share Price

Free Cash Flow Yield

Cash Flow From Operations – Total Capex

Market Cap = Current Share Price × Current Basic Shares

Enterprise Value / Sales

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Sales

Other LT Liabilities

EV / EBITDA

Enterprise Value

Basic EBIT + Depreciation + Amortization

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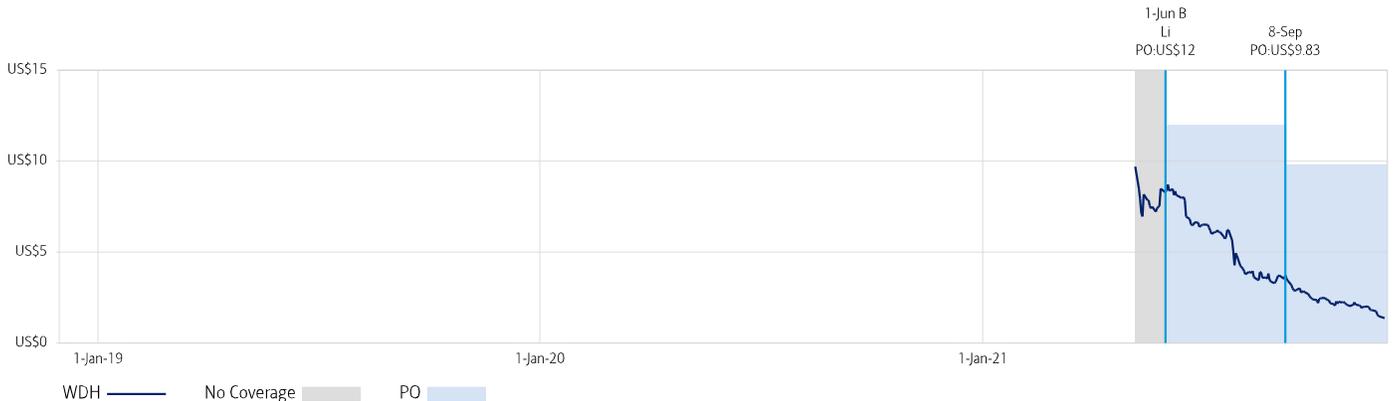
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Waterdrop (WDH) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Financial Services Group (as of 30 Sep 2021)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	138	61.61%	Buy	96	69.57%
Hold	46	20.54%	Hold	30	65.22%
Sell	40	17.86%	Sell	24	60.00%

Equity Investment Rating Distribution: Global Group (as of 30 Sep 2021)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1973	59.66%	Buy	1254	63.56%
Hold	665	20.11%	Hold	404	60.75%
Sell	669	20.23%	Sell	343	51.27%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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