CRYSTAL | EQUITY RESEARCH

FANHUA, Inc.

Initial Report

July 19, 2019

FANH / NASDAQ

Buy

Initial

$41.00

Initial

CAPITALIZATION	
Ordinary Shares Outstanding	1,360.7 ml.
ADR's Outstanding	31.9 ml.
Market Capitalization	$2,277.8 ml.
+ Debt	-0- ml.
- Cash	152.9 ml.
Enterprise Value	$2,124.9 ml.
Book Value	$ 385.1 ml.
Working Capital	$ 319.9 ml.
Dividend / ADS	$1.20 / ADS

Balance sheet figures as of 3/31/19 in US$

MARKET DATA	
Recent ADS Price, US$	$33.48
52 Week High/Low	$34.03 - $19.39
Inside Ownership	21.1%
Institutional Ownership	15.0%
Flotation, Ordinary Shares	732.0 ml.
Flotation, ADS	17.9 ml.
Average Daily Volume, ADS	664 K
Short Interest	9.1%
Beta	1.30

Source: Bloomberg LP

INVESTMENT RETURNS	FANH	Sector
Return on Equity	23.2%	13.0%
Return on Assets	13.9%	1.5%
Return on Capital	22.3%	4.5%

Source: Crystal Equity Research

FINANCIAL PROFILE US$	FY18	TTM
Sales	$504.9 ml.	$532.7 ml.
EBITDA	$ 65.8 ml.	$ 72.3 ml.
EPS / ADS	$1.43	$1.52

Source: Company Reports

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INVESTMENT SUMMARY

Initiation of Coverage. Buy rating and 6-month target price of $41.00 begin coverage of Fanhua, an insurance agency serving China consumers with life, property and casualty protection.

Market Opportunity. Low market penetration rates in China's insurance market present significant business potential for insurance providers and their distribution partners.

Favorable Demand Trends. Improved economic conditions in China have given rise to a burgeoning middle class with new found interest in protecting assets and wealth.

Competitive Position. Regulatory reform in China is clearing playing field for innovative players with coveted industry relationships and a head start on creative digital distribution capacities.

Deep Bench. With its extensive experience in insurance operations Fanhua's management team has a track record for well executed growth strategies.

Financial Strength. Strong profits and ample operating cash flow generation have helped build up cash resources and working capital.

Compelling Valuation. Valuation analysis suggests stock is currently trading 9% below intrinsic value. Our six-month target price implies 22% appreciation from current stock price.

INDUSTRY: INSURANCE SERVICES | **FANH: NASDAQ**

DESCRIPTION

Fanhua, Inc. is an insurance agency representing life, property and casualty products to China consumers. Additionally, the Company provides claims adjusting services for insurance providers. The Company has an enviable competitive position in China's fast growing insurance sector. The Company has a market presence with sales and services offices as well as a large and growing sales representative network in a number of desirable urban centers where the middle income target group can be found. Importantly, aggressive adoption of digital technologies such as mobile applications and social media platforms is making it possible for Fanhua to reach an even wider audience. Low penetration rates for insurance products in the China market suggest there will be ample opportunity for Fanhua to capture market share.

RECOMMENDATION

We have initiated coverage of Fanhua's American Depository Shares (ADS) with a Buy rating and a $41.00 target price for year-end 2019. The Company has a decades-long track record in earning profits by offering high quality products to consumers and leveraging relationships with reliable insurance providers. Profits have been elevated through critical strategic decisions by Fanhua's management team to divest of unprofitable brokerage operations and to fundamentally change sales tactics from a dedicated sales team to a platform model for property and casualty insurance products. Our earnings model reflects management's guidance and appears to support the view that Fanhua can deliver strong sales growth and profit. A valuation exercise suggests the intrinsic value of the ADS is $37.45 while the implied future price at year end is year-end 2019 is $41.00. We propose investors take advantage of the current undervaluation through long positions in Fanhua's ADS and hold for future price appreciation.

VALUATION

Price/Sales	4.2 X
Price/Cash Flow	28.1 X
Price/EPS	21.8 X
Price/Book Value	5.6 X
Consensus EPS 2019	NA
Forward PE	NA

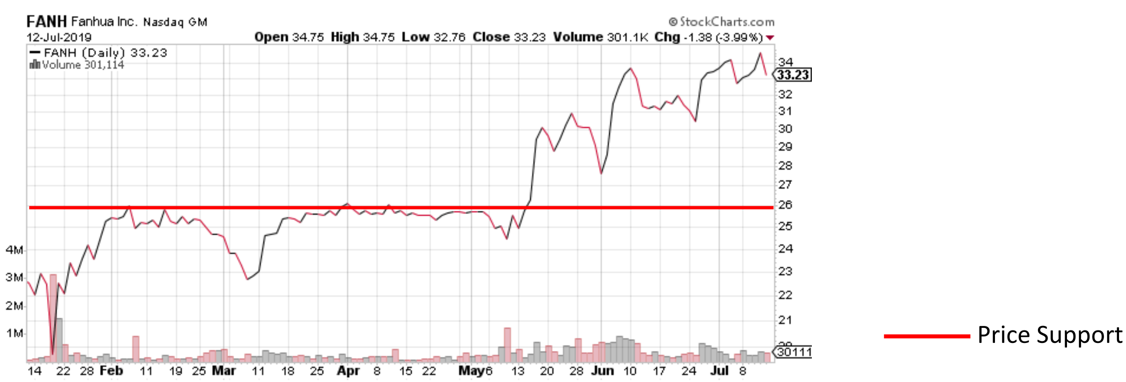
TTM ending 3/31/19

OPERATING PROJECTIONS

	2018A	1Q19A	*2Q19E*	*3Q19E*	*4Q19E*	*2019E*
Sales	$504.9	$144.8	*$158.7*	*$135.8*	*$154.8*	*$594.0*
Operating Income	$ 61.9	$ 18.8	*$ 24.2*	*$ 17.4*	*$ 22.7*	*$ 83.1*
Net Inc	$ 88.7	$ 21.9	*$ 24.2*	*$ 19.4*	*$ 23.0*	*$ 88.5*
CFO	$ 76.2	$ 7.0	*na*	*na*	*na*	*$ 96.1*
EP/ADS	$1.43	$0.39	*$0.39*	*$0.31*	*$0.38*	*$1.47*

US Dollars in millions except per share earnings

Company Reports and Crystal Equity Research Estimates



INVESTMENT POSITIVES

- A rising middle class in China presents new market opportunity for insurance providers and distributors. The developing market is driven by several factors:
    - Nationwide economic growth
    - Increased personal income and accumulation of financial and property assets
    - Heightened consumer awareness of insurance as a means to protect assets
    - Aging population that wants to protect personal objectives, life goals
    - Increased interest in health and well being
    - Keen interest in financial services for professionals, business leaders
- Market penetration rates remain low for all types of insurance in mainland China. According to Financial Times only 114 million out of population of 1.4 billion have insurance.

- China's insurance industry is modernizing through 'insurtech', the adoption of technology such as social media for marketing and sales as well as digital applications for insurance back office operations.
- Insurance providers, which are potential partners for insurance distributors like Fanhua, have emerged stronger following implementation of tough new regulations by CIRC, now CBIRC.
- Solvency ratios of insurance providers improving under stricter rules on short-term products; Moody's reports at the end of 2017, China's insurance sector had a solvency ratio of more than 200%, which was double the regulatory requirement of 100%
- Beginning in 2013, pricing liberalization by China's insurance sector regulator, CBIRC, has inspired insurers to differentiate their products and provide more variety for insurance agencies to offer consumers.
- Fanhua is approaching the insurance market with a wide footprint of sales and service locations coupled with deep network of sales representatives. At the end of March 2019, Fanhua reported 709 sales outlets in 21 provinces. Over 800,000 individuals have signed up as sales representatives, out of which over 235,000 were actively selling insurance at the end of 2018.
- Marketing and sales activities have been moved on-line with Fanhua's adoption of Internet and mobile channels. Over 2.3 million consumers have registered with the Company's *Boawang.com* website.
- Lucrative strategic investments in adjacent operations in wealth management and home equity loan services contribute to earnings.
- Fanhua benefits from the continued leadership of one of Fanhua's two founders as well as a deep bench of directors experienced in finance, economics and executive management. Insider ownership of 21.1% helps align executive interests with shareholders.
- Fanhua has a track record for both organic and acquired growth. Ample cash resources and zero leverage provide resources to undertake strategic acquisitions and invest in growth projects.
- Naturally cash generative, the Company converted of 6.5% of its total sales revenue into operating cash flow over the last three years.
- At the end of March 2019, the balance sheet was debt free and working capital was RMB 2.2 billion (US$319.9 million).
- Based on the dividend discount and comparables valuation methods, we estimate the intrinsic value of FANH ADS is $37.45, representing 9% undervaluation.

