X Financial (XYF)
Fourth Quarter 2019 Earnings Conference Call
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Executives:
Tanya Wen, Investor Relations
Simon Cheng, President
Kevin Zhang, Chief Financial Officer

Analysts:
John Cai, Morgan Stanley

Presentation

Operator: Good day, everyone, and welcome to the X Financial fourth quarter 2019 earnings conference call. All participants will be in a listen-only mode. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please also note, today's event is being recorded.

At this time, I would like to turn your conference call over to Tanya Wen. Ma'am, please go ahead.

Tanya Wen: Thank you, operator. Hello, everyone, and thank you for joining us today. The Company's results were released earlier today and are available on the Company's IR website at ir.xiaoyinggroup.com.

On the call today from X Financial are Mr. Simon Cheng, President, and Mr. Kevin Zhang, Chief Financial Officer. Mr. Cheng will give a brief overview of the Company's business operations and highlights, followed by Mr. Zhang, who will go through the financials and guidance. They are all available to answer your questions during the Q&A session.

I remind you that this call may contain forward-looking statements under the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are based on 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 and 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 statement as a result of new information, future events, or otherwise, except as required under law.

It is now my pleasure to introduce Mr. Simon Cheng. Mr. Cheng, please go ahead.

[Technical Difficulty]

Simon Cheng: Hello, everyone. We closed out this year with a solid quarter of financial and operational results. We remain committed to providing the most user-friendly and convenient financial and business services to borrowers, and made significant progress in doing so during the quarter while ensuring we remain fully compliant with the rapidly-changing regulatory environment.

We rapidly made necessary adjustments to our operations and loan product portfolio during the quarter to comply with the recent regulations governing the maximum interest rate lenders can charge. As a result of the new regulations and adjustments made to our loan portfolio, our total loans facilitated declined on a sequential basis during the quarter.

However, Yaoqianhua and Xiaoying Online Mall maintained rapid growth momentum, as consumers increasingly turn to online platforms for consumption. This trend has accelerated significantly since the coronavirus disease outbreak at the beginning of 2020, as consumers were forced to consume online, and the government-mandated quarantine, and we are well-positioned to capitalize this opportunity.

The GMV of Xiaoying Online Mall rose to RMB160.9 million in the fourth quarter of 2019, representing an increase of 107.9% from RMB77.4 million in the third quarter.

The number of transactions of Yaoqianhua increased significantly to 4.9 million during the quarter from 0.2 million during the same period last year. As of December 31, 2019, the number of active users of Yaoqianhua was around 408,000, representing an increase from around 330,000 as of September 30, 2019.

And the transaction volume for Yaoqianhua jumped significantly to RMB2 billion this quarter from RMB1.4 billion in the last quarter, while its outstanding loan balance increased to RMB1.5 billion as of December 31, 2019 from RMB949 million for September 30, 2019.

Yaoqianhua has an approved cumulative credit line of RMB6 billion and currently has a credit utilization rate of around 25.6% as of December 31, 2019. This business is rapidly contributing to a larger percentage of revenue, given its longer customer lifetime and the multiple opportunities it offers for cross-sell.

We continue to actively negotiating with our funding partners including CITIC Trust, Kunlun Bank, Blue Ocean Bank, Huishang Bank, and Yantai Bank, to further lower our funding costs.

Institutional funding accounted for 50.2% of the loans facilitated through our platform in the fourth quarter, an increase from 35.7% in the previous quarter. The trend is continuing with the proportion of funding from institutions increasing to 80.9% in January, 2020. As of December 31, 2019, the credit line provided by our institutional partners expanded to RMB46.7 billion from RMB38.4 billion as of September 30, 2019, which I believe reflects their trust in the quality of the underlying assets and the strength of our risk management systems.

We are making solid progress in driving institutional funding for all new loan products on our platform in 2020. There is sufficient institutional credit line. We are confident to achieve 100% institutional funding this year.

Since the outbreak of COVID-19, we have been tightening our risk management policies by adopting stricter requirements to evaluate borrowers and have reduced credit lines in addition to reinforcing our risk models. Over the course of last year, we have focused on strengthening our risk control capabilities, and adopted even stricter control and evaluation of borrowers at the beginning of the loan process, which is critical to reducing loan defaults at a later stage. The measures we enacted in response to the COVID-19 outbreak have been already firmly rooted into our processes for a while now, and have been strengthened during these trying times.

With the macroeconomic environment remaining highly uncertain as the outbreak of COVID-19 spreads overseas, our business will be adversely impacted during the first quarter of 2020. We expect total loan facilitation amount to decline on a sequential basis. With a clouded outlook for next quarter, we are turning our focus on acquiring more high-quality borrowers with better credit profile during this time.

