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FANH - Q4 2017 Fanhua Inc Earnings Call

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CORPORATE PARTICIPANTS

Chunlin Wang *Fanhua Inc. - Chairman & CEO*

Peng Ge *Fanhua Inc. - CFO and Executive Director*

Shirong Qiu *Fanhua Inc. - IR Manager*

CONFERENCE CALL PARTICIPANTS

Dan Tian *China International Capital Corporation Limited, Research Division - Analyst*

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Fanhua Fourth Quarter and Fiscal Year 2017 Earnings Conference Call. (Operator Instructions) .

For now 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 now disconnect at this time.

I'd now like to hand -- turn the meeting over to your first speaker today, Ms. Oasis Qiu, Fanhua's Investor Relations Manager. Thank you. Please go ahead.

Shirong Qiu - *Fanhua Inc. - IR Manager*

Good morning. Welcome to our fourth quarter and fiscal year 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, Mr. Chunlin Wang; and our Chief Financial Officer, Mr. Peng Ge. Mr. Wang will walk you through our financial results in the fourth quarter and fiscal year 2017. He and Mr. Ge will 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)



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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 by sharing a brief analysis of and our view on the current markets and regulatory trends. We will review our fourth quarter and fiscal year 2017 financial and operational performance followed by a discussion of our operational and financial outlook in 2018. Then we will have a Q&A session after the report.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Firstly, starting from the year-end 2017, bond yields have been on the rise in China as China kicked off its sweeping overhaul of its financial system in an aim to rein in shadow banking, deleverage the financial sector, reduce maturity mismatches and lift implicit government bailout guarantee, together with interest rate hike in the United States.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

In the meantime, regulations have also been tightening in the insurance industry, involving the strengthening of the management of insurance funds, implementation of the second round auto insurance pricing deregulation, adjustment in life insurance products in accordance with the requirements under the Circular No. 76 and No. 134, aiming at diffusing risk and steering the insurance industry back to its focus on protection-oriented insurance business.

Against this backdrop, the growth of China's life insurance industry slowed down as compared to 2016. Total life insurance premiums in the industry were up 20.3% from 2016 to RMB 2.7 trillion in 2017, but the growth rate dropped to 2.4% year-over-year in the fourth quarter of 2017.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

In the meantime, we also see the CIRC's effort to rectify the market has yielded positive results with obvious business structure improvement.

Long-term protection-type traditional life insurance business accounted for 76.3% of the total life insurance premiums, up 11.1 percentage points from year-end 2016.

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

(foreign language)



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Shirong Qiu - Fanhua Inc. - IR Manager

We anticipate that the regulators will further extend financial overhaul in 2018, and the rising market interest will deepen the correction in the insurance market. As such, we do expect more uncertainties in the development of the overall life insurance market. However, we believe that the driving factors for protection-type life insurance products will remain unchanged and we expect a continued solid growth in protection-type life insurance products in 2018.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

Now secondly, I would like to share with you our views on the progress that we've made in 2017. In 2017, we established a strategic guideline to guide our development in the next 3 to 5 years whereby the company will continue to actively pursue opportunities to grow our life insurance business through expanding and strengthening our sales force. In the meantime, we are dedicated to enhancing our market competence by offering a wide spectrum of financial products and services, and best-in-class technology, which we believe is the key to fulfilling our mission to help sales agents and team leaders to become the top income earners in the Chinese insurance industry and achieving our goal to become a market leader that can generate hundreds of billions insurance premiums each year.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

Following these guidelines, we continue to press ahead with our plan to further extend our footprint and increase sales force.

In 2017, we've set up new branches in Inner Mongolia, Beijing, Shanxi and Foshan. We further broadened our sales agent base through both active improvement by existing sales agents and attracting new team leaders in the market to join Fanhua with his or her entire team.

As of the end of 2017, the number of our sales agents increased by 280,000 to over 500,000 in total, creating a solid base for us to achieve our target of 1 million sales agents by the end of 2019.

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

As we were making significant progress in expanding our sales force, we recorded continued rapid growth in our life insurance business. In 2017, we achieved RMB 4.2 billion life insurance premium, of which annualized new premiums were approximately RMB 1.8 billion, up 134.9% from a year ago. And renewal premiums were approximately RMB 1.7 billion, up 83.4% from a year ago.

In the fourth quarter of 2017, despite a single-digit growth in the life insurance industry, we still managed to grow by over 50% year-over-year, of which annualized new premiums were up 21.7% year-over-year and renewal premiums were up 123.4% year-over-year.



