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Q4 2016 Fanhua Inc Earnings Call

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Chunlin Wang *Fanhua Inc - CEO*

Peng Ge *Fanjua Inc - CFO*

Yinan Hu *Fanjua Inc - Chairman*

CONFERENCE CALL PARTICIPANTS

Yuan Xue *CICC - Analyst*

Ryan Roberts *MCM Partners - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by for Fanhua's fourth quarter and fiscal year 2016 earnings conference call. (Operator Instructions) After the Management's prepared remarks, there will be a question-and-answer session.

Please follow the instructions given at that time if you would like to ask a question.

For your information, this conference is now being broadcasted live over the Internet. A webcast replay will be available within three hours after the conference is finished. Please visit Fanhua's IR website at ir.Fanhuaholdings.com under the Events & Webcasts section. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the meeting over to your host for today's conference, Ms. Oasis Qiu, Fanhua's Investor Relations Officer.

Oasis Qiu *Fanhua Inc - IR Officer*

Our fourth quarter 2016 earnings conference call. The earnings results were released earlier today, and are available on our IR website, as well as on Newswire.

Before we continue, please note that the discussion today will contain forward-looking statements made under the Safe Harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. The accuracy of these statements may be impacted by a number of business risks and uncertainties that could cause our actual results to differ materially from those projected or anticipated. Such risks and uncertainties include but are not limited to those outlined in our filings with the SEC, including our registration statement on Form 20-F.

We do not undertake any obligation to update this forward-looking information, except as required under applicable law.

Joining us today are our Chief Executive Officer, Mr. Chunlin Wang, Chairman, Mr. Yinan Hu, and Chief Financial Officer, Mr. Peng Ge. Mr. Wang will walk you through our financial results in the fourth quarter and fiscal year 2016, and then the Management and the Board chairman will take your questions after the prepared remarks.

Now, I will turn the call over to Mr. Wang.

Chunlin Wang *Fanhua Inc - CEO*

(interpreted) Good morning and welcome to join us in our fourth quarter and fiscal year 2016 earnings results. I will give you an update of our financial and operational results and Mr. Yinan Hu and Mr. Peng Ge and I will take your questions at the end of the report.

Firstly, I will give you an overview of our overall financial performance in the fourth quarter and fiscal year 2106. In 2016, China's insurance market recorded the highest growth rate in eight years with total insurance premiums growing by 27.5% year-on-year to RMB3.1 trillion. The P&C and life insurance sectors grew 9.1% and 36.5% respectively.

2016 was also a fruitful year for Fanhua. Total insurance premiums generated by the Company reached RMB14.6 billion, up 49.7%



year-on-year and our net revenues were RMB4.7 billion, up 66.2% year-on-year, which once again, significantly beat our prior guidance. The exceptional results bear a solid testament to the successful execution of our growth strategy.

One of the major highlights of the 2016 full year results was optimized business mix, life insurance business as a percentage of total revenues improved from 11.3% in 2015 to 21.1% in 2016, as a result of a 209.6% year-on-year growth to RMB990.5 million in total net revenues derived from our life insurance segment.

The results were attributable to both an explosive growth of 307.95% year-on-year in new policy sales to over RMB1.0 billion in 2016 and a 27.1% growth of renewal insurance premiums to RMB928.5 million in 2016.

13 month persistency ratio improved significantly from 85.8% same period last year to 91.2% by the end of 2016, which is comparable to the average level of the top tier life insurance companies in China and the best among our peers in the insurance intermediary sector.

The rapidly growing life insurance business has become a major source of revenue and profit for the Company.

P&C business was still the biggest revenue contributor accounting for 71.8% of our total net revenues in 2016. Net revenues derived from P&C insurance business grew 53.0% to RMB3.4 billion in 2016. Of which, net revenues from P&C agency insurance segment and insurance focused segment grew 52.2% and 67.3% respectively. In terms of insurance premium, P&C insurance business grew 43.4% from a year ago, outpacing the industry growth of 9.1%.

At the beginning of this year, we set our target of achieving over RMB1 billion annual operating profit within the next eight years. We have expected to invest up to RMB500 million in marketing activities and as a result, we might have operating loss in 2016 and 2017 and breakeven in 2018 before getting on track to high profit growth in 2019.