Table I: Industry Calendar

Date	Event	Sponsor
August 24–25, 2019	InsurTech Innovation Congress China; Beijing, China	SZ&W Group, China
September 13, 2019	Moody's Insurance Summit; Beijing, China	Moody's Corporation, USA
September 18, 2019	Institutional Investment Forum China, Beijing, China	AsianInvestor
September 19, 2019	China Law and Practice Awards; Beijing, China	SSQ Legal Search & Recruitment
September 23, 2019	InsureTech Connect, Las Vegas, USA	InsureTech Connect, LLC.
October 30, 2019	Beijing Global Investment Forum 2019; Beijing, China	Institutional Investor Forums, USA

Source: Corporate Websites

INVESTMENT RISKS

- China insurance industry under new, more intense scrutiny as new solvency regulations require a mark-to-market dynamic and shifts away from the book-value accounting practices that had tempted some insurers to undertake risky investments.
- Potential for disruption in Fanhua's revenue stream if one or more of its significant insurance company partners are singled out for regulatory action.
- High customer concentration with dependency on three insurance providers for over two-thirds of revenue.
- Risk of loss in market share to contracted insurance providers who team up with social media or e-commerce platforms that rival Fanhua's own digital distribution channel, *Boawang.com*.
- Keen competition in China insurance market among world's largest base of sales agents who are increasingly operating independently from insurance providers and agencies.
- Risk of loss in productive selling agents as foreign insurers take advantage of relaxed investment restrictions against foreign investment in insurance sector and begin building sales agent networks in China.
- Added burden in due diligence given that all business is carried out in China using the Chinese language, which could be challenging for foreigner investors attempting to evaluate and monitor operating performance.
- Greater complexity in Fanhua's organizational structure composed of off-shore ownership of domestic China operating companies.
- Translation risk as functional currency is the renminbi and the reporting currency is the U.S. dollar. Added complexity in financial analysis by investors of U.S. dollar denominated financial results given uneven effects of currency rate fluctuations.
- Potential for malicious 'short-and-distort' or 'green' mail schemes that use language, government policy, tax obligations, or financial reporting differences between the U.S. and China to insinuate impropriety by senior officers or board of directors.
- Prospect of variability in value given above average volatility in trading as evidenced by beta measure of 1.30.
- Potential for immediate loss in capital given relatively significant bid-ask spread. Currently spread is 2.6% of asking price for American Depository Shares.
- Rating and target price based on uncertain estimates of future cash flows calculated using a mix of assumptions related to business relationships, product pricing, commission compensation rates and sales volumes.

COMPANY DESCRIPTION

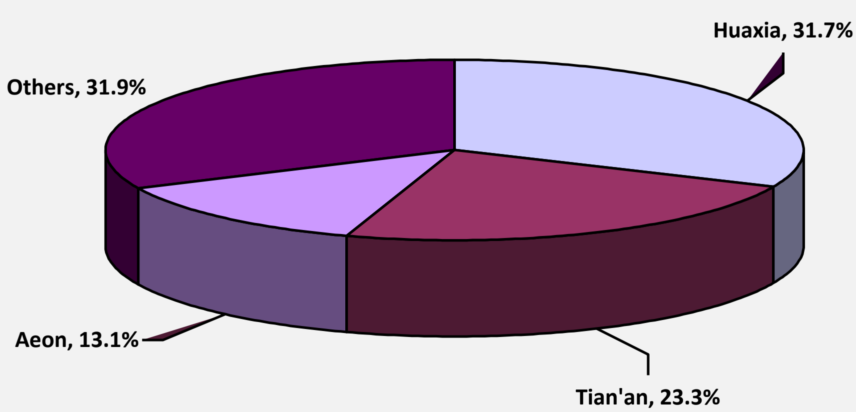
Fanhua is a leading provider of life, property and casualty insurance products and services in the People's Republic of China. The Company acts as an agent for various insurance companies pursuant to long-term contractual agreements. The majority of Fanhua's revenue comes from commissions the Company earns by distributing life, property and casualty insurance products to retail end-users. Additionally, the Company earns fees for claims adjusting services. In 2018, three of Fanhua's contracted insurance companies accounted for over two-thirds of Fanhua's total net revenue, underscoring the importance of industry relationships to Fanhua's business model.

Fanhua is organized as an off-shore holding company that operates through subsidiaries in the People's Republic of China. These subsidiaries have their roots in two companies founded separately over twenty years ago by Mssrs. Yinan Hu and Qiuping Lai and focused on car rental services and automobile emergency services. A series of acquisitions and new business starts helped form the insurance-focused business model.

An initial public offering of American Depository Receipts in October 2007, helped raise capital for the Company's investment coffers. In addition to expanding and modernizing its insurance agency operations, the Company has made lucrative strategic investments include minority equity stakes in a home equity loan service provider in China, CNFinance Holdings Ltd., Puyi, Inc., a wealth management services provider in China, and Shenzhen Chetong Network Co., Ltd., an online insurance claims services provider.

Strategic investments give the Company additional opportunity to capitalize on a central theme in mainland China economy - a fast growing middle class. Rising incomes have helped grow the middle class population group by seven times since the turn of the century. With new found disposable income the group is purchasing cars and homes as well as providing for the future through education and savings. Insurance is a key element in the evolving China economy.

Chart I: 2018 Sales Mix by Insurer



Top Five Insurance Industry Partners

1. Huaxia Life Insurance Co.
2. Tian'an Life Insurance Co.
3. Aeon Life Insurance Co.
4. Taiping Property & Casualty Company
5. Taikang Life Insurance Co.

Source: Company Reports

PRODUCTS AND SERVICES

Insurance Agency Services. Fanhua offers a mix of insurance products to individuals and business, acting in an agency or intermediary capacity through a network of sales representatives and its proprietary digital platform branded *Boawang*. Fanhua informs consumers on available coverage for their particular situation and collects premiums either through the representative or through the *Boawang* digital architecture.

Modernization of its distribution methods appears to be a key to success for Fanhua in the fast-moving insurance market in China. The Company is leveraging both business-to-business and business-to-consumer technologies using Internet websites, mobile applications and the widely accepted WeChat messaging, social media and payments platform. Fanhua launched its *CNpad* portal for auto insurance sales agents in January 2012. Since then the Company has added other platforms for both sales personnel and consumers.

The most recent innovation is the *Lan Zhanggui* platform launched in September 2017 to serve independent sale agents. In addition to transaction processing, there are features for policy comparisons and proposals, As of December 2018, the Company claimed over 800,000 users had registered with *Lan Zhanggui*, of which 150,761 were considered active by having sold at least one insurance policy in the year. Active users on the platform delivered 97.2% of total new life insurance sales during the full year 2018, making clear the importance of digital technology in competitive distribution of insurance products and services in the China market.

Claims Adjusting Services. The Company's claims adjustment services include a mix of functions such as investigation of declarations by insured parties, interviews with witnesses, police consultations, property inspection and hospital record reviews among other investigative activities needed to determine the extent of an insurance company's liability. The Company also operates *Chetong.net*, a digital platform for claims adjustors that offers claims processing tools.

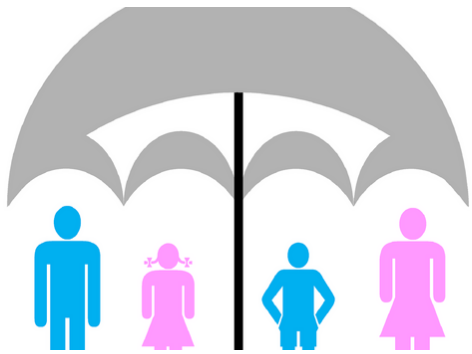
掌中保	*CNPad* Transaction Portal for Sales Agents - allows sales agents to get quotes for consumers, complete underwriting and make payments for auto insurance
保网	*Boawang* Portal for Consumers - access to menu of life-style insurance products and comparison tools through an Internet browser at *Baoxian.com*, mobile app or on the WeChat platform
懒掌柜	*Lan Zhanggui* Platform for Sales Agents - Internet-based platform for broad mix of insurance products, including life, auto, accident, travel and health coverage; integrated with *CNpad* and *Baoxian.com*
e互助	*eHuzhu* Platform for Consumers - on-line mutual aid platform for catastrophic health and accident coverage
车童网 chetong.net	*Chetong.net* Platform for Claims Adjustors - third-party claims service-sharing platform with integration of claims resources for auto and property insurance

CHINA INSURANCE MARKET

The Chinese consumer is in a state of metamorphosis. In the four decades since The People's Republic of China opened its economy, there has been profound change in the country's population. Urbanization and industrialization have been the direct consequences of the PRC's economic strategy. Income levels have risen, leading to a new middle class living largely in cities and towns.

The World Bank ranks China as 'an upper middle income' economy with a per capita income near RMB 60,000 (US$8,800) in 2017. In a separate study the consulting firm McKinsey & Company defined middle class in China as household earnings in a range of RMB 61,700 to RMB 23,000 (US$9,000 to US$34,000) and found that the percentage of China's urban population that could be considered middle class has grown from 4% in 2000 to 30% in 2018. China's National Bureau of Statistics apparently sees the country's middle class through a different lens, reporting that a monthly income of RMB 3,500 (US$510) constituted 'middle income.' The Bureau regards anyone earning more than RMB 10,000 (US$1,460) as in a high income bracket. Using this range, there are about 400 million middle class consumers in China.

Of course, the discrepancy between the views from within and without China can be explained in part by the use of per capita versus household income. The one factor upon which all observers agree is that China's middle class a rapidly growing group no matter the income threshold. The economic implications are clear. Demand in China for food and consumer goods has grown faster than the overall population since a larger group of people has access to greater disposable income. Additionally, the group is investing heavily in new homes. In turn, household formation is creating demand for durable goods such as cars and home appliances.



Another key element in the discussion is the experience of the China middle class with income and property protection systems. China's Social Security System consists of five mandatory insurance schemes, including a pension fund, medical insurance, industrial injury insurance, unemployment insurance, maternity insurance and a housing fund. Through the Social Security System the China middle class consumer has become well conditioned to the use of insurance to protect assets against adverse events and ensure accomplishment of lifetime goals. Outside the social security system, automobile insurance has been mandatory since 2009.

These economic developments have led the world's largest insurer, Swiss Re, to forecast that China's insurance market will quadruple in size as measured by insurance premiums to RMB 16.7 trillion (US$2.36 trillion) by 2036 from RMB 3.9 trillion (US$575 billion) in 2018. If the prediction is achieved, the China insurance market will be the largest in the world. The U.S. is currently the largest insurance market in the world, accounting for approximately 28% of the current global insurance premiums. However, with its building insurance market, China is expected to be the dominant region with 22% share of the global market by 2036.

