

CNFinance Holdings Limited
Q2 and First Half 2021 Financial Results Conference Call
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Executives:

Jane Jenn, Investor Relations

Bin Zhai, Chairman and Chief Executive Officer

Li Ning, Vice President of Capital Markets Department

Analysts:

William Gregozeski, Greenridge Global

Neil Gagnon, Gagnon Securities.

Presentation

Operator: Good day, and welcome to the CNFinance Second Quarter and First Half of 2021 Financial Results Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note, this event is being recorded.

I would now like to turn the conference over to Ms. [Jane Jenn]. Please go ahead.

Jane Jenn: Good morning and good evening. And welcome to the CNFinance second quarter 2021 financial results conference call. In today's call, our CEO, Mr. Zhai, will walk us through the operating results, followed by the financial results from our Vice President of Capital Market Department, Ms. Li. After that, we will have a Q&A session.

Before we start, I would like to remind you that this conference call contains forward-looking statements within the meaning of Section 21E of the Securities and Exchange Act of 1934 as amended, and as defined in the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified by terminology such as will, expects, anticipates, future, intends, plans, believes, estimates, target, going forward, outlook and similar statements.

Such statements are based upon management's current expectations and current market and operating conditions, and relate to events that involve known or unknown risks, uncertainties, and other factors, all of which are difficult to predict and many of which are beyond the company's control, which may cause the company's actual results, performance or achievements to differ materially from those in the forward-looking statements.

Further information regarding these and other risks, uncertainties or factors is included in the company's filings with the U.S. Securities and Exchange Commission. The company does not

undertake any obligation to update any forward-looking statements as a result of new information, future events or otherwise, except as required under law.

Now, please welcome our CEO, Mr. Zhai.

Bin Zhai: (Speaking foreign language).

(Translated). Thank you, operator, and thank you, everyone, for joining us in the conference call. On today's call, we will introduce the company's financial and operational results of second quarter and first half of 2021, followed by a Q&A session.

Following a good first quarter, the loan facilitation volume increased again in second quarter. After adding another RMB3.8 billion of originated loans in the second quarter, the total loan facilitation reached RMB6.6 billion in the first half of 2021, representing an increase of 100% and 113%, respectively, to the same period of last year.

The net income in the second quarter and the first half of the year was RMB[65] million and RMB150 million, respectively, both increased significantly, comparing to a net profit of RMB25 million and a net loss of RMB 40.5 million in the same period last year.

We not only delivered solid operational results in the second quarter but also in the first 6 months of 2021. The loan facilitation volume even reached a new high since the inception of the collaboration model. The reasons of our success are threefold: The huge demand for home equity loans; in the second quarter, as China's GDP grew 7.9%, the vital business operations of over 80 million grassroots micro and small enterprises in China led to a huge demand for working capital.

However, MSEs in China are usually scattered, with small scale and instable cash flow. These characteristics of MSEs make them difficult to meet the loan approval criteria at banks. Their demand for working capital cannot be satisfied by traditional financial institutions. In this market environment, we call ourselves the last mile courier to build a network of an inclusive financial system in China. In the past 2 years, we have offered loan services to over 40,000 MSEs in China.

On the other hand, home equity loan is still one of the best interest-bearing assets in the market, as we witnessed the consistent increase of property price in major cities since the second half of 2020.

Since the inception of the Collaboration Model, we have built a national [network] consisting of [60] branches in 40 cities, by collaborating with over 2,000 sales partners across China. With this network we are able to establish a wide market coverage and serve MSE owners' financing needs in a timely manner.

In the first half of 2021, we facilitated loans with a total amount of RMB6.66 billion, representing a year-on-year growth of 118% from RMB3.05 billion. The company's growth is back on a fast track.

The Collaboration Model has been well recognized by the market as we kept refining the operation in the past 2 years. To secure sales partners' loyalty to our platform, we have been

optimizing our service provided, by: First, we have been consistently adding talents to our professional management team. We also offer training programs for our sales partners to help their team members gain deep understanding of the products and risk control criteria of the trust company partners, so that they could serve MSE owners efficiently.

