Fanhua Q1 2023 Earnings Conference Call Script

Operator:

Thank you for standing by for Fanhua's First Quarter 2023 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 Fanhua's IR website at ir.fanhuaholdings.com under the "Events & Webcasts" section.

Today's conference is being recorded. If you have any objections you may disconnect at this time. I would now like to turn the meeting over to your host for today's conference, Ms. Oasis Qiu, Fanhua's investor relations manager.

Oasis Qiu: Good Morning. Welcome to our First Quarter 2023 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 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 and uncertainties include but are not limited to those outlined in our filings with the Securities and Exchange Commission, 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 chairman and chief executive officer, Mr. Yinan Hu, chief financial officer Mr. Peng Ge and chief operating officer Mr. Lichong Liu. Mr. Hu will provide a review of our financial and operational highlights in the first quarter of 2023. There will be a Q&A session after the prepared remarks. Now I will turn the call over to Mr. Hu.

Good morning and good evening! Thank you for joining today's conference call.

I will be repeating some of the highlights of our 1Q results reported last week in our earnings release. As we mentioned, with the positive macro and industry environment over the first quarter of 2023, Fanhua achieved strong results over the period with solid growth across various key operating metrics:

- Total premiums up by 29.0% to RMB4.4 billion, significantly outpacing life insurance industry premium growth of 8.9%

- New business premiums up by 51.4% to RMB851.9 million, significantly above the 15% growth rate achieved by the listed Chinese life insurers.
- Total revenues up by 20.6% year-on-year to RMB827.7 million, and operating income was up by 193.1% to RMB60.4 million, significantly exceeding our previous estimate.

For this quarter we have expressed our results relative to our industry and key listed insurance peers. We have made this comparison to demonstrate that we are executing on our well-defined strategy of driving sustainable growth in our business through 'Professionalism, Specialisation, Digitalisation, Open Platform". This strategy is starting to set us apart from our competitors as demonstrated by our 1Q results.

Please allow me to go over three key operational highlights that are direct results from the execution of our strategy:

- **Firstly, our strategic focus on quality growth produced significant increase in agent quality and productivity**. Our number of 100K Premium agents and MDRT professional agents grew 27% year-on-year. The productivity of these high-performing agents also grew 18% and 37% year-on-year, respectively, and together, they accounted for 42% of our sales over the period, up from 32% in the same period last year.
- **Secondly, we are already seeing material contributions from our open-platform and our acquisitions over the past two quarters**. As at the end of the quarter, our open Cloud Service business division has connected with over 300 external institutions and grew new business premiums by over 100% to over RMB80.6 million.

  We also executed on our strategy of consolidating the industry through M&A and made three acquisitions over the period, including Zhong Rong Hui Jin, the leading Managing General Agent in China as well as two other leading agency companies. Looking ahead, we aim to utilize the Managing General Agent model to accelerate the consolidation of licensed small-to-medium insurance intermediaries in the market. As of the end of the quarter, Zhong Rong Hui Jin is connected with 400 licensed brokers, and contributed RMB190 million in new business premium over the quarter.
- **Finally, our strategic focus on digitization is also delivering material operational gains.** The execution of our digital strategy is not only leading to higher productivity for agents on our platform but also helping us drive improvement in customer service and business quality. In the quarter, both the 13-month and 25-month persistency ratios improved to industry leading levels of 93% and 87%, respectively. Achieving higher persistency ratios translate to higher quality of business for our insurance clients and in turn drives renewal bonuses for our business.
- **This digital focus, when combined with our open platform strategy have allowed us to deliver significant economies of scale and operational efficiency improvement.** This is reflected in the substantial reduction in operating expense ratio

to 25.9% from 31.3% in the same period last year, despite significant increases in investment in digitalisation and open platform initiatives to RMB21.3 million in the first quarter of 2023, up from RMB17.3 million in the same period last year. I would like to mention that the acquisitions we have made thus far have only delivered revenue contribution. Profit contribution was limited as we are still in the process of fully integrating the acquired entities. The effect was not yet reflected in our Q1 results. As the integration of our IT and back-end systems complete in 2H of this year, we expect to see material expense and revenue synergies to be reflected in our future results.