These impressive numbers notwithstanding, it is important to note that penetration rates for insurance usage in China remain relatively low. The international law firm of Winston & Strawn LLP estimates that at the end of 2017, China's protection gap was as much as RMB124 trillion (US$18 trillion). According to Atlas Magazine, a provider of insurance news, the rate of insurance usage in China was just 0.10% in 1980. By the turn of the century, 1.59% of China's consumers had begun taking advantage of insurance policy protections. The pace of adoption has accelerated in the last two decades, bringing the overall insurance penetration rate in China to 4.42% at the end of 2017. Life policies appear to have the greatest appeal, reaching a penetration rate of 2.59% compared to 1.83% for all other insurance types. By comparison neighboring Hong Kong and Taiwan have insurance usage rates of 15% and 16%, respectively.

COMPETITIVE POSITION

There are sweeping changes underway impacting both supply and demand in the China insurance market. In our view, the unfolding situation presents both opportunity and challenge for Fanhua.

Forces of Contention. Of particular interest is the competitive position of insurance providers with which the Company contracts to serve as an agent. While there have been a number of new entrants into the China insurance market, it remains highly concentrated. Four national insurers dominate competition, including People's Insurance Company of China (PICC), Ping An Insurance, China Pacific Insurance (CPIC) and China Life Insurance. Collectively these four insurers accounted for 47% of insurance premiums in 2017. This is dramatically lower than in 2010, when this same group of four insurers commanded 95% of China's insurance premiums.

There is an expectation that the concentration in market share will continue to decline. Besides the entrance of new domestic insurance there is an expectation that foreign more insurers will enter the China market. In November 2017, the central government moved to relax limits on foreign shareholding in the capital of domestic insurance companies. At the end of 2017, only fifty foreign insurers - 28 in life insurance and 22 in non-life categories - accounted for just 6% of China's life insurance market and 2% of the non-life market. According to the Insurance Association of China, in the first four months of 2019, foreign insurance companies increased market share by 1.8% year-on-year to 6.8% of original insurance premium income.

Regulation. The regulatory landscape is shifting in China's insurance market. In April 2018, the China Insurance Regulatory Commission (CIRC) was combined with the China Banking Regulatory Commission (CBRC) to create the China Banking and Insurance Regulatory Commissions (CBIRC). The combination was expected to resolve discrepancies in responsibility between the two groups and coordinate cross-regulation of banks and insurers.

The central government through the CIRC and now the CBIRC has moved steadily in recent year to tighten regulation of the insurance industry, particularly the corporate activities of insurance providers. There appears to be new enthusiasm to monitor and enforce the quality and adequacy of capital reserves. For example, in February 2018 the CIRC took control of Anbang Insurance Group Co. Ltd. after determining that the company had acted recklessly and endangered the solvency of the company using unauthorized sales of short-term, high-yield insurance products to inflate Anbang's capital. The CIRC had to inject RMB 60.8 billion (US$8.8 billion) into Anbang to keep the company solvent. Anbang's chairman was sentenced to eighteen years in prison for fraud and embezzlement and was forced to relinquish RMB 10.5 billion (US$1.7 billion) as illegal gains. Wu's conviction provided an example of the CBIRC's willingness to act aggressively against bad actors.

<u>Consumer Expectations</u>. The aging of the China population is expected to be a disruptive force in demand in coming years. China's one-child policy was in effect from 1979 to 2016, creating a unique collection of individuals responsible for both parents. The specter of a population of dependents is expected to drive exceptional demand for life insurance products to help lessen the burden of caring for aging parents on the generation with no siblings. The age dependency ratio of people over the age of 65 to the workforce population between the ages of 15 and 65 is expected to reach 50% by the year 2055.

As a consequence of the demographic reality in China, consumers have expectations for insurance products that meet the particular needs as their unique families. Consumers may also begin to exert more power in the insurer-insured relationship, holding out for more extensive advice in selecting insurance, platforms with clear product comparisons, and higher quality customer service in claims processing.

<u>Digital Disruption</u>. The availability of consumer technology, including mobile devices, is creating expectations for simpler more transparent interactions between insurance providers and consumers. China consumers of all ages have become adept at using web-based, mobile apps and social media platforms to transact personal business. Described collectively as 'insurtech,' rapid migration to digital technologies may facilitate access to insurance and could win new business with underserved populations. Notably China's leading insurer Ping An has been a leader in technology investment.

Perhaps even more interesting is the apparent leadership role played by technology companies in modernizing China's insurance industry. In December 2017, Tencent, Inc. (0700: HK), the owner of the WeChat social media and messenger platform, established WeSure Insurance Ltd., a consumer platform for evaluating and purchasing insurance. Over the last year and a half Tencent has added at least two dozen partnerships with insurance and reinsurance companies such as Taikang, Pacific Insurance, PICC, Ping An and MetLife China. At the end of December 2018, Tencent claimed the platform had reached 20 million monthly active users.

Similarly, Internet services provider Baidu (BIDU: Nasdaq) launched an insurance sales platform in early 2018. Links to the insurance channel are available on Baidu's Wallet and Wealth Management app home pages. Baidu's insurance offering includes medical, critical illness and travel insurance products from Meiya Property Insurance, a subsidiary of American International Group (AIG: NYSE) and Tk.cn Insurance.

Digital distribution may also help smooth entrance to the China market by foreign insurance companies. At the beginning of 2019, French insurer AXA introduced a one-click travel insurance plan through WeChat Go, the app ecosystem dedicated to international travel.

Technology disruption is not likely to stop with the adoption of mobile computing and social media in distribution channels. Consulting firm Capgemini has predicted that blockchain and artificial intelligence could be among the next technologies to make inroads into insurance operations around the world. For example, blockchain could be used to streamline processes, provide transparency and increase security through data protection. Artificial intelligence could be used to reduce administrative costs and boost customer trust and loyalty.

Sales Representative Attraction. The advent of digital distribution puts pressure on insurers to make certain their policies are available to consumers on their favorite platforms as well as to put digital technology into the hands of sales agents who represent insurance products off-line. The need for competitive distribution channels presents opportunity for agents like Fanhua that have already been able to develop their own 'insuretech.'

The Company's *Boawang* platform gives consumers access to menu of medical, travel, accident, and homeowner insurance products and comparison tools through an Internet browser at *Baoxian.com*, a mobile application or on the WeChat platform. This may put Fanhua in direct competition with Tencent's WeSure platform.

Some investors may consider Tencent as an even more formidable competitor than another, more conventional insurance agency. However, we note that Tencent's financial report for the year 2018, revealed several of the Company's most high profile endeavors, including WeSure, are experiencing competitive pressures that have eroded profits. Weak profits may make it difficult for Tencent to continue investing in its ambitious insurance project. Furthermore, Tencent has recently announced a restructuring plan that shifts the company away from consumers toward business services. Tony Ma, Tencent's founder and chief executive officer, made a particular comment that "the main battlefield" on mobile devices is moving away from consumers to companies. This shift may take the pressure off insurance agents like Fanhua that have extensive relationships with consumers through their own online direct-to-consumer and offline sales representative networks. Enhanced business-to-consumer services from a powerhouse like Tencent could even be a boon to Fanhua, notwithstanding the existence of a competing distributor like WeSure.

Offline Network Advantage. While Fanhua relies heavily on just five insurance companies for the majority of its sales, we note the Company has relationships with a mix of insurers out of the 83 life insurance companies and 82 property and casualty companies cleared to issue insurance policies in China. The Company displays a 'cloud' of the insurance brands to consumers on the opening page of the Boawang website at *Boaxian.com*. A selection is shown in the table on page 11 of this report. The group includes a broad mix of China's largest insurance companies as well as the China-based joint ventures of foreign insurance leaders.

China's insurance industry is still maturing. There is significant room for growth and insurance companies are highly dependent upon insurance agents like Fanhua to reach consumers, both individuals and business. Having established a consistent team of sales representatives and claims adjusters operating from a network off offices and service outlets, we believe Fanhua offers strong appeal to its current and prospective insurance company partners.

We believe Fanhua's attraction as a distribution partner is in evidence in its insurance partners on the *Baowang* platform. For example, Zhong'An is a joint venture among China's second largest provider of life, property and casualty insurance, Ping An, Alibaba, China's ecommerce giant, and Tencent as discussed above. It is interesting to note that even though teaming up with technology giants, Ping An maintains a direct relationship with an established distributor in Fanhua. We believe the joint venture finds it valuable to maintain a relationship with an established distributor despite the appearance of a new and novel partnership of insurance with social media and ecommerce. Fanhua has proven adept at attracting and retaining a network of sales agents that can engage consumers on the offline environment, which continues to be an important sales channel in China.

INSURANCE PROVIDER RELATIONSHIPS - BAOWANG PLATFORM

	Name	Description
	Ancheng Property	RMB 4.1 billion registered capital; AM Best rated
	Meiya Property	Meiya Property Insurance
	Alliance Property	RMB 1.61 billion registered capital
	Aeon Life Insurance	RMB 1.1 billion registered capital
	Asia Pacific P&C	RMB 2.0 billion registered capital
	Chengtai Property	RMB 500 million registered capital
	China Life	RMB 28.27 billion registered capital; S&P Global Rating A+/Watch Neg; #1 life insurer by premiums
	China Taiping	RMB 5.07 billion registered capital; S&P Global Rating A/Stable; #8 P&C insurer
	China Pacific Life	RMB 8.4 billion registered capital for life insurer; #4 life insurer by policies
	Huaxia Insurance	RMB 15.3 billion registered capital
	Liberty Mutual Insurance	RMB 725.6 million registered capital
	China People's	RMB 25.76 billion registered capital for life insurer; RMB 14.83 billion for P&C insurer; #5 life insurer
	Ping An Pension	RMB 33.80 billion registered capital for life insurer; RMB 21.00 billion for P&C insurer; #2 life insurer
	Fosun Baodexin LIfe	RMB 2.70 billion registered capital for life insurer; RMB 500 million registered capital for health insurer
	Sunshine Property	RMB 5.09 billion registered capital for P&C insurer; #16 life insurer by policies; #7 P&C insurer
	Taikang Online Property	RMB 3.0 billion registered capital; no debt rating
	ZhongAn Online Property	Zhongan Online Property; joint venture of Alibaba, Tencent and Ping An Insurance; #25 P&C insurer

LEADERS AND OWNERSHIP

Fanhua has a deep bench of executive and board leadership, well steeped in accounting, finance and economics. All members of the board of directors and senior management have lengthy tenures with the Company. One of the Company's co-founders, Yinan Hu, is a member of the board of directors, providing the Company with stability and continuity.

