CNFinance Holdings Limited
Q3 2021 Financial Results Conference Call
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Executives:
Matthew Lou, Investor Relations
Bin Zhai, Chairman and Chief Executive Officer
Jay Li, Vice President, Capital Market Department

Analysts:
William Gregozeski, Greenridge Global

Presentation

Operator: Good morning, and welcome to the CNFinance Third Quarter 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 Matthew Lou. Please go ahead.

Matthew Lou: Good morning and good evening. And welcome to the CNFinance third 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 this conference call. On today's call, we will introduce the company's financial and operational results of the third quarter of 2021, followed by a Q&A session.

In this quarter, the loan scale under the Collaboration Model continued to grow at a high speed. The loans facilitated during the quarter was RMB3.1 billion, with the revenue and net income came in as RMB460 million and RMB19million, respectively. As of September 30,2021, the outstanding loan principal under the Collaboration Model remained over RMB10billion, which well exceeded our goal. We were able to finish with such results due to the following reasons.

First, the market demand for home equity loan remained strong. In the third quarter, China's economy growth maintained stable. The growth was driven by the fact that the MSEs, which scattered across the nation, was able to deliver fruitful operations.

We have built a national network consisting of 60 branches in 40 cities and 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. We were able to fulfill our responsibility as the last-mile courier to build a network of an inclusive financial system in China by servicing another 5,000 MSE owners in the third quarter.

Second, as the leader in the industry, we have established strong relationships with our trust company partners. Our loan products and operation capabilities are highly recognized by our trust partners. As a result, they strived to supply us with sufficient funding, even with stricter regulatory guidelines. Other than that, we also managed to deepen our cooperation with commercial banks. It is worth pointing out that not only did we increase our collaboration scale with the Blue Ocean Bank, we also finalized our terms to start a new collaboration with Everbright Bank and HuaXia bank.

Last but not least, since the Collaboration Model earned its recognition in the market, we are now in the driver's seat to select sales partners. We have started to introduce the concept of senior sales partners since the beginning of the year. Senior sales partners are usually experienced local loan facilitators with excellent operation history. CNF provides them with training programs on a regular basis to help them understand our products and risk control mechanism. By doing that, we are also able to acquire customers more efficiently and improve the overall quality of the customers.

At the same time, we minimized our risk exposure, as senior sales partners are more capable to fulfill their post-loan obligations. The improvement of post loan management was reflected by a decrease in our provisions for credit losses under the Collaboration Model.

Put the hard-won results aside, we also noticed some challenges that may interfere with our future growth, including, first, funding pressure. We have been reaching out to cooperate with various types of funding suppliers, yet we are still highly dependent on trust fundings at this moment. Since the beginning of 2021, the regulation on trust companies' loan products was tightened. Although our funding demand was satisfied, the funding cost was in fact increased.

We wanted to be responsible to the society and our customers. We decided not to further raise the interest rates of our loan products. As I reported in the last conference call that, the government would not loosen the regulation for rest of 2021. Our experience told us that our earlier judgment was correct.

Second, 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 carry the assets on our financial statements. We seem like a company with heavy assets whose revenue is generated from interest spread. The balance sheet cannot represent our asset-light business model. This has caused the concern of potential funding partners and is hurting our valuation in the capital market.

Third, with the liquidity of certain Chinese real estate developers in crisis, and considering the upcoming real estate tax, our management made an estimation that the Chinese property market is likely to fluctuate in the future. As the holder of the subordinated units, our asset quality is likely to be negatively affected once such fluctuation interrupts the efficiency of NPL disposal.

In response to those challenges, we will continue to promote the asset-light transformation to better serve MSE owners and improve shareholders' returns. The key tasks we will complete are as follows. First, we will continue to extend our cooperation with existing trust partners. It is even now more critical than ever now to look for innovative ways of collaboration, given the regulation shows no sign to loosen up in the near future.

We have taken a few proactive steps in this quarter. For example, our partnership with National Trust was within the scopes of regulations, but not constrained by the cap of non-standard trust products. We will remain explorative to similar types of cooperation in the future. Another goal of ours is to expand our collaboration with commercial banks. Our plan is to make a loan under the Bank Lending Model, cut a relatively large share in the overall outstanding loans by next year.