However, the operating results went far better than we have previously anticipated. We spend approximately RMB420 million on marketing programs in 2016 and generated RMB14 million operating profit, two years ahead of expectations. We recorded operating loss in the first quarter of 2016, then the loss was narrowed down in the second quarter of 2016, and turn into profit in the third quarter of 2016.

Then the operating profit increased sequentially to RMB34.7 million in the fourth quarter of 2016. The performance in the past four quarters pointed to a trend towards a sustainable profit growth going forward.

The better than expected performance in 2016 was led by two major reasons, number one, the exceptional growth of our life insurance business and number two, discontinue benefits of the adoption of CNpad and our organizational restructuring.

Despite rapid business expansions, the increase of operating expenses was much lower than business growth. If excluding marketing expenses, our operating expense ratio has been on a decline for several quarters in a row in 2016.

Year 2016 marked the beginning of our 8-year plan. Bearing a goal of achieving our RMB1 billion operating income within 8 years, we actively carried out a series of strategic measures in 2016 such as extending our sales and service network coverage, expanding our sales force, and promoting the wider adoption of mobile transaction app. We are glad that this app for us, yielded noticeable results.

Firstly, in order to further expand our sales volume and grab more market share, we set out to establish our presence in several new markets in 2016. During the year, we expanded our sales network to 21 provinces from 17 provinces in 2015. We have five new branches at a provincial level in Anhui, Guangxi, Yunnan, Inner Mongolia provinces, and Qingdao respectively, and 334 more sales outlets. We believe these new branches and outlets will bring more vitality to the company.

Secondly, we made steady progress in sales force expansion. To achieve our 8-year goal, sales force development is the key. In 2016, by leveraging on our unique entrepreneurship program, diversified product offerings and leading online platforms together with our flexible marketing strategies, we stepped up efforts to attract top entrepreneurial team leaders and individual sales agents to join Fanhua.

As a result, the number of our sales agents has almost doubled in 2016 as compared to 2015, which we believe would serve as the backbone for a fast and sustainable development of our P&C and life insurance business in the future.

Thirdly, we witnessed the wider adoption of our mobile transaction app. By the end of last September, we have successfully concluded the transition of our CNpad app to version 2.0 nationwide, with improved user experience and functionalities, CNpad app has become a powerful tool to help agents manage their business more efficiently.

It also plays an important role in attracting more agents to Fanhua. By the end of 2016, more than 212,000 copies of CNpad have been downloaded, representing an increase of 93.4% year-over-year. CNpad app contributed 39.3% of the insurance premium of our auto insurance business compared to 37% in the previous quarter and over 90% of our new term life insurance policies were transacted through CNpad app.

Looking back to the financial results of the last four quarters, we can see that the adoption of the CNpad app has significantly helped improve our back office operational efficiency as reflected by continuous decline in adjusted operating expense ratio.

For 2017, we will focus on improving and strengthening the profitability of the Company by further expanding our life insurance business. We are confident that the Company will continue to maintain strong growth momentum and achieve high profit growth beginning from 2017, we expect to achieve no less than RMB180 million operating income in 2017.

Earlier this morning, we announced the Board resolution regarding the adoption of a dividend policy. We have a track record of positive earnings and accumulated over RMB2 billion net profit in the past 10 years, since the IPO in 2007.

We have maintained a strong cash position but our Management have been very cautious in spending the cash in the past few years and the caution was partially due to our lack of visibility in the operation of our online initiative in the past few years.

However, the 2016 financial results proved the effectiveness of our marketing campaign and our growth strategy and those will strengthen our confidence in the Company's profitability forecast.

Based on this, the Management believes that it is the proper time to share the operating results with our shareholders and therefore, proposed to the Board to reward our shareholders in the form of cash dividend. We will remain committed to consistently bringing sustainable solid returns to our shareholders going forward.

Thank you.

Now, the Management and chairman will open the floor for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question today comes from the line of Yuan Xue from CICC.

Please ask your question.

Yuan Xue CICC - Analyst

(Spoken in Chinese).

Oasis Qiu *Fanhua Inc - IR Officer*

The questions were from CICC and he has three questions. The first question is regarding the suspension of business cooperation between PICC, P&C and Fanhua. Can the Management give a little bit more explanation on that and what is the reason for the suspension of business cooperation?

And is CNinsure the only insurance intermediary that PICC has suspended cooperation so far, and CNinsure's -- does the Company expect that the cooperation with other insurance companies can make up the difference?

And also, what is the impact on the Company's agency and currency adjustment business?