Senior executives and directors hold a significant stake in the Company, totaling 21.1% of outstanding ordinary shares. The Company's remaining co-founder and director, Yinan Hu, is Fanhua's single largest individual shareholder with a stake representing 14.6% of total outstanding ordinary shares. Hu is also the sole shareholder and director of the largest of the Company's three employee stock plans, which owns 200 million or 14.6% of the Company' shares. Although the stock plan has elected an employee committee to make voting decisions, we believe Hu could wield influence over the plans' actions. This gives Hu direct or potentially indirect control over a third of total shareholder votes.

Significant Shareholders

Not included among significant shareholders in Table II below is Fosun Industrial Holdings Ltd. a leading asset manager in China and a subsidiary of Fosun International Ltd. (00656: HK). Fosun invested RMB 200 million (US$29.2 million) in Fanhua in April 2017, through a private placement of 66.0 million shares of ordinary common stock. Subsequently, the shares were registered in June 2018, but were subject to a one-year lock-up agreement that expired in December 2018. Fosun has divested of its shares.

Table II: Insider and Significant Ownership

Name	Position	Years	Stock*	Options	Experience/Education
Chunlin Wang	CEO, Chairman	21	39.3 M	-0-	Law; executive management
Peng Ge	CFO, Director	21	48.6 M	-0-	Accounting, finance
Yinan Hu	Co-Founder, Director	21	199.7 M	-0-	Economics; entrepreneurship
Yunxiang Tang	Director – I, 2	7	-0-	-0-	Banking, finance
S. Markscheid	Director – I, 1, 2, 3	12	-0-	0.64	Investment advisory, finance
Allen Lueth	Director – I, 1, 2, 3	12	-0-	-0-	Accounting, audit
Mengbo Yin	Director – I, 1, 3	11	-0-	0.40	Finance, economics
Offices and Directors as a Group			287.6 M	21.1% of outstanding ordinary shares	
5% Holders as a Group			200.0 M	14.6% of outstanding ordinary shares	

**Ordinary shares*

I Independent Director
1 Audit Committee
2 Compensation Committee
3 Corporate Governance and Nominating Committee

Source: Company Reports and Crystal Equity Research Estimates

Employee Shareholder Plan

In June 2018, Fanhua implemented a program to allow certain employees to invest in the Company. Called the 521 Plan, it is available to sales team leaders and branch general managers, among other key management personnel. The Company funded the plan using American Depository Shares (ADS) purchased in the open market as well as newly issued shares. Participants in the program can acquire shares through a loan from the Company, but must pay at least 10% in cash. Accordingly, the shares are classified as treasury shares. The plan shares are subject to a five-year lock up period and the participants must fulfill performance goals within that five-year timeline to full vest in the share value. At the end of June 2019, a total of 280.0 million shares or 14.0 million ADS had been invested in the plan and are held by three separate legal entities for plan participants. The largest of the three plans holding 200 million shares (10 million ADS) represents 14.7% of shares outstanding.

Market Flotation

We estimate the flotation of shares in Fanhua is 80% ordinary shares based on insider holdings. However, the constructive flotation of shares is closer to 64% of ordinary shares. This latter estimation is based on the view that included in Company's employee share ownership plans (280.0 million ordinary shares or 14.0 million ADS) are not likely to be traded and are therefore not part of the regular trading of shares.

As of March 31, 2019, the Company's depositor for its ADS held approximately 48.1% of the ordinary shares outstanding at the time or approximately 30.1 million ADS. Management indicates that subsequent to new ADS issuances and repurchases by the Company through its 2019 shares repurchase program there are now approximately 31.9 million ADS outstanding. We estimate that the constructive flotation of ADS is approximately 17.9 million. Notably the top ten institutions holding the Company's ADS hold a total 15.5 million ADS, representing a significant portion of ADS outstanding. We believe these shares are part of the trading flotation, but some may not trade with frequency.

Table III: Institutional Ownership

Institution	ADS Shares	% Outstanding
Bank of America Corp.	2.2 M	3.7%
Matthews International Capital Management	1.8 M	3.0%
Credit Suisse AG	1.7 M	2.9%
Goldman Sachs Group, Inc.	1.7 M	2.9%
Citigroup, Inc.	1.7 M	2.9%
Vanguard Group, Inc.	1.4 M	2.4%
Franklin Resources, Inc.	1.4 M	2.4%
Capital Research Global Investors	1.3 M	2.3%
Morgan Stanley	1.2 M	2.1%
UBS Group AG	1.1 M	2.0%

Source: Company reports and Crystal Equity Research estimates

FINANCIAL PERFORMANCE

Accounting Quality

Revenue Recognition. Fanhua reports revenue from three sources: life insurance agency fees, property and casualty agency fees and claims adjusting service fees. Contracts with insurance companies specify the pricing of the insurance products Fanhua will sell and the rates at which the Company will receive fees or commissions. Revenue is recognized at the effective date of the insurance policy and when the premium has been received.

Cost of Sales. Costs of sales are composed of commissions owed to sales representatives, in-house claims adjuster salaries, platform costs and costs associated with maintaining sales and service offices. These costs included both fixed and variable elements.

Significant Accounting Estimates. The Company must make a critical estimate related to revenue recognition for insurance contracts which involve a mix of performance obligations. That said, most of the Company's revenue is recognized at the effective date of the insurance policy. Revenue associated with policy renewals is recognized when received by the insurance providers.

Accounts Receivable. Historic write-offs of accounts receivable from insurance company partners have been nominal. However, write-offs decreased to 1.1% of accounts receivable in 2018, compared to 2.0% in 2017. The Company's allowance for doubtful accounts is based on historic write-offs. Notably, in 2018, the Company's three most significant insurance provider relationships accounted for 61.4% of accounts receivable compared to 65.1% of total sales.

Intangible Assets. Intangible assets totaled RMB 204.7 million (US$30.5 million) at the end of December 2018, the last time intangible assets were reported as separately on Fanhua's balance sheet. All intangible assets have been fully amortized or written-off in prior years except for a trade name, for which the unamortized balance is RMB 7.6 million (US$1.1 million).

Employee Benefits. Fanhua does not have a pension plan as such. However, in June 2018, as part of an effort to incentivize and reward key sales personnel, the Company established a 521 plan to enable purchase of the Company's shares by eligible employees. The Company has funded the plan with 280 million ordinary shares (14.0 million ADS) purchased in the open market at an average price of RMB 183.8 million per ordinary share (US$27.38 per ADS). Participants have paid cash for 10% of the purchase price and received a loan from the Company for the 90% balance. The shares vest over a five year period. The 521 plan is accounted for as a grant of share options, the cost of which is recognized as compensation expense over the vesting period. To the extent that the prevailing market price falls below the original purchase price prior to full vesting, the Company may be subject to risk of default by plan participants.

Off-Balance Sheet Liabilities. Fanhua has no off-balance sheet obligations.

Extraordinary Items. No extraordinary items have been reported in the last three years.

Customer Concentration. In 2018, three of Fanhua's contracted insurance company partners accounted for over two-thirds of Fanhua's total net revenue, including Huaxia Life Insurance Co. Tian'an Life Insurance Co. and Aeon Life Insurance. The Company's revenue is therefore dependent to a great extent on the financial stability of these insurance providers.

Related Party Transactions. Over the last three years, the Company has reported a variety of transactions with related parties, including 1) purchase of shares from a principal shareholder by management, 2) purchase of wealth management products from a company controlled by a relative of a director, 3) loans to affiliates, and 4) repurchased shares from a principal shareholder by the Company's 521 plan. As of March 31, 2019, there were no assets or liabilities on the Company's balance sheet resulting from related party transactions.

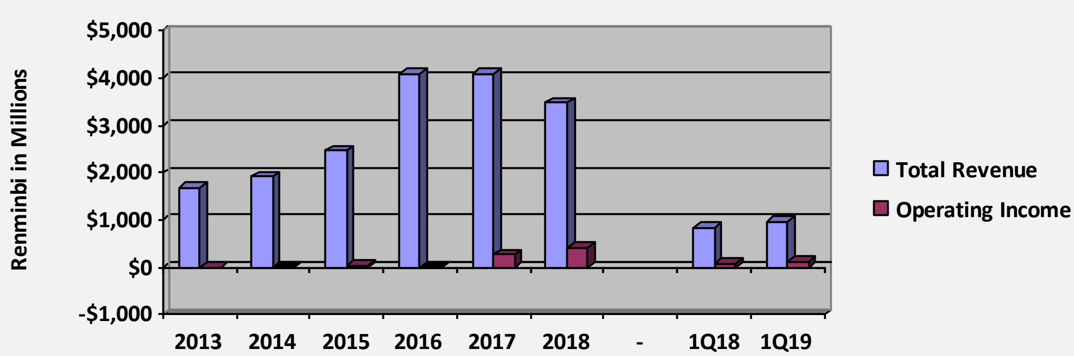
Seasonality. Fanhua experiences certain seasonality in the pace of sales activity. This is due primarily to calendar effects related to holiday celebrations in China. Consumers apparently like to get important property risk decisions made before the end of the Gregorian calendar year, causing the quarter ending December to the seasonally strongest for P&C sales. Then the next quarter ending in March is the period of lowest P&C sales activity. However, more personal decisions aimed at protecting life-time goals with life insurance come to a peak in the quarter ending March, which includes the Chinese New Year. Life insurance sales are at the lowest level in the fourth quarter ending December.

