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CISG - Q3 2013 CNinsure Inc Earnings Conference Call

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Peng Ge *CNinsure Inc - CFO*

CONFERENCE CALL PARTICIPANTS

Mike Ryan *MJR Capital - Analyst*

Steve Riccio *Landmark Capital - Analyst*

PRESENTATION

Operator

Thank you for standing by CNinsure's Third Quarter 2013 Earnings Conference Call. At this time all participants are in listen only mode. All lines have been placed on mute to prevent background noise. 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 call is now being broadcasted live over the internet. Webcast replay will be available within three hours after the conference is finished. Please visit CNinsure's IR website at ir.cninsure.net under the events and webcast 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, CNinsure's Investor Relations Officer.

Oasis Qiu - CNinsure Inc. - Investor Relations Officer

Good morning everyone. Welcome to our Third Quarter 2013 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 those 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 forward-looking statements 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 financial and operating performance in the third quarter of 2013 and take your questions after the prepared remarks. Now I will turn the call over to Mr. Wang.

Chunlin Wang - CNinsure Inc - CEO

(interpreted) Hello everyone. Thank you for joining us on the call. On today's agenda our CFO, Mr. Peng Ge, and I will discuss the operational and financial highlights for the third quarter 2013 and share with you our business outlook. We will take your questions after that.

China's insurance industry grew 10.0% year-over-year in total gross premiums in the third quarter of 2013, with limited signs for a notable recovery in the near term. While P&C insurance market maintained strong growth momentum with premiums up 15.7% from the year ago quarter fierce competition in auto insurance sector continued into the third quarter. Life insurance market remained in a re-growth territory with a 4.5% year-over-year growth in premiums in spite of some improvements in price.

Our total net revenues for the third quarter reached RMB430 million, up 6.9% from the year ago quarter exceeding our previous guidance of 5%. Gross margins saw a slight decrease year-over-year but began picking up sequentially. Though operating income recorded a slight decline from the year ago quarter the magnitude of the decline has narrowed significantly as compared to the last six quarters. Bottom line reported a strong



growth of 26% reversing the downward trend in the past two years. The results show signs that we are on track to deliver sequential improvements in both top line and bottom line.

Now looking at our three major business lines let's start with our P&C insurance business. Driven by sales volume growth and a slight increase in commission rates, our P&C business [ensured] stable revenue growth of 9.3% year-over-year in the third quarter of which brokerage business grew 126.8% representing really strong growth momentum. We were also excited to see a rebound in our P&C gross margins both year-over-year and quarter-over-quarter mainly attributable to a restraint on the commission payout ratio in our P&C business as compared to the second quarter.

Our life insurance business reported a decline of 8.9% in net revenues year-over-year but the decline was at a much slower pace as compared to the previous quarter and it was mainly caused by our shifted sales focus from participating policies to traditional long term protection policies starting from the second quarter of this year given the weakened competitiveness of participation products under current market conditions.

Traditional long term protection products contain high end added value but generally have lower policy premiums. As a result we saw a drop in our new business premiums. However, the number of new policies sold during the quarter was holding up year-on-year. Recurring premiums reported a strong growth of 14.5% year-over-year sequentially, owing to our above-average 30-month consistency ratio of over 80% as a result of our attentive auto sales management.

(Inaudible) business continued stable growth long term into the third quarter with net revenues up 11.5% year-over-year mainly driven by the rapid growth of auto related business.

On our new initiatives [growth] we are encouraged to see significant progress in expanding the application of mobile technology during the third quarter of 2013. As of today we have completed preparation for a nationwide launch of auto insurance [supported by CNpad] in all our subsidiaries and have started massive promotion in our subsidiaries in eight provinces. As of the end of the third quarter a total of 2200 units of CNpad were sold, generating RMB19 million premiums in aggregate. In the meantime, we have completed extension of module design for CNpad with access to a wider range of products such as P&C insurance, life insurance, wealth management products, private equity fund and mutual fund products.

In general testing and China operations for the new model will be conducted in the first quarter and we expect to launch the model by the end of the first quarter of 2014. We believe with access to [manifold] product offerings CNpad will become a new comparative tool for agents. We intend to enhance efforts to promote the adoption of CNpad during the fourth quarter in order to strive to achieve the annual sales target of 5000 units by year end.

We started to add wealth management products in our product portfolio early last year so as to address and meet higher end customers' need for asset appreciation in addition to insurance protection. At the end of the third quarter we have accumulated 2390 wealth management clients including 400 new clients in the third quarter. A total of RMB670 million worth of wealth management products were sold as a result of our agent referrals in the last nine months.