We target at growing our life insurance first year premiums and operating income by no less than 50% for 2023. Our strong start in the first quarter will lays a solid foundation for us to achieve these full year targets as we continue to expect second quarter results to exceed expectation and full prepared for the challenges in the second half. Going forward, we will focus our strategic execution on the following initiatives:

Firstly, we will continue to expand our service offerings to establish our differentiated competitive advantages, focusing on serving the diverse needs of our customers and their family over their entire life cycle, by facilitating insurance sales in various service settings, leveraging on our abundant services resources including insurance trust, health-care & elderly care services and education solutions.

Secondly, we plan to train 3000 external candidates as a Family Office Consultants through family trust training camps, thereby helping us to attract top talents in the industry. This year, we plan to increase spending on hosting training courses to train and certify 3000 external elite agents as Family Office Consultants, increasing professionalism and providing another point of differentiation.

Thirdly, we will implement 'Full-License' Holder plan among our agents. In response to the regulatory requirement for tied management of agents, we will provide targeted trainings to our top agents including those who are MDRT members according to their personal professional levels to help them obtain financial professional qualifications and certifications, so as to further improve their professional image/competence and productivity.

Fourthly, we intend to accelerate market consolidation through open platform strategy and M&A. We plan to fully open our platform to the industry to develop "digital tenants", particularly targeting at dedicated independent sales teams who can bring in high quality business. For 2023, our target is to migrate 500 of our platform's institutional customers to our digital tenant system.

2023 is an important year for Fanhua, it marks the 25th anniversary of our company. It is a milestone that fills each and every one of us at Fanhua, which we are truly proud for. Over the past 25 years, we are proud that we have navigated through China's economic and financial industry cycles, each time emerging stronger than before. For me personally, this is my second time being Chairman and CEO of Fanhua, having left the position of being CEO of the Company in 2011 and left the position of being chairman of the Company in 2017 to pursue my other interests outside of the company. This is a company I founded 25 years ago, by no exaggeration, it's my second child and I have always had the best interest of the company at heart.

Looking ahead, we intend to invest significantly in our human resource capability, to attract the best individual talents in the market across all levels – from the Board level, to Senior Managers to our front line agents. We are confident that with the right strategy the right team and the right execution, the Fanhua we will create over the next 25 years and beyond will be able to deliver the results expected from all our stakeholders.

This concludes my presentation. Now the floor will open for your questions.

…………………………………………**Q&A Session**……………………………………..

Yuyu Zhang, CICC

So the first question was related to the savings product demand [ph]. So previously, China insurance regulator has asked insurers to lower estimated returns for new products. So do you see strong demand for those products? And how do you expect the momentum of savings product sales? And the second question, we also see in the last year and the Q1, the average take rate of the Company declined gradually. We know it's mainly due to the changing product mix and reduced [indiscernible] commission. I think it's a really a negative impact on our brokerage income, while our FYP actually has a really good performance. So could you share some more color on how you see the future trend of your take rate and what actions the Company will take. And last question is in terms of the open-platform strategy. In the previous conference call you said you plan to invest or acquire around 10 small or middle sized insurance agencies and is there any change to this plan?

Yinan Hu (Interpreted)

Thank you for the questions, Yuyu. This is CEO Mr. Yinan Hu. Mr. Hu, will like to invite Mr. Liu Lichong, our Chief Operating Officer to address the first question. And our CFO to answer your second question regarding the trend in our commission rate, and he himself will answer your third question regarding to the M&A progress.

Lichong Liu (Interpreted)

So with the imminent downward adjustment in the guarantee returns from life insurance products in the new product pricing, we do see very strong demand for savings products, including annuity and whole life insurance products. However, in the second half, how will that change? We still believe that for the longer term, the demand will remain robust for savings products because of the three contributing factors. Firstly, we've seen the acceleration in aging populations and lower risk appetite among consumers, while the ageing population still have very strong demands for products that can cater to their needs in their retirement.

And then secondly, we have seen the downward trend in interest rate in the long-term. So even though the assumed interest rate for new product pricing are adjusted downward to 3%, that still provides a quite attractive returns. And thirdly, with the softening economy, we're seeing a kind of consumption downgrade and also investment product downgrade. Because of the softening economy there are not many attractive investment choices, while insurance still offers a kind of safe asset class. Thank you.