Currency. All of Fanhua's business activity is conducted in the People's Republic of China. All sales and most expenses are denominated in the country's official currency, renminbi. Financial results in the Company's reporting currency, the United States dollar, may vary depending upon the prevailing exchange rate. Financial measures used in this report such as growth rates or profitability ratios are calculated in the Company's functional currency to avoid the distortion of translating results into US dollars.

Profitability and Cash Flow Generation

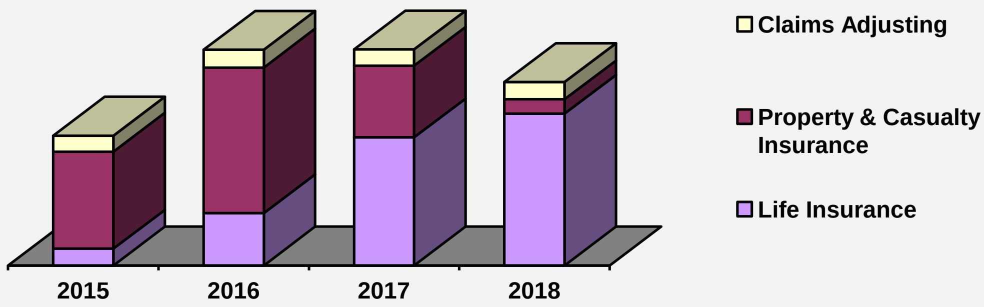
Fanhua is a well established insurance agency operation with a history of sales growth driven by robust consumer demand for insurance products and the addition of new insurance provider relationships that has expanded the selection of insurance products. Competitive pressures that had led to operating losses in the property and casualty (P&C) segment in 2016 and 2017, triggered a decision in October 2017, to fundamentally change the distribution approach from a sales agent model to a platform model. Commission rates offered by insurance providers for platform sales are lower than for the sales agent model. As a consequence P&C commissions have diminished in magnitude beginning in 2018.

Chart II: Historic Sales and Operating Income



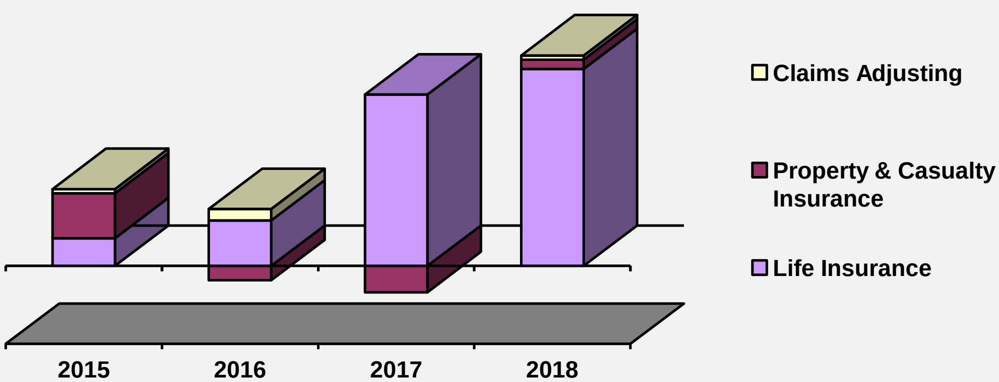
Source: Company Reports

Chart III: Sales Mix by Segment



Source: Company Reports

Chart IV: Segment Operating Income Mix by Segment



Source: Company Reports

Segment Performance

Life insurance sales now provides the majority of revenue for the Company, reaching 82.7% of total sales in 2018, compared to 59.3% contribution to the top-line in the previous year. Fees from claims adjusting services climbed to 9.4% of total sales in 2018, surpassing revenue from P&C insurance sales at 7.9% of the total.

All of Fanhua's revenue from the sale of life insurance and a portion of the sales of P&C insurance are the result of sales activities by sales representatives. Most of these sales personnel are independent agents and not employees of the Company. The commissions owed to sales personnel are largely variable and depend upon the level of sales activity. Cost of sales reached 67.6% in the full year 2018, compared to 74.8% in the prior year. In the most recently reported quarter ending March 2019, costs in the life segment increased to 70.0%.

The strategic move to a platform approach appears to have restored profitability to the P&C segment. In the full year 2018, the P&C platform delivered an operating profit margin of 8.8% compared to operating losses in the previous two fiscal years.

The portion of P&C insurance not handled by sales personnel is executed on the Baoxian.com platform. There are fixed cost elements and variable cost elements for maintaining and executing sales on the Baoxian.com platform, including maintaining the platform architectures, refining the consumer interface, and processing orders and payments. Following the change in strategy in the P&C segment, shifting to a platform model, the cost of sales in the P&C segment has declined dramatically. The platform model earns lower fees from the insurance provider, but the elimination of commissions to sales agents leads to a lower cost of sales. In the most recently reported quarter ending March 2019, the cost of sales in the P&C segment was 64.6%. This compares to 76.5% in the full year 2018. In the year 2017, when the Company was still reliant largely on sales agents to generate P&C sales, cost of sales in the segment was 90.6%.

Claims adjusting services are carried out by in-house agents and by outside claims adjustors through *Chetong.net*, a digital platform of tools for claims agents. Costs in this category are also a mix of fixed and variable elements. The cost of sales in the claims adjusting segment was 57.3% in the quarter ending March 2019, compared to 59.3% in the full year 2019.

Operating Cash Flow

The Company converted 15.1% of sales to operating cash flow in 2018, a dramatically higher rate of cash generation than the previous year when the sales-to-cash conversion rate was 3.7%. The increase in operating cash flow in 2018, was due primarily to an overall increase in profits and to a restoration of profitability to the P&C segment, albeit nominal. Operating cash flow in the first quarter returned to 4.8% of sales compared to 3.6% in the first quarter of the previous year. We note that the insurance subscription rates vary seasonally with P&C sales at a seasonal low and life insurance sales at a seasonal high in the March quarter. Nonetheless, Fanhua consistently delivers positive cash flow, which bodes well for future growth investment.

Balance Sheet and Capitalization

Working capital at the end of March 2019, totaled RMB 2.1 billion (US$319.9 million). Cash and short-term investments are the largest two components of current assets, followed by accounts receivable from insurance company partners. Boosted by strong cash flows, the Company ended the most recently reported quarter with RMB 1.0 billion (US$152.9 million) in total cash on the balance sheet. Additionally, the Company held RMB 1.4 billion (US$203.8 million) in short-term investments that could be converted to cash should the Company need cash resources for an opportunistic investment.

Collections on accounts receivable appear to be a priority. At the end of 2018, there were 53 days sales outstanding (DSO) based on sales activity in the year 2018. The collection period appears to be in-line with insurance distribution business models. That said, we note that the DSO measure had been consistently near 46 days, increasing by a week in 2018.

Fanhua is capitalized exclusively with equity, leaving only operating obligations in current and long-term liabilities. Shareholder equity totaled RMB 2.6 billion (US$385.1 million) at the end of March 2019. In addition to RMB 349.6 million (US$52.1 million) in capital from the sale of ordinary shares of common stock, equity includes RMB 1.9 billion (US$276.2 million) from retained earnings.

Investments in Related Businesses

Fanhua's balance sheet and reported income reflect investments the Company has made in complementary businesses. The Company owns 18.5% of CNFinance Holdings Ltd., a home equity loan service provider, 4.5% equity interest in Puyi, Inc., a provider of wealth management services, and a 40% stake in Shanghai Teamhead Automobile Surveyors Co., a provider of loss adjustor services. All three exclusively serve the China domestic market. At the end of March 2019, Fanhua reported RMB 611.7 million (US$91.1 million) in long-term assets related to the three positions. Collectively, book value of the investments represents 14.2% of total assets.

Using the equity method to account for the investments, Fanhua included RMB 174.5 million (US$25.4 million) in income from the affiliates in reported net income in 2018. This compares to RMB 108.9 million or (US$16.7 million) in the previous year. Income from the investments represented 28.4% and 5.7% of reported net income in 2018 and 2017, respectively. Notably in 2016, the percentage share of affiliate income in total net income was 33.3%, making it clear that these investments can have a significant impact on reported earnings depending upon the relative profitability of each.

EARNINGS MODEL

Our projection of future sales and earnings relies first on management's guidance recently provided following the report of year-end 2018 and first quarter 2019 financial results. We have also taken into consideration current economic conditions in mainland China that we believe impact consumer demand for insurance products. Additionally, our view is informed by the fluidity of competitive conditions that require investments in technology to gain and protect market share. We have also considered recent regulatory changes that have opened the insurance industry to new foreign competitors and tightened restrictions of certain life insurance products.

Guidance

Management provides guidance for the forthcoming period with each quarter financial report. With the year end 2018 financial report the following guidance was offered for the year 2019:

- Annual Premium Equivalent (APE) on regular life insurance products is expected to increase by 30% year-over-year
- Renewal insurance premiums are expected to grow by 50% year-over-year to RMB 5.6 billion and operating income to RMB 600 million
- Investment income is expected to decline in 2019 as the Company uses cash reserves for share repurchases, cash dividends and loans to support the 521 plan
- Equity interest in CNFinance Holdings may decline in the year as CNFinance alters its business model to a light-asset platform model
- Growth in earnings per share in 2019 is expected through a combination of a small increase in net income and a reduction in shares outstanding due to repurchase of shares that reduces the number of shares outstanding

In late May 2019, along with the first quarter 2019 financial report, management expanded on its previous guidance or the year 2019, with the added nuance that total second quarter operating income is expected to growth 20% year-over-year.

Sales and Cost Assumptions

Our projection of Fanhua's future sales and earnings is based upon a series of assumptions related to the China insurance market and our assessment of Fanhua's competitive position.