Second, we optimized the data processing and storage of our online system to make it more efficient and visible to users. We hope to service MSE owners in time and cut our own cost at the same time. The drastic increase in loan origination volume was a proof to the capability and efficiency of our loan processing system. Based on our internal assessment, our current system is capable to support an annual [capacity] of RMB30 billion to RMB50 billion in the loan origination volume

We delivered strong results in the past 2 quarters, but at the same time, we also noticed some challenges to our future growth, including funding pressure. We are highly dependent on trust companies as funding partner. Since the beginning of 2021, the regulation on trust companies' loan products was tightened. As a result, trust companies reduced our funding quota. We also suffered from a subsequent rise of financing cost. We do not expect this regulation to loosen up in rest of 2021, and therefore, our loan [facilitation] will possibly be affected.

We have noticed the uncertainties of property price and liquidity due to government policies in controlling property prices and impacts from the COVID-19 pandemic. In 2021, the government actively initiated measures to control property price, including announcing suggested prices to secondhand properties in multiple cities, as well as tighten mortgages to slow down property transactions. The management believes that such uncertainties will negatively affect the loan origination volume and NPL deposal.

Under the Collaboration Model, sales partners bear the risks. However, due to the business structure agreed upon with the trust companies, we are the holder of subordinated units in the trust plan. As a result, we have to consolidate the assets on our financial statements. We seem like a company with heavy assets where our revenue is generated from interest spread. The balance sheet cannot represent our true business model, which is, in fact, an asset-light loan origination platform. At the meantime, the look of the balance sheet is also a constraint when we reach out to new funding partners

In order to consistently grow our business and serve MSE owners in the changing market, we plan to further refine the current platform model and introduce a new asset-light service platform by taking the following measures: Transferring all assets and risks to any investors with preferences in high-risk and high-return assets backed by properties. Our company will focus on online and offline origination, and post-loan management service.

Collaborating with different types of funding partners to serve MSE owners with different credit ratings. Other than strengthening our collaboration with trust companies, we have proactively reached out to various financial institutions. We hope by introducing more diversified loan products, MSEs could enjoy the benefits of more affordable loans. We have signed collaboration agreements with commercial banks including Everbright bank, Blue Ocean Bank and Huaxia Bank with a possibility to issue ABS. We believe that creating a broadened financing channel will help us bring diversification of our loan products, and offer more choices to MSE owners.

We will continue to improve our service to MSE owners. First, we will further expand our service network nationwide. The current network has [60] branches scattered across 40 cities, penetrating into the markets, and discovering the financing needs of MSE owners. Other than that, we will prioritize technology development to improve the loan management system's capabilities in storing data; and to increase the efficiency in overall process to satisfy the financing needs of MSE owners, also with a goal to reduce operating cost of our Company.

To achieve our mission of make finance more human and follow the government's policy of developing an inclusive finance system, we will leverage our advantage gained from years of dedicated work in the industry, and build a service platform that is asset-light, turnover-high and scale-large. We will proactively work with funding partners to push out diversified loan products, consistently provide MSE owners with affordable, accessible and efficient financial services

At last, today we announced our CFO, Mr. Li Ning, would step down from CFO position in November. I want to take the time to thank Mr. Li [for] years of hard work. Mr. Li has served as the Company's CFO since 2010. In the past 11 years, he made significant contribution in leading CNFinance to become a leading home equity loan service provider in China, and put dedicated work in transformation from a privately-held company into a NYSE-listed company.

On behalf all of us here in CNFinance, I would like to thank Mr. Li Ning for his leadership, dedication, and professionalism. I wish him best of luck with his future endeavors. We have already commenced the search for a new CFO.

With that, I would like to hand the call over to Ms. Jay Li, the vice president of the capital market department, who will walk you through the second quarter and first half financials.

Ning Li: Thanks, Mr. Zhai, and thanks again to everyone joining us today. I will walk you through our second quarter and first half of 2021 financials. We believe our year-over-year comparison is the best way to review our performance. Unless otherwise stated, all percentage changes I'm going to give will be on that basis. Also, unless otherwise stated, all number I'm going to give will be in RMB.

We will go through the figures for the second quarter of 2021 first, and followed by that for the first half. As of June 30, 2021, total outstanding loan principal increased to RMB11.6 billion, compared to RMB9.7 billion as of December 31, 2020.

Total loan origination volume was RMB3.8 billion, increase 103% from RMB1.9 billion in the same period of 2020.