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Renewal premiums have become an important contributor for the growth of both insurance premiums and revenues on the life side. We were also proud that our 13-month persistency ratio hit record high at 94.7% in the fourth quarter of 2017.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Life insurance business has become our largest business segment, accounting for 59.3% of our total business mix in 2017. In the fourth quarter, its contribution to our total revenues increased further to 71% from 27.4% in same period last year.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Now let's turn to our P&C segment. Most of our P&C operation have completed the transition towards the platform business model in the fourth quarter of 2017. During the quarter, RMB 630 million insurance premium were transacted through CNpad auto app and we recorded RMB 6.3 million platform management fee, accordingly.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Driven by the steady progress in market expansion and stellar growth of our life insurance business, our operating income was up 191.1% year-over-year to RMB 62.1 million in the fourth quarter of 2017 and reached RMB 273.1 million in 2017, well above our previous guidance of RMB 118 million.

Net income attributable to shareholders was up 186.0% to RMB 449.2 million. Diluted net income per ADS achieved USD 1.13 in 2017.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Based on a solid bottom line performance in the fourth quarter of 2017, our Board of Directors declared a quarterly dividend of USD 0.2 per ADS payable to shareholders of record on March 26, 2018.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

We are pleased to see continued rapid development across our various online platforms. In particular, Baoxian.com generated RMB 730 million in insurance premiums in 2017, up 697.1% from 2016, mainly attributable to its efforts to enhance the cooperation with other Internet channels. Baoxian.com made approximately RMB 5 million profit in total in 2017, and we expect its profitability will continue going forward.

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

(foreign language)

Peng Ge - *Fanhua Inc. - CFO and Executive Director*

And then secondly, eHuzhu's number of registered users have exceeded 2.7 million by the end of 2017, up 101.6% from a year ago. More than 714 valid claims were processed on the platform with the amount of contribution in total of more than RMB 1 million.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

In September 2017, we officially launched a new platform called Lan Zhanggui, which can be literally translated as lady boss. It was put into official operation in October after completing the transitioning of CNpad Life Insurance Application to Lan Zhanggui. It's an all-in-one insurance service platform that basically integrates most of the key functions of our existing online platforms, enabling customers access to all of our product offerings, assisting sales agents to manage sales activities more efficiently and facilitating application of big data in back-office operation. We believe that it will open up new opportunities for us to further enhance our leading position in the online and offline space.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Now I would like to share our view on the business and financial outlook in 2018. Firstly, the rising market interest rate that we've witnessed in the fourth quarter of 2017 has continued to go up in 2018 as the result of government's tightened measures to deleverage, reduce mismatches and remove government bailout guarantee, adopt look-through approach in supervision and prohibit multi-layers of nesting. Against this backdrop, we believe that the trends of product structure optimization has already begun in the insurance industry with insurance companies shifting more and more focus towards protection-type of life insurance products. And protection-type of life insurance products will become the mainstream product, which will inevitably impose higher requirements on the sales capabilities of insurance companies' distribution channels. Insurance companies or intermediaries with larger number of sales agents or stronger agency channels will enjoy more advantages for distribution of protection-type life insurance products. And among all the protection-oriented products, we believe that the growth of health insurance will take the spotlight.



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As such, we are confident about achieving positive growth in new life insurance premiums in 2018, and we expect operating income to grow by no less than 40% year-over-year in 2018 and reach no less than RMB 80 million in the first quarter of 2018.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Secondly, as Notice No. 76 and No. 134 took effect in 2017, restricting the sales of short-term and fast-return, savings-type life insurance products, we have recorded strong sales of annuity and participating insurance products in the first and [third] quarters (corrected by company after the call) of 2017, which largely contributed to the record-high new premium growth during those periods.

Due to the unusual concentrated sales in the first and [third] quarters (corrected by company after the call) last year prior to product bans, we expect to see a major decline in new life insurance premiums in the corresponding periods in 2018. However, we remain optimistic about positive annual growth in each of the next fourth quarters in the protection-oriented life insurance businesses, which have higher embedded value.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Thirdly, as the financial market evolves from chaos into order, we believe it is the right time for us to expand into wealth management space. Management has decided to officially engage in fund and loan distribution business by referring our customers to qualified fund sales companies, wealth management companies, securities companies, bonds or loan service providers. In return, we will receive referral service fees from these companies without assuming credit risk. We believe this new initiative will be conducive for strengthening our marginal profitability. Thank you.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

And in the Year of Dog, we would like to wish you a Happy New Year and great health and prosperity. Thank you.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Now management will open the floor for your questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question in queue is from MW Kim.

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

This is MW Kim from JPMorgan. I have 2 questions to the management. The first question is about the industry dynamics. As Mr. Wang mentioned, the China's life insurance industry is clearly in the stage of business transformation. So as an early mover and also one of the dominant player in the life insurance distribution channel, the company is currently enjoying decent operating profit, selling more protection policies. So going forward, do you expect that company is to keep strong distribution bargaining power in terms of the choosing sales partner and managing the commission rate and also the product perspective? And also, do you believe that the current industry's life insurance commission structure to last for next couple of years? We actually observed the opposite outcome in the nonlife insurance sector. And second question is about the -- your dividend policy. Compared to the last couple of years, the company seemed to enter the stage of making decent profit in core life insurance sales. And overall, the business is not taking the balance sheet risk and life insurance business is pretty promising. And as of the Q4, the company has more than USD 400 million in cash based on my observation. So we really appreciate the company's quarterly dividend payout in 2017, and should we expect a more generous payout ratio potential in 2018?