During the third quarter we devoted a lot of effort to push for the restructuring of our sales system across the Company and we are glad that we have completed the task as of today. CNinsure's sales and service group Company has started operation as scheduled, after we changed from the P&C insurance business unit, the life insurance business unit and the eCommerce business unit into three business divisions under the Group Company and merged the public functional departments of the three former business units at a Group level.

The former life insurance business unit head office also moved the entire office from Beijing to Guangzhou. At a subsidiary level we have also achieved smooth transition when we combined P&C and life insurance subsidiaries in some regions. We are really relieved to see that almost none of the key personnel have left the Company as a result of the restructuring and all the personnel involved are appointed to positions that better suit each other's qualifications and capability. We believe those efforts are instrumental in helping the Management and operational efficiency across the Company from top to bottom and will lay a sound foundation for executing our strategy. We expect the benefits of restructuring will be gradually realized over the next quarters.

Despite all the challenges we are proud to maintain our dominant leadership in the Chinese insurance intermediary sectors, as partially evidenced by two awards that we recently received. We were named the Insurance Agency of the Year and Innovative Insurance Service Provider, which was the second time in the past two years that we have been awarded those two prizes, demonstrating the continued high recognition of our brand and service quality by our insurance company [colleagues] agents and our funds.

The accomplishment of our strategy application and the recognition by our insurance colleagues, agents and clients reaffirms our confidence in our future growth outlook. We believe that as we continue to execute our strategy, we are well poised for a stable growth of both bottom line and top line within the next few quarters, with in-house leading positions in the Chinese insurance intermediary and financial services markets.

Thank you. Now I will turn the call over to our CFO, Mr. Peng Ge.

Peng Ge - CNinsure Inc - CFO

(interpreted) Thanks, Mr. Wang. I'm pleased to report our financial results for the third quarter 2013. The numbers I will refer to will be in RMB unless otherwise indicated. Total net revenues for the third quarter 2013 were RMB430.6 million, up 6.9% from the year ago quarter. Total operating costs and expenses for the third quarter 2013 were RMB428.8 million, up 7.2% from the year ago quarter. Commissions and fees expenses for the third quarter 2013 were RMB317.3 million, up 7.8% from the year ago quarter. Selling expenses for the third quarter 2013 were RMB27.3 million, up 40.6% from the year ago quarter. General and administrative expenses for the third quarter 2013 were RMB84.2 million, down 2.6% from the year ago quarter. The decrease for the third quarter 2013 was primarily due to a decrease in share based compensation expenses.

As a result of the foregoing factors, operating income for the third quarter 2013 was RMB1.8 million, down 39.1% from the year ago quarter. Operating margin was 0.4% for the third quarter of 2013 compared to 0.7% from the year ago quarter. Interest income for the third quarter 2013 was RMB20.7 million, down 18.2% from the year ago quarter.

Income tax expenses for the third quarter 2013 was RMB4.7 million, down 62.8% from the year ago quarter. Net income attributable to the Company's shareholders was RMB29 million for the first quarter 2013, up 26% from the year ago quarter. Basic and diluted net income per ADS was RMB0.58 for third quarter 2013, up 26.5% and 26.6% respectively from the year ago quarter.

Adjusted EBITDA was RMB28 million for the third quarter of 2013, down 10.2% from the year ago quarter. Adjusted EBITDA margin was 6.5% for the third quarter of 2013, compared to 7.7% for the year ago quarter.

As of September 30, 2013, the Company had RMB2.3 billion in cash and cash-equivalents. CNinsure expects its total net revenues to grow by approximately 5% for the fourth quarter of 2013 compared to the corresponding period of 2012. This forecast reflects CNinsure's current view which is subject to change. Thank you. We're ready to take questions.

Operator

Fine thank you. We will now begin the question and answer session. (Operator instructions). All right thank you, our first question comes from the line of [Arthur Hall] from [Hall Co Incorporated]. Please go ahead.

Unidentified Participant

Yes, congratulations on winning the insurance industry awards again, I think that's very commendable. I'm trying to understand the increase in productivity from the CNpad, and I see that you have about 2200 units and about 50,000 agents, so about 4% or so of your agents have the pad, and yet it seems like that accommodated about 29% of your revenues from the P&C sector, if I understood that right. You said you've made RMB90 million out of about RMB320 million in total P&C revenues. Could you explain a little bit more how those numbers are figured and what the increase in productivity is for an agent that has the CNpad? Thank you.



Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) CNpad was put into full operation starting at the end of first quarter and early second quarter, and then we started to roll out the CNpad and the system gradually in our subsidiaries. We have done it in a gradual process and we haven't really done it any massive rollout because we still think that technology and also the system operation, there's still room for improvement in both technology and operations.

And I would like to close by the RMB90 million from contributed by CNpad in growing premiums instead of operating -- instead of our revenue. And then (inaudible) and we [don't] sell 2200 units of CNpad in the past nine months. But I would like to emphasize that most of the sales happened in September and some of them may not start to contribute [opinions] yet so it doesn't, it's not really make sense to calculate the per unit productivity based on this number.

We have made a major breakthrough in the design for CNpads. Previously we only had a CNpad that supported the sales of ordinary insurance, but now we have already completed the design for a CNpad that enables the sale of some boat insurance products and simple -- some simple life insurance products and we believe that this will make -- increase the attractiveness of CNpad to our agents and we have started rolling out that new CNpad in Shandong and we expect to complete -- expect to roll it out nation-wide by the end of this year. And we are encouraged that -- and this is not, I mean this, this accomplishment is not made easily. Actually we have make a lot of innovations and overcome a lot of difficulties during this process. And I would like to clarify again, the RMB90 million is the total premiums in the past nine months and in terms of the percentage of the contribution from CNpad in the third quarter, it accounts for about 2% to 3% of total net revenues in the third quarter.

So right now the average per unit productivity is about 40,000 per month, and we actually expect that figure to decline over time in the next few months as we -- as we establish the sales. Because it takes time for the CNpad to fully make its contribution and but we believe that after one year's time, the per unit productivity should increase. Our current focus is to sell CNpad to our sales agents, but starting from second quarter next year our focus will be shifted towards activating the new -- I mean to make sure our agents may still use our CNpads. Thank you.

Unidentified Participant

All right, thank you.

Operator

Thank you, and our next question comes from the line of Mike Ryan of MJR Capital. Please go ahead.

Mike Ryan - *MJR Capital - Analyst*

Thanks for taking my question. I have two. One is just a follow up to the last question, and then a question of my own. Did I catch you right, did you say that the CNpad is, productivity is \$40,000 of premium per month?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted). Yes, \$40,000 premium per month, per CNpad.

Mike Ryan - *MJR Capital - Analyst*

Right, so that would be for three months about \$262 million? So that means that a fair amount of the units that got rolled out got rolled out towards the end of the quarter?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted). Could you say the number again?

Mike Ryan - *MJR Capital - Analyst*

Yeah, so if it's \$40,000 in premium per unit per month, \$40,000 times 2190 units for three months is about \$263 million. So given you only did \$90 million in premium, does that mean that most of the units got rolled out towards the end of the quarter?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) Actually we sell 1200 units CNpads in September in one month. The calculation of 40,000 units per unit productivity is actually for CNpad that have been in operation for two months. Right now about 50% of the 2200 units CNpad are in actively use, so there's a difference between the total sales number and the number that are in active use.

Mike Ryan - *MJR Capital - Analyst*

Great, thank you. My question was around income from affiliates. It is now a more material number to the earnings of CNinsure and I was wondering if you could give us some more detail on what is in income from affiliates. I assume that, you know, equity method accounting for the consumer finance business, the research and wealth management business and the asset management business. Are there any other businesses in there?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) The income from affiliates mainly comes from the equity -- the Company that we own about 20% equity interest. So we will record a portion of their net income as our investment income.

Mike Ryan - *MJR Capital - Analyst*

Right, and given that CFSG is now a material portion of your income, can you give us revenues and income from CFSG for the last, you know, four quarters?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) Based on the accounting principles, since we only own about 20% equity interest in this company we cannot really consolidate their revenues in our P&L and we can only recognize the investment income from their contribution. But if you're interested, they have an official website, I think you can take a look at their website for more information. But because they are not public company yet, probably most of the information available from this website operational related, and operational related.

Mike Ryan - *MJR Capital - Analyst*

Just for clarification, I'm not questioning at all the accounting for it and, you know, I understand that you're not consolidating it because of the accounting rules associated with that. I just was wondering if you could provide us the revenue and income given that it's now a material part of earnings so we could get a better sense as to how the business has been performing, how revenues have been growing and how profits have been growing.

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) What this Company is primarily engaged in, the offering of micro-loans, asset management services, and retail investment banking services and their profit is expected to be around RMB100 million for this year and the annual growth rate in the past few years has been attained at around 30% to 50%. As for whether it's necessary for us to disclose any additional details about this Company, we will have a discussion with our auditor and our legal counsel to evaluate the possibility.

