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CISG - Q2 2012 CNinsure Inc Earnings Conference Call

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CORPORATE PARTICIPANTS

Oasis Qiu *CNinsure Inc - IR*

Chunlin Wang *CNinsure Inc - CEO*

Peng Ge *CNinsure Inc - CFO*

PRESENTATION

Operator

Thank you for standing by for CNinsure's 2012 Q2 earnings conference call.

(Operator instructions)

After the management 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 call is now being broadcast live over the internet. Webcast replay will be available within one hour after the conference is finished. Please visit www.cninsure.net, under the investor relations section. Today's conference is being recorded. If you have any objection you may disconnect at this time. I would now like to turn the meeting over to your host for today's conference, Miss Oasis Qiu, CNinsure Investor Relations officer.

Oasis Qiu - *CNinsure Inc - IR*

Welcome to our second quarter and first half 2012 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 legislation of the US 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 are and uncertainties include but are not limited to, those outlined in our filings with the SEC, including our registration statement on (inaudible). We do not undertake any obligation to update this forward-looking information except as required under applicable law.

Joining us today is our Chief Executive Officer Mr. Chunlin Wang and Chief Financial Officer Mr. Peng Ge. They will walk you through our second quarter and first half of 2012 financial and operating results and discuss the progress of our strategy to transition. They will take your questions after the prepared remarks. Now I will turn the call over to Mr. Wang

(Spoken in Chinese)

Chunlin Wang - *CNinsure Inc - CEO*

(Interpreted) Dear shareholders, investors, analysts, good morning. Thank you for joining us on today's conference call. Mr. Peng Ge and I will begin today's call with a review of our second quarter and first half of 2012 financial and operating performance followed by an update on the progress of our strategy of transition, then we will go into the Q&A session.

The global and domestic macroeconomic situations were increasingly challenging in the first half of 2012. China's GDP growth for this year is expected to be below 8% reaching an eight year low. Against this backdrop the growth slowdown for China's insurance industry continued into the first half of 2012 with a single digit year on growth of 5.9% in terms of total premiums. P&C insurance sector grew 14.4% from the first half of 2011 but the market competition among insurers [were getting intensified] that insurers had to increase incentives and (inaudible) marketing campaigns which eroded some of the underwriting profits. Life insurance sector on the other hand only grew 0.23% year on year in terms of premiums in the first half of 2012 as insurers continued to face difficulties in agent recruitment and retention, declining productivity and weak insurance sales.



Impacted by the macroeconomic situation and structural changes of China's insurance industry, our total net revenue was up 3.3% year on year in the second quarter of 2012. Cost increases however outpaced the revenue growth due to the challenging operating environment. As a result our net income attributable to the Company's shareholders for the second quarter of 2012 was down 67.2% and non-GAAP net income attributable to the Company's shareholders, which included share-based compensation expenses, was down 34.3% year over year.

Looking at our three major business lines, the net revenues of our P&C insurance segment witnessed a marginal decrease of 0.6% year on year, primarily due to increased market competition as insurance companies strengthened their investment in direct sales and telemarketing. Despite, insurance companies have been increasing commissions paid to the direct sales channel, but we also need to increase commission's payout to our sales agents, benchmarking the market level which further squeezed the profit out of labor-driven sales model and reduced the gross margins of our P&C insurance segment.

On the life insurance side, impacted by the weak performance in the life insurance industry, our sales of new policies recorded a negative growth, but the total net revenue derive from life insurance business was up nearly 9% from the year ago quarter, primarily driven by the increase in the sales of short term house insurance and recurring commissions derived from regular premium insurance policies. The current premiums recorded a strong growth of 22.5% year on year for the second quarter of 2012. (inaudible) was relatively stable with net revenues up 7.9% from the year ago quarter although its gross margin witnessed a slight decrease.

Behind the second quarter (inaudible) rapid growth of the Chinese insurance market, starting from 2011 its inherent efficiency and its [expensive/expansive] development model and industry is in a critical period of structural changes. In the meantime the regulatory body continued its effort to push the insurance industry to develop in a sustainable and healthy way. Recently the CIRC issued a series of rules and regulations that allows insurance companies to broaden their investment scope and continuously encourage product and service innovation in an effort to drive insurance companies to strengthen their core competencies in asset management and product design.