Shirong Qiu - Fanhua Inc. - IR Manager

(foreign language)

Chunlin Wang - Fanhua Inc. - Chairman & CEO

(foreign language)

Shirong Qiu - Fanhua Inc. - IR Manager

First of all, thank you, MW, for your questions. The current financial market and insurance market overhaul aims at increasing the stability and the security in the market. And in the past couple of years, there have been some issues happening in the insurance industry, and that's why the regulations seems to be even tougher than the other industries. But the overall direction of the regulatory overhaul is basically to to steer the industry back to focus on more healthy and sustainable product mix, especially the protection-type of products. And we believe that any insurance entities with good sales force and also good accumulation will enjoy more advantages from this trend. As for Fanhua, we do enjoy first-mover advantages in terms of both of the number of sales agents and in terms of our technology and our management level and our ability in asset deployment as well as our team-building and culture-building ability. And we are confident that we will continue to maintain positive growth in the sales of protection-type of products, and we believe that our growth will outpace that in the industry. As for the commission structure outlook, we believe that as long as a company can provide good business quality, insurance company will give them favorable treatment. And for Fanhua, because we have -- we provide them very good business quality and also very sustainable sales volumes, we are able to enjoy from the cooperation with insurance companies. And we have -- basically, we have the largest say in choosing which company to work with us. And we don't really think the commission structure will change just like what has happened in the nonlife insurance sector because life insurance business is quite different from P&C insurance business in its nature and the commission structure is more systematic and follows the rules of the basic laws. Basically, every insurance companies or insurance entities have their own basic laws which defines the commission structures. And in case of sales agents or insurance intermediaries to use their own money to to buy the insurance policies and to benefit from the commission that they receive from insurance company, insurance companies and insurance intermediary will pay a lot of attention to controlling the commissions not exceeding certain levels. Otherwise, there will be some systemic risk, causing huge loss to insurance companies and also causing a lot of liabilities for the commission income for insurance intermediaries. So we don't really think the commission structure will change as much as what happened in the nonlife insurance sectors.



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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

And we expect that in the next 3 to 5 years, long-term protection-type products will still be sold mainly through agency channels. And for the smaller and medium-sized company, if they want to transform their business structure to more protection-type of products, they will have stronger reliance on distribution channels with large sales agency force. Regarding with our cooperation with insurance companies, we believe that we will have even better terms, including the commission, which basically has been reflected in our cooperation with some new business partners.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

As for our dividend policy and cash position, as we have shared with the market before, we expect that in the next 2 years, the financial market overhaul will create a more healthy environment for the development of the financial market. And therefore, we would like to further explore the opportunities in the financial services areas by acquiring some good wealth management company. And then secondly, we also expect that technology will develop rapidly in the next couple of years. And if there are some good technology companies stands out in the market, we would like to further upgrade our technology capabilities through acquisitions.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

As we announced last year, the payment dividend payout ratio is no less than 50% of our earnings. So this 50% will still be the bottom line. Based on that, we may consider more generous options, if possible.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

(foreign language)

Operator

And the next telephone question comes from Dan Tian from CICC.



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Dan Tian - *China International Capital Corporation Limited, Research Division - Analyst*

I have 2 questions today. First is about the life business. In 2017, what's the split of commission revenue between protection product and saving product? And if there's going to be -- is there going to be any change in 2018 projected? The second question is how much profit are we expecting from the commission of renewed premiums in 2018?

Shirong Qiu - *Fanhua Inc. - IR Manager*

(foreign language)

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

Regarding the first question about our product mix in terms of insurance premiums. Pure long-term protection product accounted for 40% to 50% of our life insurance premiums, and the endowment insurance accounted for roughly 10%. So total -- the total protection products is about 60% of our total life insurance business mix. And then annuity products accounted for roughly 40%. And we expect that in 2018, protection type of products, including pure term protection and endowment will account for 60% to 70%.

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

(foreign language)

Shirong Qiu - *Fanhua Inc. - IR Manager*

We have very good business quality in terms of the persistency ratio, which is one of the reasons that insurance companies are more willing to cooperate with us. In 2017, the 13-month persistency ratio was 94.2%, which was a quite remarkable achievement. And this is a very solid data, actually. We haven't made any measures to manipulate or to increase this ratio. So we expect that going forward, the renewal commission will become an important contributor to the growth of our profit, and we expect in 2018 about RMB 200 million profit will be generated from renewal premiums.

Operator

There are no more further questions at this time. I'd like to hand the call back to Oasis for any closing remarks. Please continue.

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 does conclude the call. You may disconnect. Goodbye.



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