- Continued extension of Fanhua's insurance provider relationships with both domestic and foreign insurance companies
- Maintenance of current complement of insurance sales and claims adjusting service offices
- Continued growth in active uses of the *Boaxian.com* consumer platform, although at a slower pace than in the year 2018, when active users grew by 69.7% year-over-year
- Modest expansion of the sales representative network for life insurance products from current level of 860,000 agents registered with *Lan Zhanggui* sales agent platform at the end of March 2019, with maintenance of performing agents near 240,000
- Modest expansion of sales representatives registered with *CNpad Auto* from the current level of 560,000 activations with maintenance of active agents near 51,000
- Stabilization of life insurance premiums at recent rates
- Stable sales agent commission rates
- Increases in operating costs and expenses at 10% per year
- Investment in a range of RMB 50 million to RMB 100 million (US$7.4 million to US$14.5 million) in the maintenance and feature development of existing consumer and sale agent facing digital platforms
- Continued share repurchases according to current authorization
- Exchange rate of RMB 6.700 to US$1.00

The combination of these assumptions results in the sales and earnings results as shown in Table IV below. The table below provides a summary in renminbi. In tables beginning on page 23 of this report sales, cost, expense and earnings projections are shown in detail in US dollars. We project 13.0% year-over-year growth in sales in 2019, compared to the previous year, followed by 16.8% top-line growth in the year 2020. Our model suggests net income could decline in 2019 as income from affiliates and investment income decline. However, a reduction in shares outstanding due to the Company's ongoing share repurchase program should help deliver flat or slightly higher earnings per share in 2019.

Table IV: Summary Historical and Projected Sales and Earnings

RMB	2017 Actual	2018 Actual	*2019 Estimate*	*2020 Estimate*
Sales	4,099.5 mln.	3,471.3 mln.	*3,981.7 mln.*	*4,636.0 mln.*
Operating Income	273.1 mln.	425.7 mln.	*557.2 mln.*	*655.9 mln.*
Earnings / ADS	1.13	9.83	*9.80*	*10.80*
Cash flow from operations	152.1 mln.	523.8 mln.	*645.0 mln.*	*715.1 mln.*

Source: Company Reports and Crystal Equity Research Estimates

Upside Potential

We view our initial estimates as generally conservative. However, there could be upside to our model related from sales force performance and the addition of new insurance partners.

Management indicated in recent interviews that the Company plans to grow its sales force and improve productivity of its active sales agents. Our initial estimates are predicated only on modest growth in the sales agent network over the next two years. The upside may come from a source that others have point to as a deficiency.

Fanhua has accumulated a large number of registrations for its *CNpad Auto* and *Lan Zhanggui* platforms for sales agents. A significantly smaller number of the sales agents are actively selling insurance through Fanhua than have registered on these two platforms. Nonetheless, over the last three years active users of have grown at compound annual rates of 19.5% and 24.5% for *CNpad* and *Lan Zhanggui* sales agent platforms, respectively. A comparison of active agent growth to sales growth in the *Lan Zhanggui* platform underscores the value of increasing the number of active agents. In the same three-year period that the network of active agents using the *Lan Zhanggui* platform increased 24.5%, sales revenue generated on the platform grew 49.0%.

The Company is in the midst of identifying non-active sales personnel in its sales agent networks and is assisting registered users who wish to remain in good standing to submit documents for the CBIRC Practice Registration requirement for insurance agents. Nonetheless, we view the inactive registrations as a valuable database of 'warm leads' that Fanhua could tap and convert to active sales activity. We believe platform registrations could be a lower cost means of recruiting sales agents and promoting productivity than other channels such as advertizing or recruiting programs. Importantly, the CBIRC regulatory agency limits agents to registration with one insurance entity.

The China market appears to differ from the balance of the world's insurance markets, in that sales agents remain the most important distribution channel for insurance products and service. Indeed, China has the largest force of insurance sales agents in the world. Fanhua management has suggested that building sales agent headcount is a key driver behind new business growth. While management does not view other insurers as competition for good sales agents, there is a clear trend among Chinese sales agents to operating independently either through platforms like Fanhua's *CNpad Auto* or *Lan Zhanggui* or by setting up their own agencies. Chinese consumers are apparently driving this trend with a preference for independent advice and the ability to compare insurance choices.

The Company may add more insurance provider relationships particularly as foreign insurance companies enter China's market subsequent to relaxation of foreign investment limits in the insurance industry. However, our model assumes no new relationships in the near-term.

In a recent interview, management indicated that as an intermediate insurance agency, Fanhua could be a beneficiary of the incursion of foreign insurance providers. Their optimism is apparently based on the view that building a sales agent network is costly and time consuming. An existing network can give the new foreign competitor quicker access to a large consumer base. As noted in the Competition section, Fanhua already has proved capable of landing foreign providers through relationships with AIG and Liberty Mutual. Here again Fanhua's sales agent network and perhaps even its database of *CNpad* and *Lan Zhanggui* registrants could be important selling points as new foreign competitors enter the China market.

VALUATION

Valuation of Fanhua ADS is frustrated by the fact that it is a security that trades in the U.S. equity market, but is a foreign corporation supported by earnings gleaned from China-based business. Given that Fanhau has consistently paid a dividend, one option is to value of Fanhua's ADS using the dividend discount model. Unfortunately, this model requires an estimate of both required return and future earnings growth.

Undaunted, we estimated required return using the Capital Asset Pricing Model using the 10-year bond in the U.S. for the risk free rate, the ADS beta measure for FANH shares. Our rationale in using U.S. equity market data is that a security that trades in the U.S. equity market it should be evaluated in that capital market dynamic. Furthermore, historic trading in the stock that informs the beta measure of volatility reflects investors' views on the foreign operation and its habituated market. An expected return of 4.7% for the broader market was used based on a survey of projected returns for 2019 for the U.S. equity market and the 10-year bond rate of 2.5% was applied. For the third and last required component of the model we used the Company's ADS beta measure of 1.20. For the dividend discount model, the 2019 dividend of $1.20 per ADS was used along with a reasonable steady state growth rate of 2.0%. The latter assumes that the Company can maintain current market share and sustain recent profit levels in the domestic China market. The final result of this combination of assumptions for the dividend discount model is an intrinsic value of US$38.22 per ADS.

An alternative valuation method is the use of valuation metrics for comparable securities. For this purpose we used a group of forty-two companies operating in China and with securities trading in the U.S. equity market. The group was limited to companies focused on finance and/or consumer services such that demand conditions and business models would be similar to Fanhua. On average the group was larger in size than Fanhua, but less profitable and with higher leverage. Applying the average multiples of sales, cash flow, earnings and book value to those metrics for Fanhua, the implied intrinsic value of the Company is US$36.67 per ADS.

This analysis suggests FANH is undervalued by 8.0% to 10% at the current price level.

Both methods can be used to calculate a future or targeted value for FANH ADS by using projected sales, earnings and balance sheet values. Using the dividend discount model with a projected dividend of $1.32 per ADS, suggests a value of $42.04 at the end of 2019 or six months hence. Using the comparable multiples with projected sales, earnings, cash flow and book values delivers a future value for FANH of US$40.16 for the same time frame.

The forward looking valuation suggests there could be 22% upside potential in FANH shares over the next six months from the current price level.

OUTLOOK

In our view, the outlook for FANH ADS is promising. We anticipate favorable comparisons with each quarter report in the periods ahead. Fanhua has become fairly consistent in reporting the details of quarterly performance, making it easier for investors to track period-to-period performance. Management has been faithful in holding quarterly earnings conference calls. The improved transparency should translate into improved investor sentiment. It is also notable that Fanhua's ADS has become relatively well-seasoned since an initial launch in 2007, and trading volumes are improving.

Trading and Valuation Catalysts

Top-most in catalysts for the FANH ADS price is likely to be strong quarterly sales and earnings comparisons throughout the balance of 2019. We expect Fanhua management to continue reporting quarter results in a timely manner and that results are more likely than not to represent positive year-over-year growth. We also note that quarter reports have become more and more detailed in content particularly related to productivity metrics.

Continued strength in the China insurance market should also help support Fanhua valuation. We expect timely news and policy announcements in the China market that show attractive fundamental developments in the market.

The Company is facing a shareholder lawsuit filed earlier in 2019. The case is at an early stage with both plaintiff and defendant filing initial briefs with the court, but no trial date has been set. Indeed, such disputes can be dismissed by the court of settled before a trial begins. In the meantime, news of the various steps in the legal action could roil trading in the ADS.

The shareholder lawsuit makes it clear that Fanhua has been vulnerable in the past to so-called 'short and distort' stock publications. Typical of such schemes, two reports published in August 2018 and January 2019, focus on a few data points from the Company's financial report and use innuendo in the guise of analysis to make it appear that management has nefarious or corrupt motivation in their conduct. An investigation by the Company's independent directors and a special counsel in early 2019, concluded the allegations were without merit.

Our own review of the allegations made in the two reports on a point by point basis determined that the analysis supporting the claims made in the reports were inadequate in most cases and faulty in others. For example, the allegation was made that the October 2017 sales of Fanhua Times Sales & Service Co. and eighteen P&C agencies was never completed. Pages of innuendo and conjecture were offered up as proof of this charge, most of which was misapplication of circumstantial information. In our view, a more important question in the matter is whether Fanhua received payment as promised for the transaction, relinquished control of the operations, and no longer report the assets, revenue and costs in the Fanhua consolidated financial reports. The details of the transaction are included in the Company's reported assets and cash flows in 2017 and 2018. Thus to answer the question objectively investors are highly dependent upon the veracity of Fanhua's financial reports and the thoroughness of the Company's auditors.

It is worthwhile to note that the Company's auditor, while an independent public accounting firm and affiliated with a prestigious U.S. accounting firm, is not currently inspected by the U.S. PCAOB (Public Company Accounting Oversight Board). This private-sector non-profit organization was set up to the Sarbanes-Oxley Act of 2002 to oversee the audits of public companies in order to promote preparation of informative, accurate and independent audit reports. The PCAOB has not been allowed to inspect accounting firms in the PRC which are auditing Chinese companies that trade on U.S. exchanges. There is a risk that the Company's filings, which are reliant on audits performed by its accounting firm, could be rejected by the U.S. Securities and Exchange Commission (SEC) in the future.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST.

