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FANH - Q3 2017 Fanhua Inc Earnings Call

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NOVEMBER 21, 2017 / 1:00AM, FANH - Q3 2017 Fanhua Inc Earnings Call

CORPORATE PARTICIPANTS

Chunlin Wang *Fanhua Inc. - Chairman & CEO*

Shirong Qiu *Fanhua Inc. - IR Manager*

CONFERENCE CALL PARTICIPANTS

Howie Xia

Myung Wook Kim *JP Morgan Chase & Co, Research Division - VP*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by for Fanhua's Third Quarter 2017 Earnings Conference Call. (Operator Instructions) For your information, this conference call is now being broadcasted live over the Internet. Webcast replay will be available within 3 hours after the conference is finished. Please visit Fanhua's IR website at ir.fanhua.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.

Shirong Qiu - *Fanhua Inc. - IR Manager*

Good morning. Welcome to our third quarter 2017 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 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 and Chairman, Mr. Chunlin Wang; and Chief Financial Officer, Mr. Peng Ge. Mr. Wang will walk you through our financial results in the third quarter 2017. He and Mr. Ge will then take your questions after the prepared remarks.

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

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Thank you for joining us on today's conference call. Here with me, we have our Chief Financial Officer, Mr. Peng Ge. We will begin today's call with a review of our third quarter 2017 financial and operational performance, followed by a brief discussion about business outlook. Then we will have a Q&A session after the report.



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Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

In the third quarter of 2017, we recorded RMB 1.1 billion in net revenues, among which life insurance revenues with RMB 730.5 million, representing a year-on-year growth of 177.5%.

Operating income beat our expectations, were RMB 83.2 million, increasing by 10x from a year ago. Our total operating income for the first 3 quarters of 2017 was RMB 217.6 million, which means that we have completed and exceeded our annual targets of RMB 180 million in operating income, far ahead of our schedule.

In the third quarter, our net income attributable to the company's shareholders was RMB 112.3 million, up 249.8% year-on-year.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Now let's look at the performance of each of our major business segments. Firstly, life insurance business. In May 2017, CIRC Issue No. 134 notice, prohibiting the sales of universal life insurance or unit linked insurance products as rider policies and the payment of survival benefits on endowment and annuity insurance products in the first 5 years, while the annual payable amount is capped at no more than 20% of the contributed premiums. This regulation, which came into effect on October 1, 2017, was one of the major catalysts behind the explosive growth in the sales of our annuity life insurance products in September, during which the first year premium on life insurance business reached RMB 570 million, up 380% from a year ago, which is the highest single month new policy sales ever recorded by the company.

In the third quarter, first year premiums of life insurance business reached RMB 850 million, up 197.5% year-on-year. 13-month persistency ratio was 93.6%, which ranked us among the best performers in the industry. As a result, our renewal premiums doubled year-on-year to RMB 470 million in the third quarter of 2017.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Secondly, the P&C business. The revenue of P&C insurance in the third quarter dropped by 67.5% from a year ago, primarily due to our decision to cut low-margin channel business, which we believe didn't contribute much to our core competitiveness, and instead only retained retail P&C business, which is beneficial to the development of life insurance business as we previously announced in the second quarter 2017.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

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Shirong Qiu - Fanhua Inc. - IR Manager

We are glad that our P&C insurance segment has completed a transition towards the platform model. From the fourth quarter onwards, we will continue to provide best services to our sales agents and customers under the new model. We believe that this transition will not only enable us to continue to meet our customers' demand for wider range of products but also allowed us to focus our resources on expanding life insurance business and be prepared in capturing new growth opportunities in the P&C insurance sector in the near future.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

Our 4 major online platforms have maintained steady and fast growth in the third quarter of 2017, among which CNpad App. The number of registered users as of September 30, 2017, reached 330,000. Active users in the third quarter were nearly 100,000, a year-on-year growth of 19 -- sorry, 91.9%. Transaction volume in terms of insurance premiums on the platform has recorded RMB 1.4 billion, increasing by 39% from a year ago.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

Baoxian.com, as of September 30, 2017, number of registered users has amounted to 1.3 million. Active users in the third quarter were over 70,000. Transaction volume through the platform has exceeded RMB 110 million for the third quarter, with a year-on-year increase of 492.3%. Most importantly, the platform has been making profits for the last 3 quarters.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

And thirdly, eHuzhu. Over 3 years of operation, eHuzhu has become the largest online mutual aid platform in the industry in terms of number of valid claims. As of September 30, 2017, the number of registered users has doubled compared to the corresponding period of 2016, reaching to 2.2 million. More than 535 valid claims were processed on the platform, with the amount of contribution in total of more than 87 million.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

And fourthly Chetong.net, which is the China's first sharing economic-based online platform for insurance survey and claims adjustment services. As of September 30, 2017, number of registered users has reached 32,000, with more than 1.2 million orders processed since its inception.