Mike Ryan - *MJR Capital - Analyst*

Okay, and we still currently own only 20% of CFSG; and is there any plan to increase that ownership?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) It's our wish to increase our shareholding in that company but I think we need to talk about this with their shareholders and the management to see whether the opportunity has opened up.

Mike Ryan - *MJR Capital - Analyst*

Okay. I would appreciate any more color you can give us on future calls on CFSG. That would be great and maybe as well if you could just send me the website address so that I can look at it. Last call and then I'll jump off and let somebody else jump in. We invested in the research, wealth management, asset management business a couple of years ago now and it was nice to hear that that business is moving along. I was wondering instead of assets that were structured or -- in the quarter if you could give us revenues and profits from it and how it's growing?

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) Do you mean the other company?

Mike Ryan - *MJR Capital - Analyst*

Yes, the five -- what was it called -- it's the joint venture with Puyi Investment. It was Fanhua Puyi Investment Management.

Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) We have about 19.8% equity interest in that company and their business model is kind of similar to (inaudible) but due to their short operating history, they have been in operations for only like one and a half years, their net profit has been kind of flattish year-over-year but the asset under management had grown very strongly. Last year the asset under management, their asset under management was about RMB600 million on [base] but this year they said they can achieve RMB1 billion.

Thank you. Hello?

Operator

Great, thank you. Our next question comes from the line of Steve [Riccio] from Landmark Capital. Please go ahead.



Steve Riccio - Landmark Capital - Analyst

Hi, I apologize in advance because I'm new to your story. I'm just looking over your balance sheet and I'm sure you've probably got questioned on this many times in the past but I'm trying to understand why you've had a persistently high cash balance, especially considering that it appears that your tangible book value is above your current stock price on a per share basis. So could you just walk me through the reasoning for the high cash level?

Chunlin Wang - CNinsure Inc - CEO

(interpreted) Historically CNinsure has very strong cash generation capacity. In the past few years, basically our cash inflow was equal to the net income of the Company. So over the past few years we have accumulated a lot of cash and then starting from 2010 the Chinese insurance industry has slowed down quite a lot and also given the uncertainty in the Chinese economic outlook we have started to hold a more conservative attitude towards the use of cash and we have basically stopped the previous expansion model, i.e., to expand our sales network through acquisitions. And we want to make sure that we have enough cash in hand to prepare for the future uncertainties.

Then additionally, CNinsure is transitioning ourselves from an insurance broker into a fully [hunted] financial service provider and in order to do that actually we need to invest a lot of capital, make a lot of additional capital investments, but we believe that this investment should be very important to boost CNinsure's growth for the next few years, next five years.

Steve Riccio - Landmark Capital - Analyst

Okay, I understand -- obviously every company wants to have a very strong balance sheet but could you just give me a sense as to what you think your actual sort of safety cash level will be say two or three years from now because I'm looking at this and I see a balance sheet that seems to be over-capitalized and I understand you obviously want to have a lot of cash to execute your strategic plan. But it seems to me that now would be maybe a good time to put some of that cash to use and return it to the shareholders in the form of preferably maybe a share buyback or maybe even some dividends at some point.

Chunlin Wang - CNinsure Inc - CEO

(interpreted) Well, for the capital expenditure we have actually made our plans. In addition to the investment opportunity that we mentioned just now we also need to invest a lot of money to buy back our minority interest of our affiliate, and also we need to invest in CNpad as well as our B2C website to make sure that we can take full advantage of the current market opportunities to establish our leadership in this area. And also we want to, as I mentioned just now, it's our wish to increase our shareholding in CFSG and also Puyi Investment, so we want to make sure that we have enough cash in place.

We also want to make some investments in terms of our brand recognition.

Steve Riccio - Landmark Capital - Analyst

That all makes a lot of sense but as you said in the beginning of your answer, your business generates a lot of cash annually, right, so your cash continues to build. It just seems to me that with your, I guess current stock price and your current market capitalization which is below the net cash value of the business on your balance sheet that at some point it would be a good opportunity for you guys to buy back some shares. The fact that your business has traded for a long period of time now at or below net cash levels means, at least to me, that some investors don't understand your plans for the cash on your balance sheet. So I would encourage you to provide more details, specific details, on your use of that cash going forward.



Chunlin Wang - *CNinsure Inc - CEO*

(interpreted) We care a lot about our shareholders' interests. We have announced a share buyback and executed a share buyback program last year and we will also carefully consider the proposition of another share buyback and also we will consider making more details -- disclose more details about our plans in using the capital.

Steve Riccio - *Landmark Capital - Analyst*

Okay, thank you very much.

Operator

Great, thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you for participating, you may all disconnect.

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