Yinan Hu *Fanjua Inc - Chairman*

(interpreted) It is a quite sudden notice. Our subsidiaries were verbally notified by the local branches of PICC P&C in the afternoon of last Thursday. And so far, we haven't received any formal written notifications from PICC P&C and so we don't really know for sure, the actual reasons behind the suspension of business cooperation.

The only reason that we got was actually from the explanation provided by the local branches of PICC when they gave us verbal notice that it was -- it may be caused by some internal investigations -- ongoing internal investigations in PICC P&C. As for whether any other insurance intermediaries were also given the same notice of the suspension of business cooperation, we don't know for that. We don't -- we haven't really seen any signs or received any notification from other insurance companies about their intention to stop cooperation with us.

So we are still conducting our normal business operations and continue the business cooperation with other insurance companies as usual.

And after the notifications from -- after receiving the notice from PICC P&C, we have responded quickly. And we have evaluated the impact and also made plans to direct the business previously derived from PICC P&C to other insurance companies and as well as strengthen our strategic cooperation with our existing -- with our other existing business partners.

So far, we had business cooperation with PICC P&C on three areas, including the insurance brokerage business the insurance agency business which mainly include the auto insurance business and then thirdly, the claims adjustment business.

In terms of the insurance brokerage business, the disruption of business cooperation may have more direct impact on the revenues on our insurance agency -- or sorry, on the insurance brokerage business.

And then for the claims adjustment business, the disruption in business may have impact on both revenue and also profits. And for the agency business, we think that there won't be any big impact. Basically the impact will be quite limited, because the auto insurance market is quite competitive, so it's easy to get alternative product providers. And actually, as a matter of fact, after the notice that we received from PICC, other insurance companies have basically offered more -- stronger support and also better terms to us in order to cooperate with us.

And then in terms of the overall impact, we do expect that the revenue may decrease in 2017 as a result, but the impact on the profit will be limited, because, first of all, on the P&C insurance business, we already started to subsidize auto insurance business in 2016, so the profits derived from this part of business was already quite small.

And then for the claims adjustment business, as we mentioned, there may be impact on both revenue and profits, but because claims adjustment business only accounted for 7% of our total revenues as of the end of 2016, and PICC contributed approximately 14% of our total claims adjustment revenues, so the impact on the revenue should be quite small. And the impact on the profit side will also be quite small as well.

In 2015, we have undertaken a strategy which is to focus more resources on the development of life insurance business by basically subsidizing P&C business in order to gather agents to generate more cross-selling opportunities for life insurance -- for the development of life insurance business.

And so far, life insurance business is the major profit contributor for the Company, and we're going to continue this strategy in 2017. And after thorough evaluation, we will maintain our original profit guidance. We still believe that we can achieve the profit goal that we set previously.

Yuan Xue CICC - Analyst

Okay. Thank you. (Spoken in Chinese)

Oasis Qiu Fanhua Inc - IR Officer

Sorry. The second question is regarding our life insurance agency's growth momentum going forward. As he observed, there has been a drop in the sales of universal life insurance products, while the gross premiums for the more traditional life insurance products have been -- recorded a very strong growth. Do you see any increase in demand from life insurance - life insurance companies to sell more traditional long-term protection type of products through CNinsure -- through Fanhua?

Chunlin Wang Fanhua Inc - CEO

(interpreted). Starting from the second half of last year, the CIRC has been focused quite a lot, has been emphasized quite a lot about that insurance industry should return to its basic function of offering protection to the society. So the CRRC issued some kind of restriction, some rules that restricted the sales of banking products, and they -- it also required the bank channels should sell more longer-term health insurance products and traditional life insurance products.

So we can see that the insurance company -- the life insurance company started to attach more importance to the sales of traditional life insurance products. And we also see more life insurance companies to approach the company to have a more in depth corporations for the sales of this type of product.

And insurance companies are also more willing to invest more to promote the sales of long term life insurance products and health insurance products. And that's also one of the major reasons that drove the strong growth of gross insurance premium. Thank you.

Yuan Xue CICC - Analyst

(Spoken in Chinese)

Oasis Qiu Fanhua Inc - IR Officer

The third question is regarding our dividend announcement. He asked that it is actually the first time that Company announced, ever announced, a dividend policy. Can the market expect -- can expect a more regular dividend payment going forward?

And then, our CFO would like to make added comments on your previous question.