We continued to ramp up investment in our technology-based risk infrastructure and consumer acquisition, as we believe this is the foundation of our business growth and a major factor to attract institutional investor interest in the underlying assets on our platform. Based on our robust risk management capability, we will weather the storm of the COVID-19 and emerge stronger than before.

In conclusion, we are confident that our growth strategy has laid a solid foundation to adapt to changing times, while we transition from a pure financial service provider to a more comprehensive business service provider. We are ideally positioned to continue benefiting from the enormous growth opportunities in China’s personal finance industry. We are committed to providing the most user-friendly, convenient and comprehensive financial and business services and the best loan services to our customers.

Now, I will turn the call to Kevin, who will go through our financials.

Kevin Zhang: Thank you, Simon, and hello, everyone. Although we are facing a series of challenges, including changing regulation requirements, transition of funding source from P2P to institutional partners, the impact of COVID-19 in the past 3 months, we still had some strong points in the fourth quarter and the whole year of 2019.

Total loan facilitation amount was RMB39 billion in 2019, an increase of 6.8% year-over-year. The total loan facilitation amount in the fourth quarter of 2019 was RMB8.9 billion, at the higher end of our previously-announced guidance range.

Even though the total number of loans facilitated of Xiaoying term loan in the fourth quarter decreased year-over-year, the average loan amount per transaction was RMB14,600, an increase of about 64% from the same period of 2018 and an increase of 13.7% sequentially. The average consumption amount per user of Xiaoying Revolving Loan also increased 49% in the fourth quarter to RMB8,268 compared to RMB5,668 in the third quarter of 2019.

The number of active borrowers during the quarter decreased by 29% because certain existing borrowers are not qualified to borrow money on our platform anymore after we implemented our more stringent standard to evaluate borrowers in October 2019. Together with more modification for our pricing model, we believe that the transformation would make us final survivor in the current volatile environment.

The percentage of loan products we facilitated that were covered by ZhongAn Insurance decreased further to 73% during the quarter as we continue to reduce our insurance coverage rates to lower our customers' borrowing costs. We expect that in 2020, the percentage of loan products covered by ZhongAn will be less than 50%. The change would minimize the risk of high concentration to ZhongAn for the purpose of credit enhancement and increase the flexibility and the diversity when we bring our products.

It is our mission to create more value for our customers and shareholders, as we recover from the highs and lows of 2019 and navigate the challenging market in 2020. We remain in full compliance with current regulations, and are confident in our ability to stand out amongst our peers and take advantage of market consolidation, and will reduce costs further by improving operational efficiency.

Now I'd like to brief some financial performance. I will not go through our detailed lines. You can refer to more details in our announcement.

The net revenues in the fourth quarter of 2019 decreased by 22.9% to RMB665 million from RMB863 million in the same period of 2018. The revenue in 2019 decreased by 12.8% to RMB3,088 million from RMB3,540 million in 2018, primarily due to, first, the change in product mix with Yaoqianhua, which now accounts for a large proportion of the transaction volume; and second, an increase in the proportion of the revenue generated by the loans facilitated through the consolidated trust, which were recorded over the life of the underlying financing using the effective interest method.

Origination and servicing expenses in the fourth quarter of 2019 increased by 26% to RMB413 million from RMB327 million in the same period of 2018. It was primarily due to the following factors: first, an increase in collection expenses which were in line with the growth of the Company's business; and second, an increase in customer acquisition costs for the recently launched revolving credit product, Yaoqianhua; and third, an increase in interest expense related to loans facilitated through the consolidation trusts.

The G&A expenses and sales and marketing expenses all decreased in the fourth quarter of 2019. For the G&A expenses, it decreased by 23% to RMB53 million from RMB69 million in the same period of 2018. For the sales and marketing expenses, they decreased by 62% to RMB20 million from RMB52 million in the same period of 2018, which reflects the fact that we were adopting a series of measures of cost controls.

Provision for contingent guaranteed liabilities in 2019 were RMB7.7 million compared with RMB216 million in 2018. It's because there was no deterioration service in the estimated default rate for loans subject to guaranteed liabilities facilitated in prior periods.

Provision for accounts receivable and contract assets in the fourth quarter of 2019 decreased by 53% to RMB52 million from RMB111 million in the same period of 2018, primarily due to a decrease in accounts receivable and contract assets, which was in line with an increase in the proportion of net revenue generated by the loans facilitated through the consolidated trusts.

The non-GAAP adjusted net income attributable to X Financial shareholders in the fourth quarter of 2019 was RMB117 million compared with RMB280 million in the same period of 2018.

But our cash and cash equivalents was still very strong. It was RMB1,006 million as of December 31, 2019, compared with RMB931 million as of September 30, 2019.