We believe such regulatory approaches to accelerate further division of labor in the insurance industry. The CIRC also adopted various measures to insure the professional insurance intermediary are strong enough to shoulder the responsibilities during the industry's structural changes, such as raising the entry barrier for professional insurance intermediaries, restricting the license issuing to [then deal the] insurance intermediary, then encourage them to either establish professional intermediary companies of their own or cooperate with existing ones. The CIRC also continued to push forward with some of the insurance sales agent marketing system and strengthen that first to (inaudible) into professional insurance intermediary sector, which we believe all this effort will bring a strong upside, growth opportunities for large professional insurance intermediaries.

For CNinsure, (inaudible) can cause increased and sluggish flows of new life insurance policy sales in the past two quarters, again demonstrating that the growth model that CNinsure relied on in the past decade, which featured rapid expansion, low value-added and quantity accumulation is shaky against a backdrop of economic structural transformation in China and the ongoing reform of the development model in the Chinese insurance industry. But we are glad that we have foreseen the changes and made the right decision that in the second half of this year to proactively initiate a strategy transaction of the Company towards e-commerce and higher value-added business in order to optimize the profit models of our various business units and strengthen the Company's long term competitive (inaudible).

During the second quarter of 2012 we stayed focused on the transition and making progress in the foreign areas, especially on the e-commerce side. We have completed the system development of the mobile South Asian business support system, which is a B to B module of our e-commerce platform and continuously improve the back office operation. This is (inaudible) data connection, product uploading and interface experience of the system. We are currently in the process of an integration pattern and in fact have launched a system terminal --

(Spoken in Chinese)

-- or what we call palm tablets in September.

Secondly, as part of our new life insurance strategy, which has shifted towards being more urban areas focused and more efforts to develop a lead sales team and provide comprehensive initial services, we have completed drafting and promoting the studio mechanism in major cities and started to sell wealth management products through our established life insurance sales network so as to tap into the mid and higher end markets.



On the sales team expansion front, we continued promoting the multi licensed agent system amongst our existing sales agent force in order to improve top performance contents in diversified financial services.

In the meantime we sped up efforts to attract new highly productive South Asians to join CNinsure by offering them better back room support, diversified product offerings and important revenue sources.

Although the transition may continue to weigh upon us in the near to medium term, but we believe the initiatives will help the Company build a healthier organization structure and a more vigorous profit model and more compelling platforms and prepare the Company [vote] for the burgeoning opportunities arising from awakening demand for asset protection and wealth management services from the expanding middle class in China as China shifts towards a more domestic demand driven economy. We expect our top line and bottom line to trend to the rapid growth path in 2014.

Thank you and now we'll turn the call over to our CFO Mr. Peng Ge for the financial results.

Peng Ge - CNinsure Inc - CFO

I'm pleased to report the result for the second quarter of 2012. Numbers I will refer to will be in RMB unless otherwise indicated. Total net revenue for the second quarter of 2012 were RMB409.9 million, up 2.3% from the year ago quarter. Total operating costs and expenses for the second quarter of 2012 were RMB392.1 million, up 32.1% from the year ago quarter. Commissions and fees expenses for the second quarter of 2012 were RMB266.3 million, up 29.8% from the year ago quarter. Selling expenses for the second quarter of 2012 were RMB21 million, up 8.9% from the year ago quarter from the year ago quarter. General and administrative expenses for the second quarter of 2012 were RMB104.8 million, 24.7% (sic - see press release page 2 "44.7%") from the year ago quarter.

As a result of the foregoing factors, income from operations for the second quarter of 2012 was RMB17.8 million, down 82.8% from the year ago quarter. Non-GAAP operating income, which excludes share-based compensation expenses, was RMB54.5 million for the second quarter of 2012, down 50% from the year ago quarter. Interest income for the second quarter of 2012 was RMB22.5 million (sic - see press release page 2 "RMB2.1 million"), up 71% from the year ago quarter. Effective income tax rate was 33.8% for second quarter 2012, compared to 19.5% for the year ago quarter. Net income attributable to the Company's shareholders was RMB32.8 million for the second quarter of 2012, decreasing 67.2% from the year ago quarter.