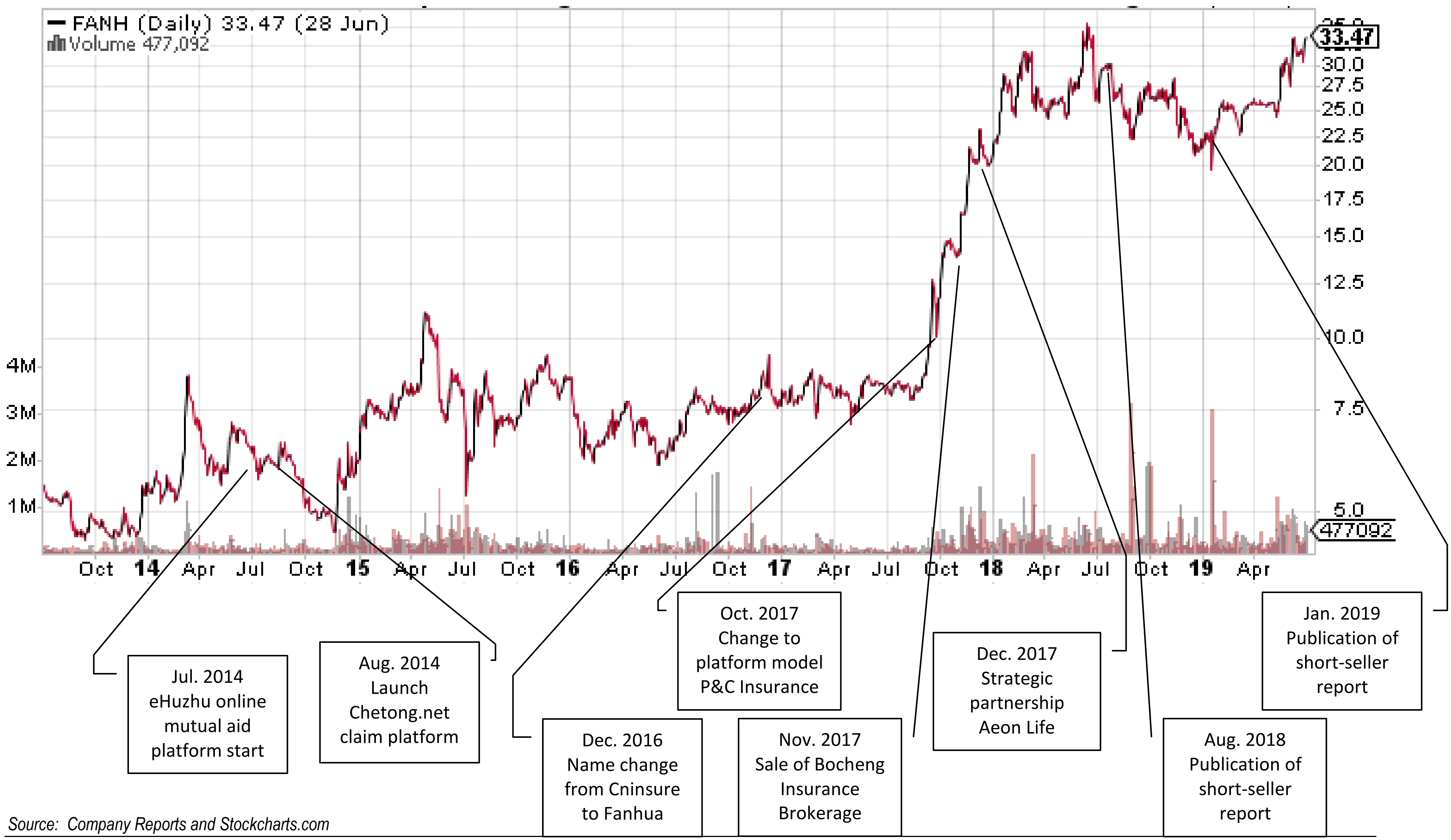
Table V: Historic and Projected Sales and Earnings

US Dollars in Thousands	2016	2017	2018	*2019*	*2020*
Agency, life insurance	142,668	372,630	417,537	*519,814*	*613,433*
Agency, property & casualty insurance	396,936	208,378	39,720	*25,531*	*30,448*
Claims adjusting	48,454	47,378	47,617	*48,690*	*48,060*
Total revenue	588,058	628,386	504,874	*594,035*	*691,940*
Agency, life insurance	96,965	251,501	282,605	*359,713*	*423,269*
Agency, property & casualty insurance	321,700	188,823	30,369	*16,372*	*19,487*
Claims adjusting	28,779	29,898	28,239	*28,162*	*27,394*
Cost of sales	447,444	470,222	341,214	404,247	470,149
Gross profit	140,614	158,164	163,661	*189,787*	*221,791*
Operating expenses:					
Selling expenses	72,419	34,088	33,608	*37,543*	*42,997*
General and administrative expenses	69,415	82,096	68,130	*69,110*	*80,906*
Total operating expenses	141,833	116,183	101,739	*106,653*	*123,903*
Operating income (loss)	(1,219)	41,980	61,922	*83,134*	*97,888*
Other income (expense)					
Investment income	16,603	29,477	28,428	*20,711*	*18,209*
Interest income	994	3,979	4,975	*62*	*-*
Other, net	1,489	2,195	1,717	*216*	*-*
Total other income (expense)	19,086	35,651	35,120	20,989	18,209
Income (loss) before income taxes	17,867	77,632	97,042	*104,124*	*116,097*
Provision for income taxes (benefit from)	3,925	25,791	32,665	*30,243*	*34,829*
Share on profits (losses) in affiliates	6,956	16,744	25,375	*14,981*	*14,925*
Net income (loss) from cont. oper.	20,898	68,585	89,753	88,861	96,193
Discontinued operations, net of taxes	3,247	842	-	-	-
Net income of non-controlling interests	(1,635)	(382)	(1,044)	*(359)*	*(400)*
Net inc. (loss) available to shareholders	22,510	69,045	88,708	*88,502*	*95,793*
Net EPS (loss), available to shareholders	$0.02	$0.06	$0.07	*$0.07*	*$0.08*
Net EPS (loss), ADS	$0.37	$1.13	$1.43	*$1.47*	*$1.60*
Weighted shares outstanding, diluted	1,208,821	1,261,223	1,240,854	*1,205,833*	*1,200,000*
Exchange rate	6.943	6.5063	6.8755	6.7000	6.7000
SELECTED MEASURES:					
Sales growth, yr/yr	188.9%	6.9%	12.1%	*24.5%*	*18.0%*
Net income from cont. oper. growth, yr/yr	-21.0%	228.2%	30.9%	*-1.0%*	*8.3%*
EPS cont. oper. growth, yr/yr	-19.4%	135.9%	12.4%	*1.9%*	*8.8%*
Gross margin	23.9%	25.2%	32.4%	*31.9%*	*32.1%*
Operating margin	-0.2%	6.7%	12.3%	*14.0%*	*14.1%*
Net margin	3.6%	10.9%	17.8%	*15.0%*	*13.9%*
Cost as % of sales	76.1%	74.8%	67.6%	68.1%	67.9%
Selling expenses as % of sales	12.3%	5.4%	6.7%	6.3%	6.2%
General & admin. expenses as % of sales	11.8%	13.1%	13.5%	11.6%	11.7%
Effective tax rate	22.0%	33.2%	33.7%	*29.0%*	*30.0%*

Table VI: Historic and Projected Financial Results by Quarter

Dollars in Thousands	1Q	2Q	3Q	4Q	2018	1Q	2Q	3Q	4Q	2019
Agency, life insurance	107,287	122,154	95,299	106,900	417,537	128,023	141,791	117,164	132,836	519,814
Agency, property & casualty insurance	14,740	13,871	7,213	5,718	39,720	5,680	5,672	6,716	7,463	25,531
Claims adjusting	12,409	10,885	11,633	14,200	47,617	11,078	11,194	11,940	14,478	48,690
Total revenue	134,436	146,910	114,145	126,818	504,874	144,781	158,657	135,821	154,776	594,035
Agency, life insurance	74,651	83,635	58,928	75,145	282,605	89,624	96,418	82,015	91,657	359,713
Agency, property & casualty insurance	12,781	11,036	4,739	3,354	30,369	3,668	3,630	4,299	4,776	16,372
Claims adjusting	7,813	6,830	6,424	8,122	28,239	6,347	6,493	6,925	8,397	28,162
Cost of sales	95,245	101,502	70,091	86,620	341,214	99,639	106,540	93,239	104,830	404,247
Gross profit	39,191	45,408	44,054	40,197	163,661	45,142	52,116	42,582	49,946	189,787
Operating expenses:										
Selling expenses	7,764	8,145	8,293	10,402	33,608	9,632	9,944	8,392	9,575	37,543
General & administrative expenses	17,051	17,980	17,623	17,666	68,130	16,673	17,976	16,784	17,678	69,110
Total operating expenses	24,815	26,125	25,916	28,069	101,739	26,305	27,920	25,175	27,253	106,653
Operating income (loss)	14,376	19,283	18,138	12,129	61,922	18,838	24,197	17,407	22,693	83,134
Income (loss) before income taxes	21,191	27,274	31,271	20,223	97,042	24,603	29,421	22,481	27,619	104,124
Income available to shareholders	20,758	25,969	28,429	16,378	88,708	21,944	24,226	19,368	22,964	88,502
Net EPS (loss), available to shareholders	$0.02	$0.02	$0.02	$0.01	$0.07	$0.02	$0.02	$0.02	$0.02	$0.07
Net EPS (loss), ADS	$0.32	$0.40	$0.44	$0.29	$1.43	$0.39	$0.39	$0.31	$0.38	$1.47
Weighted shares outstanding, diluted	1,302,989	1,301,504	1,300,948	1,132,884	1,240,854	1,123,330	1,250,000	1,250,000	1,200,000	1,205,833
Exchange rate	6.2726	6.6171	6.868	6.8755	6.8755	6.7112	6.7000	6.7000	6.7000	6.7000
SELECTED MEASURES:										
Gross margin	29.2%	30.9%	38.6%	31.7%	32.4%	31.2%	32.8%	31.4%	32.3%	31.9%
Operating margin	10.7%	13.1%	15.9%	9.6%	12.3%	13.0%	15.3%	12.8%	14.7%	14.0%
Net margin	15.4%	17.8%	25.1%	13.5%	17.8%	15.2%	15.3%	14.3%	14.9%	15.0%
Cost as % of sales	70.8%	69.1%	61.4%	68.3%	67.6%	68.8%	67.2%	68.6%	67.7%	68.1%
Selling expenses as % of sales	5.8%	5.5%	7.3%	8.2%	6.7%	6.7%	6.3%	6.2%	6.2%	6.3%
General & admin. expenses as % of sales	12.7%	12.2%	15.4%	13.9%	13.5%	11.5%	11.3%	12.4%	11.4%	11.6%