Peng Ge (Interpreted)

I would like to clarify on the definition of commission rates. And from insurance point of view we've actually seen that the commission rate will probably in the downward trend to be in line with the international practice as well as regulators requirements, or regulators' wish to lower the financial costs for financial institutions in China. And then for Fanhua, because we sell a wide variety of products, so, the changes in product mix as well as the term that customers choose to pay their premiums will have impact on the overall commission rate.

However, if on the basis of annualized premium equivalent basis, our first year commission rates remains quite high. But having said that, I would like to emphasize that the key operating matches that the company ought to focus on are our first year premiums, net revenues and gross margin, as well as persistence ratio. I think these are the better operating metrics to measure the company's financial performance.

As Mr. Liu mentioned that there will be some changes in savings products with the upcoming transition to the new product pricing, which means that the cost for insurance company will be lower. Probably that will impact our sales in the short-term. However, in the longer term, we still believe that the demand for savings products will remain robust.

And we believe that for for insurance intermediaries their key competitive advantage should be the ability to offer a comprehensive service or comprehensive solutions to address customers' diverse demands, instead of simply selling insurance products. As Mr. Liu mentioned that we would like to further broaden our service offerings to include trust services, health care, and elderly care and as well as education solutions to customers. This will be the key for us to further enhance our competitive advantages.

Mr. Hu mentioned that we target at growing our first year premiums and operating income by 50% year-over-year for 2023. I believe that if we can achieve this 50% full year target, we will also see a continued improvement in our gross margin, net profit margin as well as persistency ratio.

Yinan Hu (Interpreted)

The industry is evolving towards high-quality growth, which means higher business quality with lower costs. What's happening in the market right now is actually in favor of our M&A strategy. Or i.e. created a much more favorable environment for us to pursue acquisitions. So we will stick to our open-platform strategy and M&A strategy. There's no change to our acquisition target for this year.

M&A is not purely business combination. I think the base for our acquisitions relies on technology, digital capabilities and AI technology applications. In the longer term, we believe that technology will be a key contributors to drive business growth for insurance intermediary. I'm quite confident that Fanhua has stayed far ahead of our peers in terms of IT investments and technological capabilities in China, as well as in Asia.

However, right now in China, and in other Asian markets that we observed, technological investment is not really enough. And that's the key reason that restricts the further high quality growth of insurance intermediaries. The demand for technology is quite strong but a lot of licensed insurance intermediary companies as well as independent agents cannot really afford to invest in IT systems on their own.

So, the core of our M&A is to export our digital technological advantages and digital capabilities. So that we can allow more insurance intermediary companies to benefit from Fanhua's technological advantages and help them to double their sales capabilities while lowering the operating expenses and building momentum for sustainable growth. And for our future M&A targets, we will focus on enabling technological empowerment to the acquired entities and we will pursue quality instead of quantity. Thank you.

Operator

Thank you. Our next question comes from the line of Dan Wong from JPMorgan. Please ask your question, Dan?

Oasis Qiu

So, the questions from JPMorgan's. He has three questions. The first question is regarding our agents’ productivity. In the first quarter, we see a strong improvement in agent productivity. But probably that's because of a low base last year. And he is wondering whether or not the high productivity of our agents will be sustainable in view of the fierce competition in the market.

And the second question is regarding the company's share buyback plan’s progress. The company announced a share buyback plan in December last year, but now with the company's M&A strategy, probably the company would like to reserve more cash to pay for the acquisition. How the company's capital deployment plan will be and what's the plan for share buybacks?

And the third question is regarding regulation. The regulator has adopted quiet tight regulations to supervise the insurance intermediary markets. But we believe that with a more stringent compliance framework and a more stricter supervision on business quality of the company, that will help the company to improve sales volume as well as lower risk. So what's the opportunity there for the company?

Again, the three question will be divided among the management, our CEO Mr. Lu answer your first question regarding agent productivity. And Mr. Ge will answer the second question regarding share buybacks and Mr. Hu himself will answer your third question regarding regulation.

Lichong Liu(Interpreted)

We are actually seeing that over the past few years the number of agents that have dropped significantly in the market. And on the contrary the productivity of agents --- per capita productivity actually have been increasing. There are two main reasons. First of all, customers demand has transitioned from kind of relatively lower end products, i.e. critical illness products to higher value products -- savings type of products.