Net margin was 8% for the second quarter of 2012, compared to 25% for the year ago quarter. Excluding share-based compensation expenses, non-GAAP net income attributable to the Company's shareholders was RMB69.5 million for the second quarter of 2012, decreasing 34.2% from the year ago quarter. Non-GAAP net margin was 17% for the second quarter of 2012 compared to 26.3% for the year ago quarter. Basic and diluted net income per ADS was RMB0.66 and RMB0.65 respectively for the second quarter of 2012, down 67.3% and 66.6% from RMB2.00 and RMB1.96 respectively for the year ago quarter. Non-GAAP adjusted basic and fully diluted net income per ADS, which excluded share-based compensation expenses, was RMB1.39 and RMB1.38 respectively for the second quarter of 2012, representing decreases of 34.2% and 33% from RMB2.11 and RMB2.07 for the year ago quarter. From 30th June 2012 the Company had RMB2.5 billion in cash and cash equivalents.

CNinsure expected total net revenue to remain approximately flat for the third quarter of 2012, compared to the corresponding in 2011. This forecast reflects CNinsure's current and preliminary view which is subject to change.

Now (inaudible) Mr. Wang and (inaudible) from Mr. Ge, we'll open the floor for you questions.

QUESTIONS AND ANSWERS

Operator

We'll now begin our question and answer session.



(Operator instructions) The first question is [Jeff Sin] from the [Investor Corp] please go ahead.

Unidentified Participant

(Interpreted) The question is from Jeff Sin and his question is related to our compensation expenses for this quarter which has increased significantly, and we mention that the reason for the increase is due to some adjustments with the recognition measures. We would like you to elaborate a little bit more on this. And then he also asked about what will be the compensation expenses level for the coming quarters?

Unidentified Company Representative

(Interpreted) We issued a stock option early this year and the total amount of the cost has been evaluated by an independent appraisal and approved by our auditor, and the total amount of the share based compensation expenses has not changed. And previously we amortized these expenses evenly on a quarter basis.

However, because we adopted a new incentive program which allowed some of us South Asians to participate in the stock option program and the vesting of their options is tied to their portfolio and auditors think that we should adopt a more conservative way to recognize the expenses.

So, for this quarter, we adopted an accelerated amortization method to recognize the expenses which resulted in an increase of share based compensation expenses in the second quarter. But for the current quarter, the share based compensation expenses will be back to the normal level which is approximately RMB12 million quarterly.

Thank you.

(Operator instructions)

Operator

The next question is [Jason] from Invesco. Please go ahead.

Unidentified Participant

(Interpreted) The second question is regarding our cash and how much of the cash is interest bearing and how CNinsure invests that amount of cash. Is it in the form of deposit in the bank or any other investment?

Unidentified Company Representative

(Interpreted) The cash on -- we have a centralized management of the cash by the Group and most of the cash right now is put in the bank in the form of CD or short term deposit and we also will put some of it into short term investment with a little bit higher interest, little bit higher returns which is allowed by the regulations and with minimum risk.

Unidentified Participant

Yes, thank you.

(Operator instructions)

Operator

The next question is Jason from Invesco. Please go ahead.

Unidentified Participant

(Spoken in Chinese) (Interpreted) And the question is for CEO, Mr. Wang, and the first question is regarding, we notice that the commission revenue ratio has increased significantly in the second quarter and we mentioned that the reason is because the increase in labor cost and the changes in the operating environment as well as the impact on the direct sales. We wonder how direct, if there is any pressure to intermediaries and whether this situation will continue or will it improve in the medium term.

And then the second question is regarding that we mentioned that our top line and bottom line go back to a [record growth] in 2014 and what is the drivers for the growth and what is the growth rate will be like.

Chunlin Wang - CNinsure Inc - CEO

(Interpreted) First of all, I would like to tell about the channels, the sales channels in the Chinese insurance market. First of all is the direct sales of the insurance companies which compose of the channel marketing and the entire sales agents of insurance companies. Then the second channel is intermediaries, including professional intermediaries and ancillary intermediaries.

Right now, the ancillary insurance intermediaries is the largest channel and the direct sales the second largest channel while the professional insurance intermediaries only account for 5% to 6% of the market shares in China right now.

So any changes happening in the policies related to the direct sales channel and the ancillary intermediary channel will have very strong inference on the professional insurance intermediaries.