Considering the impact of the COVID-19 outbreak in early 2020, the Company’s total loan facilitation amount for the first quarter of 2020 has been negatively impacted. Although the decline has been partially offset by the relative growth in Yaoqianhua and Xiaoying Online Mall, X Financial expects a first-quarter loss with drop in revenue. The Company plans to provide a business update in the first quarter 2020 earnings release. This forecast reflects the Company’s current and preliminary views, which are subject to changes.

Now, this concludes our prepared remarks, and we'd like to open the call to questions. Operator, please.

Questions and Answers

Operator: Ladies and gentlemen, at this time, we will begin the question-and-answer session. (Operator Instructions). John Cai, Morgan Stanley.

John Cai: Sorry, I joined a little bit late, so I guess I missed some part on the prepared remarks. So just wonder is there anymore color on the risk trend you see? Basically on a month-on-month basis, how does that recover? Any color of quantitative metrics that we can share? So related to that is do we have an assessment of loss related to the outbreak itself at this moment?

And the second question is on the volume basis. So just wonder on a month-to-month basis, April-March, do we see any pickup of the sequential growth?

And the final question is on the income tax. I think it's credited, so just wonder what's the reason behind that? And how should we think of the tax rate in this year?

Simon Cheng: Okay. Thank you, John. This is Simon. I think your question is regarding the Q1 outbreak of COVID-19, what's the impact on our business. Absolutely, there is a big impact in our business because people were not allowed to go out to work. So some of our customers have been losing their income. We saw an increase in delinquency in February and March. However, in April, we're pretty much back; the whole delinquency situation is pretty much back to what it was before the outbreak.

So it's going to be a one-time shock to our business, so we would have some loss, but it's just one-time and besides, it's still manageable to our business. So that's regarding the loss.

And the second question is regarding the trend, if we see some growth. We still see future demand at this time in March and April. However, because of this macroeconomic environment and this uncertainty around the future economic situation, as well as the employment and the income of our customers, we are quite cautious at this time actually. We see the demand, but all the credit quality is very tight at this moment so that's why we will see our business loan volume facilitation will decline in Q1 2020.

And regarding the income taxes, I think Kevin --

Kevin Zhang: I will explain all your questions of income tax. Okay. First, I would like to attend to as the whole year. For the whole year, we have net income before tax, that's around 663 million. And actually, for this year, our actual tax rate is about 15% and that means for the 600 million profit that we have, we should have 90 million of income tax expense.

But finally, in our P&L, we show income tax benefit of 93 million and that's because we have a total income tax benefits of about 180 million, which includes about 110 million of tax exemption for our major subsidiary, which was qualified as a new and hi-tech enterprise. And that means we have a tax benefit from this company, and the total exemption of the tax for this subsidiary in 2018 would be about 110 million. And the remaining 70 million consists of two parts: First, we have withdraw of, or revert of the withholding tax around 47 million. And the withholding tax reflects to the previous accrual of the profits in our certain VIE entities. But in 2019, and some of the VIE entities actually was in a loss. So the previous accrued withholding tax would now revert. And the remaining 23 million are mainly for the additional tax reduction in 2019; for example, the R&D cost tax reduction. Such tax reduction was mainly in the fourth quarter of 2019.

So I hope that clears up all your questions.

John Cai: Yes, okay. Thank you. One quick follow-up on the -- I saw on the prepared remarks that on this quarter, we address to comply with the latest APR cap. So just wonder how would that impact our take rate. Going forward, is there any guidance on the take rate? And given the COVID-19, what's the further pressures from the COVID-19 on our take rate, just your guidance in short.

Kevin Zhang: Okay. First, as we previously communicated, we actually have some change in November 2019. That means we tried to fully apply the regulation requirement, we have changed our total borrowing cost from APR 36% to IRR 36%. And but considering a serious reduction, for example, the impact of risk and the other cut-off of the tax on it, so for Q4, the take rate from our service income decrease about 1.1%.

And we believe that in the first quarter of 2020, it will keep decreasing because the change in the previous adopting in November 2019. That's only about [technical difficulty] Q4 in 2019. So actually, we believe that the take rate will keep decreasing.

And secondly is we actually increased our insurance premium and guarantee fees, which was another way to decrease our take rate. So actually, we found that maybe in March 2020, the take rate for our business will be very low, maybe decrease around 1% to 2%. That's why we actually foresee a loss in Q1 2020.

John Cai: Okay. Thank you very much.

Operator: (Operator Instructions). And ladies and gentlemen, at this time, and showing no additional questions, I'd like to turn the conference call back over to Ms. Wen for any closing remarks.

Tanya Wen: Okay. Thank you, everyone, for joining us on the call today. If you haven’t got a chance to raise your questions, we will be pleased to answer them through follow-up contacts. We look forward to speaking with you again in the near future. Thank you.

Operator: Ladies and gentlemen, that does conclude today's presentation. We do thank you for joining. You may now disconnect your lines.