Oasis Qiu Fanhua Inc - IR Officer

Well, our CFO Mr. Ge would like to answer your last question first.

Peng Ge Fanhua Inc - CFO

(interpreted) Well, the Management has been thinking quite a lot about what's the proper way to return to shareholders, and we have also noticed that our stock price haven't been performing very strongly, and so we are thinking, what's the better way to enhance shareholder returns? However, in the previous years, the Company has been exploring our growth strategies, and as Mr. Wang mentioned just now, we haven't seen a lot of certainty or visibility on our online strategy. So that's why we've been very cautious to make any decision.

However, after we reported the 2016 results, we -- the Management feels more confident about growth prospects already. And also we feel more confident about our profitability outlook, as well as our future cash flow outlook going forward. So that's why the Management proposed to the Board that probably we should have a dividend policy to return, to give better returns to our shareholders. And the proposal was well-supported by the Board at the -- in the Board meeting at the end of February.



And this dividend announcement is not a one-off thing. It's going to be a regular dividend policy. We hope that we can continue to maintain an annual dividend payment going forward.

Oasis Qiu Fanhua Inc - IR Officer

Mr. Wang wants to add a few comments on your second question regarding growth of life insurance business momentum.

Chunlin Wang Fanhua Inc - CEO

(interpreted) The Management has full confidence that in 2017 the life insurance business will double in terms of sales volume. And in view of that, we also have confidence that our operating income will grow by over 50% in the next three years on a compound growth basis. Thank you.

Yuan Xue CICC - Analyst

(Spoken in Chinese)

Operator

Our next question today comes from the line of Ryan Roberts from MCM. Please ask your question.

Ryan Roberts MCM Partners - Analyst

Good morning and thank you for taking my question. My question was actually on the margins for the year. I see that you reiterated and saw that the future guidance for operating profit is pretty strong for the full year. I was just curious if that reflects any increase in margin versus 2016 at the operating level.

Oasis Qiu Fanhua Inc - IR Officer

(Spoken in Chinese)

Chunlin Wang Fanhua Inc - CEO

(interpreted). That's right observation. And as we expect life insurance business will increase in terms of percentage of our total revenues, the gross margin will improve as a result of that.

And secondly, we also expect the operating expense ratio will continue to go down going forward, and that will also improve our overall margins.

And we expect our gross margin will be maintained at around 25% and net margin at 5% in 2017. That's the average margin level for overall business.

Ryan Roberts MCM Partners - Analyst

Right. If I could ask a quick follow-up on that. So in terms of the original thought process in terms of 2016 to increase selling and marketing expenses, so, I guess, what changed? And going forward, how should we look at that expense line? Obviously, it ramped up significantly in 2016, but it sounds like that's going to come back quite a bit in 2017. I'm wondering if you can give us some color on that.

Oasis Qiu Fanhua Inc - IR Officer

(Spoken in Chinese)

Chunlin Wang Fanhua Inc - CEO

(interpreted). We made a huge investment on marketing activities in 2016, and that's one of the major reasons for the increase in selling expenses. And the investment in marketing expenses has helped drive -- driven the Company's growth quite a lot, especially the strong growth from life insurance business, at over 100% in 2016. So we can see that this marketing strategy has been quite effective and we're going to continue in this kind of investment.

But because it will become a regular investment, we will probably do it in a different way and it will become -- may increase commission

payout to promote the P&C sales in order to generate more cross-selling opportunities for our life insurance business. So as a result of that, our -- the gross margins on our P&C side may decline, but as we mentioned, the life insurance business will increase in terms of percentage of our total revenues, it will help boost the gross margins overall.

Ryan Roberts *MCM Partners - Analyst*

Got you. Thank you. That's very helpful. And congratulations on the solid end to the year.

Oasis Qiu *Fanhua Inc - IR Officer*

Thanks.

Operator

(Operator Instructions).

There are no further questions on the line today. I would now like to hand the conference back to Management. Please continue.

Oasis Qiu *Fanhua Inc - IR Officer*

Thank you for joining us on today's conference call. If you have any further questions, please feel free to contact. Thank you.

Operator

Ladies and gentlemen, that concludes our conference for today. We thank you all for your participation. You may now disconnect.

Editor

Portions of this transcript that are marked (interpreted) were spoken by an interpreter present on the live call. The interpreter was provided by the Company sponsoring this Event.

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