Interest and financial service fee on loans was RMB449 million, a slight decrease of 0.2%, primarily due to the combined effect of, A, increase of average daily outstanding loan principal, and B, lower interest rates on loans facilitated to comply with the rules and regulations issued by relevant PRC regulation authorities.

Interest expense was RMB195 million, compared to RMB187 million, primarily due to the increase in the principals of borrowings from the trust companies.

Collaboration cost for sales partners increased to RMB107 million for the second quarter of 2021, compared to RMB104 million in the second quarter of 2020, primarily due to the higher outstanding loan balance, was originated under the new collaboration model.

Provision for the credit losses was RMB15 million, a decrease of 74% from RMB57 million in the same period of 2020. The decrease was mainly attributable to the combined effect of, A, the increase in outstanding loan principal under the collaboration model that was guaranteed by the Credit Risk Mitigation Positions put up by the sales partners;

And B, lower probability of default under the current expected credit loss model, which takes into account a more positive outlook for the Chinese economy in the second quarter of 2021 as compared to that of in the same period of 2020 under the impact of COVID-19 pandemic; and C, the company received recoveries in the quarter after charged-down loans that are 180 days past due to net realizable value.

Total operating expenses were RMB87 million, a decrease of 24%, compared with RMB114 million in the same period of last year.

Income tax expense was RMB8 million, a decrease of 46% from RMB15.6 million in the same period of 2020. This is primarily due to the decrease in the amount of taxable income.

Net income was RMB65 million in this quarter, an increase of 159% from RMB25 million in the same period of 2020.

Now we are moving onto our financials for the first half of 2021. Total loan origination volume was RMB6.7 billion, compared to RMB3.1 billion in the same period of last year.

Interest and financing service fee on loans was RMB871 million, a decrease of 7% primarily due to the combined effect of, A, increase of average daily outstanding loan principal, and B, lowered interest rates on loans facilitated in an effort to comply with the rules and regulations issued by relevant PRC regulation authorities.

Interest expense was RMB351 million, compared to RMB388 million in the same period of 2020, primarily due to the decrease in the principals of the borrowings under guarantee on repurchase.

Collaboration cost for sales partners increased to RMB205 million for the first half of 2021, compared to RMB198 million in the same period of 2020, primarily attributable to the increased loan balance under the collaboration model.

Provision for credit losses was a recovery of RMB3 million, while there was a provision of RMB277 million in the same period of 2020. This is primarily due to the result of, one, the increase in outstanding loan principal under the collaboration model that was guaranteed by the Credit Risk Mitigation Positions put up by the sales partners;

And B, lower probability of default under the current expected credit loss model, which takes into account a more positive outlook for the Chinese economics in this year, as compared to that in last year the same period under the impact of COVID-19 pandemic; and C, the Company

received recoveries in the first half of 2021 after charge-down the loans that are 180 days past due to net realizable value.

Total operating expenses were RMB182 million, a decrease of 16%, compared to RMB215 million in the same period of last year.

Income tax expense was RMB38 million, an increase from RMB1 million in the same period of 2020, primarily due to the fact that we recorded an income before income tax expense for the first half of 2021, as compared to a loss before income tax expense for the same period of 2020.

Net income was RMB151 million, compared to a loss of RMB41 million in the same period of 2020.

As of June 30, 2020, the Company had cash and cash equivalents of RMB1.6 billion, compared with RMB2 billion as of December 31, 2020.

The actual delinquency rate for loans originated by the Company decreased to 18.9% at June [30], 2021 from 22.6% as of December 31, 2020.

The actual NPL rate for loans originated by the Company decreased to 8.6% as of June 30, 2021 from 11.7% as of December 31, 2020.

With that, we'd now like to open up the call for Q&A. Operator, please begin.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). William Gregozeski of Greenridge Global.

William Gregozeski: Congratulations on the big loan origination volume number. Are you seeing a continuation, or do you expect to see a continuation in that number or growth? And also do you have the availability of funds to support that level of demand?

Ning Li: Hi, Bill. Could you repeat your first question again? We kind of had a bad connection just now.

William Gregozeski: Yes, I just said you had huge loan origination volume growth. Do you see that continuing; is that demand going to continue? And do you have the access to the capital to support that demand?

Unidentified Company Representative: Okay. (Speaking foreign language).