The current situation is that for the past one to two years, P&C Insurance Company has been making a lot of profits and they are comfortable and they are competing for more market shares and one direct way for them to do that is to raise the commission, including the commissions paid out to ancillary insurance intermediaries and also to their sales agents. So if CNinsure, we don't increase our commission payout to our sales agents we will lose the market share.

Also, because of the high CPI level and the increase of the living costs of South Asians and also South Asians have higher requirements for their quality of life in the future, there are asking us to pay more commissions in order to cover that. Otherwise, the current commission level will not be attractive enough for them to stay in the industry.

As for looking forward, we don't really think that this cost of compensation will be sustainable because we are already seeing P&C Insurance Company's profitability weakening. If they continue this (inaudible) competition by paying out more commissions, they will start to make loss again. So the only way for them to maintain their market shares is to improve their service, product and also the brand recognition. We are already seeing insurance companies paying more and more attention to this area as well. So we believe that the situation will start to improve next year.

We are already seeing that, Jason, last year so that is why we decided to push forward the strategy transition in 2011 and that is because we've seen that (inaudible) competition will not be sustainable not only for insurance companies, but the insured. It's not sustainable for CNinsure to keep paying more commission now to keep them. So we have seen that the way to help the South Asians to make more money is to improve their efficiency, reduce their operating cost and help them to assets to more diversify (inaudible).

And in terms of -- we've also done a lot of things to improve the -- service and products. For the service, we would like to combine our (inaudible) order service company with our (inaudible) adjusting (inaudible) to establish a service platform and then we also would like to provide the South Asians with (inaudible) the palm tablet or the South Asian business support systems to help them to do business more easily.



And as for the life insurance, we are (inaudible) our life insurance business (inaudible) was [Puyi] Wealth Management Company and credit brokers company in order to introduce more diversified part of this offering to our [South Asians].

So all these initiatives are proceeding pretty well, as we expect. So that's why we think we should be able to get back to the rapid growth chart in 2014 and, hopefully, we will get another double digit growth in 2014. And we are confident that the double digit growth will continue at least for three to five years after 2014. Thanks.

(Operator instructions)

Operator

The next question is Jason from Invesco. Please go ahead.

Unidentified Participant

(Interpreted) The next question from Jason is another topic. CNinsure has a lot of cash and the stock price is pretty low right now.

Despite some e-commerce, what else is CNinsure going to do to make good use of the cash? And then the privatization deal was restored last year. Is CNinsure going to reconsider the possibility, given that there are a lot of Chinese companies have been doing their privatization deal and CNinsure has a lot of cash in the accounting system, that CNinsure is capable of doing such a kind of transaction?

Chunlin Wang - CNinsure Inc - CEO

We feel kind of lucky that we have so much cash in hand right now because if you look at the current situation in the insurance market and the financial services industry, it is actually a golden age for a company like CNinsure to grow bigger. So we really need an adequate cash reserve in hand to take advantage of those opportunities.

As we mentioned, we don't use a lot in the e-commerce and right now we mainly focus on building the B2B model, but we believe for the B2B market it will become mature in the next couple of years and when that comes, that will require a lot of cash to fund the marketing campaign.

Then we also need a lot of cash to make sure that the (inaudible) and looking at the capital market right now, given the current situations, we don't really think that a share buyback will be long lasting to push up our stock prices. So we kind of think we need to reserve more cash to support our business development.

Then as for privatization, after the restore of the last privatization deals, the management would like to focus all our energy on the business operation and the company growth. But having said that, if there is a right opportunity, if there is a good opportunity and our strategy transition goes well we will not rule out the possibility to consider that.

Unidentified Participant

(Interpreted) The last question is that, CNinsure issued a stock option at the stock price of USD6 back in March. If the market situation continues and CNinsure doesn't do any share buyback or dividend characterization and the stock option tips underwater, does the option actually lose incentive functions, how does the management think about that?



Chunlin Wang - *CNinsure Inc - CEO*

Because the management and keepers now of the company, we are quite confident about the business operation of CNinsure so we do believe that our stock price will have upside room and the current stock price doesn't really concern us very much and we didn't see a high turnover because employees losing faith in the outlook of the company. But having said that, we will consider various possibilities including increasing the cash compensation to employees.

Operator

Thank you for your participation in CNinsure conference. There will be a webcast replay within an hour. Please visit CNinsure IR website at www.cninsure.net under the investor relations section.

Thank you all for attending. You may now disconnect. Good-bye.

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