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Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

The third quarter 2017 was a special quarter for us. 10 years ago, on October 31, 2007, Fanhua went public on the NASDAQ global market as the first Asian insurance broker ever listed on the main board of any stock exchange. Since then, we have entered into another rapid development cycle and made outstanding accomplishments.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Over the last decade, our revenues have increased by almost 10x, accelerating from RMB 120 million in the third quarter of 2007 to RMB 1.1 billion in the third quarter of this year.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Over the last decade, we have built up a sales team which is on a par with that of most insurance companies. 10 years ago, our sales network cover only 8 provinces, consisting of 171 sales outlets and 11,000 agents. Today, our network covers 29 provinces with 1,053 sales outlets, 410,000 sales agents, 1,300 claims adjusters. As compared with 1,200 employees 10 years ago, we now employ over 4,000 staff, among which 200 mid- and senior-level managers have been with us for over 8 years on average.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Over the last decade, we have continuously broaden our product offerings and optimized our business mix. Diversified financial product offering has become a part of our core competitiveness, with large-scale and large sales network as well as industry-leading business quality, we've built trust with our business partners and becomes the choice for many insurance companies when it comes to insurance distribution.

Our insurance business partners have increased from 45 10 years ago the 90 today. 70% of the corporation are strategic partnerships on headquarters-to-headquarter basis. Revenue structure has also undergone great change. 10 years ago, our revenue was generated from life and P&C insurance business, with the former accounting for 10% only, and the latter, 90%. Today, we have 3 mature business lines: life insurance, P&C insurance and claims adjusting. Revenue of life insurance business, which is of higher embedded value, make up 7 -- 67.6% of our total revenues, becoming the cornerstone of our revenues and profit.



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Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Over the last decade, we have strongly emphasized and continuously invested in technology, which places us in a leading position in the industry when it comes to Internet application.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Our core business system is not only efficient and effective but also substantially enhanced with management by standardizing operation and the management procedures. The CNpad App, Baoxian.com, eHuzhu and (inaudible) Internet project that we have adapted and established since 2010 are taking the leading -- taken a leading position in each of their respective niche markets. Transaction volume of auto insurance on CNpad is likely to achieve nearly RMB 3 billion in 2017 and nearly all life insurance new business are conducted via CNpad. Baoxian.com, an online platform for standardized products such as accident and health insurance, is expected to maintain strong, profitable growth as the transaction volume is expected to grow over RMB 500 million in 2017. Chetong.net is looking at a year-on-year growth of over 55% in terms of the number of claims processed via their platform in 2017 and a possible breakeven in 2018.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Luckily, we did not get lost in the Internet fever like other companies, investing huge amounts of money for nothing. In fact, we empower our off-line sales and service network with Internet technology to elevate sales and service quality and efficiency so as to provide customers with supreme experience. We believe that an online plus-offline development model is the trend for insurance intermediary companies, and we are leading the trend.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Over the last decade, we have stayed ahead of the market trend to capture business opportunities and optimize our development model to cope with changing market environment. We believe that it is our innovative and revolutionary spirit that enables us to keep solidifying our leading position in China's insurance intermediary market since our listing 10 years ago.



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Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Foreign sequential growth of operating income for the last 4 quarters are an indication of our 10 years IPO anniversary. Operating income in the third quarter of 2017 recorded RMB 83.2 million, increasing by more than 10x from a year ago. Net income attributable to the company's shareholders reached RMB 112 million, with a year-on-year growth of 250%. The results have well proved the success of our growth strategies and testify that we are on track to a sustainable, profitable growth. In light of this, on September 18, 2017, our Board of Directors adopted a regular quarterly dividend policy and on November 19, 2017, declared a quarterly dividend of USD 0.01 per ordinary share, which represents 75.3% of the company's net income attributable to shareholders for the third quarter 2017. The dividend will be payable on or around December 22, 2017, to shareholders of record on December 10, 2017. We have face to continue to bring shareholders with decent returns going forward.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

The fourth quarter of each year is usually the time when life insurance companies and distribution channels will focus on preparation for the jump start sales at the beginning of next year. In lieu of this, together with the implementation of No. 134 notice, which may lead to many hot sales life insurance products taken off shelves across the industry, we expect the growth of our life insurance business may slightly slow down quarter-over-quarter. However, we're still confident that our operating income in the fourth quarter will be no less than RMB 60 million. Thank you.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Now the management will open the floor for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from the line of [Xu Yuan] from CICC.

Unidentified Analyst

(foreign language)



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Shirong Qiu - *Fanhua Inc. - IR Manager*

And he has 2 questions, the first question is regarding our P&C business. How we are progressing with regard to our transition towards the P&C platform model and what achievements we have made so far in this regard. And the second question is regard to our sales force. Right now, we have about 410,000 sales agents. what's our plan to improve the productivity and the retention ratio for agents going forward? And whether or not we will continue to grow the number of sales agents in the next 3 years.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

So far, we have been making smooth progress with regard to the transition towards the platform model in the third quarter. We haven't experienced any internal conflicts with regard to this transition. And then secondly, we have also spin-off our P&C subsidiaries by selling the shares to Cheche Network, which is a company that operates an auto insurance platform.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

And secondly, with regard to our sales force, we believe that division of labor in the industry will be a trend going forward. And the independent insurance intermediaries will see a migration of sales agents from insurance companies to the independent insurance intermediaries sector. We are still confident to achieve our annual target to grow the number of our sales agents to 500,000 by the end of this year and to further grow the number to 1 million by the end of 2019. And also, we believe that it takes time to accumulate a sales force and to solidify the sales force. We will definitely enhance training and also improve our cultural development to our sales agents in order to optimize their productivity.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Thank you.