(Translated). I will take your questions. Like CEO just mentioned in his remarks, as China's economy grows by high speed, we continue to see on the future demand from the MSE owners for capital. And we have a very established sales network and our system is capable to support

our loan facilitations. So like I just -- like the CEO just mentioned in his remarks too, our system is capable to support the annually loan facilitation of RMB30 billion to RMB50 billion. And we believe the huge demand from the MSE owners will continue and carry through. And our CEO have something to supplement.

Bin Zhai: (Speaking foreign language).

(Translated). This year so far, we have had huge demand for capital from MSE owners, and we think that this will carry through to the remaining of the year. And the main challenge to us right now is that we are highly depended on the trust companies to support our capital, our fundings. But they are facing tightened regulations, so that our partner was kind of brought from down from -- by the trust companies. And we have taken many measures to reduce the effect of tightened trust company fund, but we will see that to be of our assistant not until Q4, the fourth quarter or the first quarter in 2022.

So that's my answer to your question.

William Gregozeski: Okay. And you mentioned signing up the commercial banks, which seems like a great thing for you guys in the platform. You're getting that access to capital from that channel. How much availability do you have? Are these trials, or is it a good amount of capital you're going to have and what's the rate on that?

Bin Zhai: (Speaking foreign language).

(Translated). So we have already signed collaboration agreements with 3 commercial banks, so one being the Everbright Bank, one being the Guangzhou Bank; and there is a smaller one comparing to the last 2 mentioned, the Blue Ocean Bank. The main advantage that brought up by collaborating with commercial banks is that we can cover MSE owners with different credit ratings. So the agreement deal is signed. Right now, we are just trying to see if we are compatible in our collaborations and trying to see how the system is going.

So yes, that's my answer to your question.

William Gregozeski: Okay. So there hasn't been any large-scale lending from the banks yet? It's just more in a test run?

Bin Zhai: (Speaking foreign language).

(Translated). Yes, you're correct.

William Gregozeski: Okay. And last question is on previous calls, you've talked about Class A, Class B, Class C loan products, you were going to roll out with different rate structures. Can you provide an update on those?

Bin Zhai: (Speaking foreign language).

(Translated). So that's our initial ambition. When we said we are trying to collaborate with commercial banks is that we want to just cover customers with different ratings, with different

credit ratings. So we were slowly collaborating with the trust companies, the customer we could cover was mainly -- so in our internal classification, the Type B and Type C customers. But based on our past experiences, we don't really see that they have too high a risk. So by collaborating with the commercial banks, we are trying to cover the so-called Type A customers.

But however, we are not sure at this moment if they are really going to be of higher quality than the customers we are serving now because right now in China, the credit system, credit rating system, isn't fully established. So we really have -- we are not really fully sure of whether the Type A customers are going to be better customers than B and C customers.

So what we're hoping right now is that we could offer loan products with interest, with annual interest rates from 10% to 18%, so that we can cover more customers, more borrowers.

That's my answer to your question.

William Gregozeski: Okay, perfect. Thank you guys very much.

Operator: (Operator Instructions). Neil Gagnon of Gagnon Securities.

Neil Gagnon: Can you give us your review on this quarter? How did it live up to your expectations, and what base does it set for your expectations for the second half?

Bin Zhai: (Speaking foreign language).

(Translated). First off, we are seeing sufficient huge demand for the whole year. So based on our internal record, the application every month is well over RMB2 billion. However, we could only facilitate around RMB1 billion every month. So there is a 50% gap in between the demand and supply. And since last year, we have seen consistently increase of property price in China; the increase was even over 30% in some major cities in China.

So those two factors lead us to believe that there is going to be huge demand in the remaining of the year, in the second half of the year. But there are two considerations: First off, is to secure access to enough funding. And the second thing is that starting from this June, we have seen tightened regulations on the property price as well. So we tend to be more conservative when doing businesses in those cities where the property price is considered to be too high.

But after all, we are still very confident to reach our set goal from the beginning of the year to reach RMB10 billion in outstanding loan principal by the end of the year. Actually, we have already reached that goal at the end of the second quarter. So we are working on refining our business by this moment; that's our priority.

Thank you. Thank you for your question.

Neil Gagnon: Thank you.

Operator: This concludes our question and answer session. I would like to turn the conference back over to [Jane Jenn] for any closing remarks.

Jane Jenn: This will conclude the conference call today. If you have any further questions, please reach out at ir@cashchina.cn. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. And you may now disconnect.