Exhibit I: Corporate History and Stock Price Movement



Source: Company Reports and Stockcharts.com

Table VII: Comparable Stocks - Consumer Products and Services

COMPANY	SYM	OPERATIONS	RECENT PRICE	TRLNG REV	OPER MARGIN	DEBT / EQUITY	ROE	MARKET CAP	PRICE/ SALES	PRICE/ CSH FL	PRICE/ EARN	PRICE/ BK VAL
360 Finance, Inc.	QFIN	Finance	$11.60	$648.3	26.8%	0.00	33.5%	$1,670.0	2.6	40.3	8.5	1.9
Acorn International, Inc.	ATV	Consumer services	$20.09	$32.2	10.9%	2.08	45.0%	$51.8	1.6	10.8	1.4	0.7
Ambow Education Holding	AMBO	Consumer services	$3.86	$531.5	5.2%	0.16	14.0%	$83.6	2.1	3.3	94.6	2.4
ATA, Inc.	ATAI	Consumer services	$2.45	$68.6	31.0%	0.01	Neg	$58.3	0.7	Neg	0.4	1.3
Baozun, Inc.	BZUN	Consumer services	$54.70	$784.8	5.0%	49.55	14.1%	$3,280.0	3.7	Neg	92.7	10.4
Bright Scholar Education Holdings	BEDU	Consumer services	$10.20	$250.0	14.3%	1.70	14.0%	$1,200.0	4.2	14.9	33.2	3.0
China Bat Group, Inc.	GLG	Finance	$0.48	$0.9	nm	42.81	Neg	$4.0	4.6	Neg	0.4	1.4
China Distance Education Holdings	DL	Consumer services	$5.25	$182.4	4.1%	46.05	13.3%	$176.2	1.0	3.5	13.6	3.0
China Finance Online Co.	JRJC	Finance	$0.88	$42.1	-45.3%	23.34	Neg	$20.9	0.5	Neg	Neg	0.6
China HGS Real Estate	HGSH	Finance	$0.84	$44.6	20.6%	70.98	1.7%	$37.7	0.9	6.6	13.3	0.2
China Internet Nationwide Financial	CIFS	Consumer services	$2.08	$14.4	-64.9%	0.05	Neg	$44.9	3.1	Neg	Neg	0.7
China Life Insurance Co.	LFC	Life insurance	$12.83	$91,306.0	3.5%	26.73	6.9%	$108,240.0	1.2	2.8	19.3	1.4
China Online Education Group	COE	Consumer services	$7.10	$166.7	-19.6%	0.09	Neg	$148.9	0.8	34.4	Neg	Neg
Dragon Victory International	LYL	Finance	$1.00	$4.7	2.8%	0.00	3.4%	$11.4	2.4	Neg	23.3	1.0
Golden Bull Ltd.	DNJR	Finance	$3.23	$7.9	-52.1%	0.00	Neg	$49.7	6.3	Neg	Neg	4.2
Hailang Education Group	HLG	Consumer services	$58.26	$170.1	20.1%	0.00	21.2%	$1,500.0	8.9	17.2	44.4	7.5
Hexindai, Inc.	HX	Finance	$2.53	$61.3	8.3%	15.81	4.2%	$124.5	2.0	15.2	25.3	1.0
Huazhu Group	HTHT	Consumer services	$36.03	$1,464.4	6.7%	473.79	10.7%	$10,700.0	6.8	24.1	51.4	9.3
iQIUI, Inc.	IQ	Consumer services	$20.75	$3,636.6	-38.9%	95.37	Neg	$15,050.0	3.2	35.9	19.6	4.6
JD.com, Inc.	JD	Consumer services	$31.50	$67,236.0	0.7%	22.18	2.2%	$52,820.0	0.6	17.4	214.3	4.7
LexinFinTech Holdings	LX	Finance	$12.03	$1,105.4	42.2%	88.86	71.7%	$2,110.0	2.2	5.2	13.0	4.8
LightInTheBox Holding Co.	LITB	Consumer services	$1.46	$227.5	-18.3%	0.00	Neg	$98.2	0.5	Neg	Neg	Neg
Longevity Acquisition Corp.	LOAC	Finance	$10.13	$0.0	nm	0.00	Neg	$53.4	na	Neg	Neg	3.7
MDJM, Ltd.	MDJH	Finance	$2.74	$2.4	-23.4%	0.00	Neg	$33.6	14.0	Neg	Neg	3.9
Nam Tai Property, Inc.	NTP	Finance	$10.03	$1.1	nm	0.00	Neg	$383.1	nm	Neg	Neg	1.7
New Oriental Education & Technology	EDU	Consumer services	$97.08	$2,950.0	9.5%	2.23	11.6%	$15,370.0	5.2	19.7	59.2	7.4
Noah Holdings	NOAH	Finance	$44.87	$478.6	24.7%	4.66	14.4%	$2,700.0	5.4	18.0	21.6	3.1
Phoenix New Media Ltd.	FENG	Consumer services	$3.20	$200.4	-9.1%	8.78	Neg	$232.9	1.2	Neg	Neg	0.6
Puhui Wealth Investment Mngmnt.	PHCF	Finance	$2.84	$5.3	19.2%	10.30	4.1%	$32.7	6.2	Neg	34.2	2.3

Comparable Stocks continued

COMPANY	SYM	OPERATIONS	RECENT PRICE	TRLNG REV	OPER MARGIN	DEBT / EQUITY	ROE	MARKET CAP	PRICE/ SALES	PRICE/ CSH FL	PRICE/ EARN	PRICE/ BK VAL
Puyi, Inc.	PUYI	Consumer services	$9.04	$25.3	38.1%	1.64	33.4%	$545.2	21.5	83.2	53.2	19.4
Secoo Holding Ltd.	SECO	Consumer services	$7.24	$784.0	2.6%	83.61	10.2%	$363.8	0.3	Neg	16.2	1.7
Senmiao Technology Ltd.	AIHS	Finance	$2.21	$2.9	nm	19.68	Neg	$61.3	19.6	Neg	Neg	4.4
SSLJ.com Ltd.	YGTY	Finance	$3.80	$20.6	nm	0.00	Neg	$11.5	0.6	Neg	Neg	Neg
TAL Education Group	TAL	Consumer services	$38.50	$2,560.0	13.3%	0.51	17.5%	$22,760.0	8.9	117.1	62.9	9.2
Tarena Internatonal, Inc.	TEDU	Consumer services	$2.18	$325.8	26.6%	1.47	Neg	$123.9	0.4	7.5	Neg	0.7
TMSR Holding Company	TMSR	Finance	$1.51	$23.0	0.8%	5.03	Neg	$30.0	1.3	Neg	Neg	1.6
Tuniu Corporation	TOUR	Consumer services	$3.15	$326.0	-11.9%	8.20	Neg	$404.5	1.2	10.4	Neg	0.8
Vipshop Holdings	VIPS	Consumer services	$8.66	$12,300.0	2.9%	8.46	14.9%	$5,760.0	0.5	6.9	18.0	2.3
Wins Finance Holdings	WINS	Finance	$15.06	$21.9	15.7%	2.52	1.6%	$298.8	13.7	35.2	28.5	1.1
Yintech Investment Holdings	YIN	Finance	$4.39	$159.2	60.2%	3.02	Neg	$313.6	1.7	Neg	Neg	0.6
Yirendai, Ltd.	YRD	Finance	$14.07	$817.9	17.2%	4.20	23.9%	$864.4	1.2	Neg	5.3	1.2
		Average	$14.14	$4,609.5	4.1%	27.41	16.8%	$6,044.5	4.2	24.1	37.2	3.4
Fanhua, Inc.	**FANH**	**Insurance services**	**$33.48**	**$532.7**	**12.3%**	**0.00**	**23.2%**	**$2,180.0**	**4.2**	**28.1**	**21.8**	**5.6**

US Dollars in Millions

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ANALYST

Debra Fiakas, CFA is a seasoned, credentialed investment professional with a diversified and successful track record as a research analyst and as an investment banker. Her decade-plus career includes solid experience in all aspects of the equity capital markets with particular emphasis on emerging growth companies operating in the technology sectors. Ms. Fiakas is also the principal member of Crystal Equity Research, LLC.

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Holds	10%
Sells	27%
Total	100%

HISTORICAL RECOMMENDATIONS AND TARGET PRICE: Fanhua, Inc. / FANH

Report	Date	Price	Rating	Target Price
Initial	7/19/19	$33.48	Buy	$41.00 (six-month)

DISCLOSURES

Name	Symbol: Exchange	Disclosures
Fanhua, Inc.	FANH: Nasdaq	D, F, G

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