Operator

Our next question today comes from the line of M.W. Kim from JPMorgan.

Myung Wook Kim - *JP Morgan Chase & Co, Research Division - VP*

My name is M.W. from JPMorgan. So first of all, thank you for the strong quarterly earnings reporting, which is far above the company's RMB 50 million of the operating income guidance last quarter. So I have 2 questions. My first question is about your earnings outlook. So as management mentioned, although there was a prepaid demand in the industry, the Q3 digit shows the company's revenue and earnings structure has potentially



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changed to the life insurance brokerage model from the nonlife brokerage business. So we think that the China household life insurance consumption will structure the growth trend, and it is very early stage of the journey. In the next couple of years, if China's life insurance industry is growing in a healthy way with a 5% of insurance penetration growth by 2020. So how does it impact on the life insurance brokerage industry and company's revenue and earnings structure? My -- the second question is about the commission structure. So I believe that China is in early stage of insurance market development compared to the other North Asian countries. It should mean that so far, the regulator has not been highly focusing on the customer protection or the adequate life loading margin structure. Starting from this year, we see the favorable document by CIRC for controlling the product margin and insurers lease management practice. So current companies had very strong earnings growth momentum perhaps achievable under the assumption that current industry commission structure remains pretty stable. So my question is should we confirm potential the industry commission structure change in the next couple of quarters following the life protection or the health insurance market development?

Shirong Qiu - Fanhua Inc. - IR Manager

(foreign language)

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

The first question with regard to the revenue and profit structures. We believe that life insurance business is a more valuable business for insurance intermediaries, which enabled us to generate more stable revenues and recurring revenues and profits. So we will continue to focus on expanding our life insurance business. And secondly, we also believe that online and offline is a better model for the development of independent insurance intermediaries. And looking forward, we believe that starting from the fourth quarter, 90% of our revenues will come from life insurance business and more than 90% of profit will come from life insurance business.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

And the second question, we believe, that all the mature insurance market has well-developed insurance intermediaries. Only with the development of insurance intermediaries can the industry maintain a healthy and rapid development. So we believe that the CIRC will encourage the development of insurance intermediaries going forward. as for the commission levels that paid by insurance companies, small and medium-sized company has actually paid more than 150% to 200% to acquire new business if they distribute through their own channels, which is much higher than the distribution cost that they pay to independent insurance intermediaries. While the larger insurance company, their acquisition cost for new business is roughly 100%, which is slightly lower than that through the insurance intermediaries. But we believe that with the further development of independent intermediaries and also with the intensified market competition, that situation may change over time. So therefore, we don't believe that the commissions paid by insurance companies to independent insurance intermediaries will go lower. However, with the competition getting more intensified, we do believe that the margin might be squeezed slightly over time. Thank you.

Operator

Our next question today comes from the line of Howie Xia from BeaconLight Capital.



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Howie Xia

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

There are 2 questions. First of all, as regard to the number of sales agents. In the past 4 to 5 quarters, our agents increase by 40,000 to 50,000 each quarter -- or quarter-over-quarter. However, in the third quarter, our agents increased by 85,000 compared to the last quarter, which is a big increase compared to the previous quarters. So what has changed in the overall market that has driven this rapid growth? And the second question is with regard to -- so right now, we have 410,000 sales agents. How many of them produce policies or produce life insurance business each month?

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

It is true that since we started implementing our 1 million sales agent plan 1 to 2 years ago, number of our sales agents has been growing quite rapidly. And our subsidiaries, all of them, have to bear a target, which is part of their KPI to achieve certain number of agents. And the reason that the increase in the number of sales agent's faster than the previous quarter, it has something to do with the normal practice across the industry. Usually in July and August, most of the insurance companies or insurance distributors will focus on recruiting sales agents rather than just simply focusing on growing new business. So that's the major reason.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

We are targeting at achieving an active ratio of 50% in terms of agents, defined by the ratio of agents who produce auto insurance business or life insurance business or accidental or health insurance business and even recommend new members to join into the eHuzhu. And then among the total numbers, 10% of the agents will be those who sell life insurance policies each quarter. Right now, we have 16% of agents who cross sell both auto and life insurance products.

Chunlin Wang - *Fanhua Inc. - Chairman & CEO*

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Thank you.

Operator

There are no further questions on the line today. I will now like to hand the conference back to management for closing remarks.



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Shirong Qiu - *Fanhua Inc. - IR Manager*

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

Operator

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

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