And for savings product the ticket size is larger. And then secondly, because this product are more complicated and required a more comprehensive financial knowledge or knowledge in wealth management. So usually this type of products are sold by more professional top performing agents.

And then secondly, for the critical illness products. Critical illness products are kind of replaced by online medical insurance products. And for those agents, who can only sell simple critical Illness products, will naturally be replaced as well. So only those who are knowledgeable enough and who have more comprehensive knowledge can stay in the industry.

Fanhua has shifted our focus to serving middle class or high net worth individuals or ultra high net worth individuals. And this customers groups require more professional service by more professional agents. So that's why in the past few years, we have stepped up investments to recruit professional agents and to train professional agents, as well as increase our investment in digitalization to increase the empowerment to our agents to help them to improve their professional capabilities. And as a result, we have seen a 50% growth in a number of MDRT agents in the past years. And in the first quarter, we also see substantial growth in a number of MDRT agents.

So we have this right strategy. In addition to that, we believe that service is quite crucial. So that's why we have considered insurance plus services or insurance plus wealth management including elderly cared, insurance trust services as important part of our overall strategy. With this service offerings, our top agents will be able to serve the diverse demands of our high-end customers. So with the customer demand and with the ability of the top agents, I believe that the policy amount of the product that we sell and also the productivity of our agents will remain at quite high-level.

Ge Peng (Interpreted):

Fanhua is a quite responsible company to shareholders. I have recapped the use of our capital since IPO. We have spent around RMB1.7 billion on cash dividends since our IPO and spend around RMB700 million on share buyback, totaling RMB2.4 billion, which represented over 50% of our total operating cash flow, amounting to like RMB4 billion. So that shows our commitment to maximize shareholder returns.

In the past 3 years since 2020, due to the COVID-19 and a softening economy, the industry has undergone substantial changes. Fanhua, however, has sticked to our strategy. And we have saw material contributions from the execution of a strategy in the first quarter of 2023. In my view, I believe that our cash should be earmarked to build momentum for sustainable rapid growth in the future in the longer term, including on our strategic initiatives, such as M&A.

And because of what's happening in the past 3 years, our stock has been significantly undervalued. We believe that share buyback will be a much more efficient means to maximize shareholder returns compared to dividends. So that's why we announced a 20 million share buyback plan last December. And despite the restriction of the window period, and the restriction on the trading volume that company can buy, we have purchased about 72,000 ADSs amounting to US$600,000. That's the progress that we've made in terms of our share buyback.

Hu Yinan:

I would like to add a comment on your first question. And this is also the strategy that we have sticked to over the past 25 years. We believe that no matter how professional or how elite the sales agents are, if they only sells insurance products, it will not be sustainable for them to sustain high productivity.

So transition to become a financial advisor who can offer more comprehensive solutions to their customers, covering not just insurance, but also insurance trusts, tax planning, or legal advice, will enable them to better serve customers demand and sustain higher productivity. And I believe that is an irreversible trend for agents to transition or transform themselves to become financial advisors for their customers.

So that will pose higher requirements on the compliance of the company. This is a huge challenge. But at the same time, it also presents great opportunities for the company. I believe that any companies who can help other institutions or independent agents to address the compliance issues, they will have the future.

My long-term vision has been to transform the company from a sales-oriented insurance intermediaries into a platform company or infrastructure platform provider to the industry. And this is what we've been pushing forward in the past few years. We're dedicated to providing an infrastructure platform to the whole industry. And we're also working on building a unified compliance model and a unified risk management model built on the basis our digital technology. Right now our existing organizations contributed 80% of our revenues. I'm hoping that in the future 60% of the revenues will be generated by the platform services that we provide to the industry.

The new regulation changes pose great challenges to a lot of industry players. However, we see it as a great opportunities for Fanhua. And in response to the market changes and to capture the market opportunities, we have retained Boston Consulting Group as our consultant to give us advices on our open-platform strategy. And so far, BCG has completed their first Phase of work, and this has helped us greatly [on executing on our open platform strategy] and deliver great results. And I believe that this will be helpful for us to build our digital compliance model and digital risk management model going forward. Thank you.

Oasis Qiu

Thank you for participating in our conference call. If you have any further questions, please feel free to contact us. Thank you.

[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call and may be modified to correct translation discrepancy.]