Second, we will start dialogues with investors who understand our business and have the intention to participate and our trust company partners. Our goal is to finalize a deal with the terms that allow such investors to take CNF's current role as the holder of the subordinated units of the trust plans. Upon the finalization of such negotiations, our role as the loan service provider and the mezzanine level investor will be clear, allowing us to focus on building an asset-light loan platform with the prospect and capability to expand with quick turnover.

Third, to promote the Company's strategical transformation to an asset-light platform, we plan to dispose of certain legacy loans under the traditional model in the fourth quarter. We believe the advantages are threefold. First, this will improve our financial performance and help the Company to broaden funding sources and improve its valuation in the capital market; second, the Company's compliance risk will be reduced; and third, when the legacy loans are disposed, we will be well-positioned when price of the property market fluctuates. We have obtained quotations from several potential buyers. We will conduct evaluations and endeavor to sell such loans at fair market prices.

In the process of our transformation, we will keep frequent and constructive dialogues with regulators at all levels, and proactively consult our auditor regarding the accounting treatment, to ensure we stay compliant in all aspects the full time during our upgrade. As an ancient Chinese saying warns, all are good at first, but we should ensure that the cause achieves fruition. We believe this also applies to our business operations. We have experienced ups and downs but never lost our dedication.

We have made unwavering efforts to follow the government's call of developing an inclusive financial system. We hope to finish our transformation in the near future and carry forward our mission of make finance more human. Our pursuit to service MSE owners will remain unchanged. By leveraging our advantage gained from years of dedicated work, we will continue to provide MSE owners with affordable, accessible and efficient financial services.

With that, I would like to hand the call over to Ms. Jay Li, from the Capital Market Department, who will walk you through the third quarter financials.

Jay Li: Thanks, Mr. Zhai, and thanks again to everyone joining us today. I will walk you through our third quarter financials. We believe 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 numbers I'm going to give will be in RMB.

The total outstanding loan principal was RMB11.1 billion as of September 30, 2021, compared to RMB9.7 billion as of December 31, 2020, while the total loan origination volume remained stable at RMB3.1 billion in the third quarter of 2021 compared with the same period of 2020.

Interest and financial service fees on loans decreased by 3.7% to RMB455 million for the third quarter of 2021 from RMB473 million primarily due to the combined effect of, A, the increase in the balance of average daily outstanding loan principals, and B, the lowered interest rate on loans facilitated in the effort to comply with rules and regulations.

Interest and fees expenses increased by 18.8% to RMB219 million for the third quarter of 2021, compared to RMB184 million, primarily due to the increase in the principals of other borrowings as well as the funding cost from trust companies.

Collaboration cost for sales partners decreased to RMB102 million for the third quarter of 2021 from RMB113 million, primarily due to the fact that the Company cut down the rate of incentives paid to sales partners in response to the overall lowered interest rates on loans.

Provision for credit losses increased by 4.8% to RMB33 million for the third quarter of 2021 from RMB31 million. The increase was mainly attributable to the combined effect of, A, the increase in outstanding loan principal of non-delinquent loans and loans delinquent within 90 days, which resulted in the increase in collectively assessed allowances. And B, the Company [revised] recoveries in the third quarter after charging-down the loans that are 180 days past due to net realizable value.

Total operating expenses decreased by 21% to RMB93 million for the third quarter of 2021, compared with RMB118 million in the last year.

Income tax expense decreased by 73% to RMB7 million for the third quarter of 2021 from RMB25 million, primarily due to the decrease in the amount of taxable income.

Net income decreased by 62% to RMB19 million for the third quarter of 2021 from RMB50 million.

As of September 30, 2021 and December 31, 2020, the Company had cash, cash equivalents and restricted cash of RMB2 billion and RMB2 billion, including RMB1.4 billion and RMB1 billion from structured funds respectively, which could only be used to grant new loans and activities.

The actual delinquency rate for loans originated by the Company decreased to 20.4% as of September 30, 2021 from 22.6% as of December 31, 2020.

The actual NPL rate for loans originated by the Company decreased to 7.5% as of September 30, 2021 from 11.7% as of December 31, 2020.

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

Questions and Answers

Operator: We will now begin the Q&A session. (Operator Instructions). Our first question comes from William Gregozeski with Greenridge Global.

William Gregozeski: A couple of questions -- when you're talking about disposing of the legacy loans, are you talking about the loans prior to the current structure with the sales partners, or are you talking about getting rid of everything that you have a subordinated interest in to really clean up the balance sheet?

Bin Zhai: (Speaking foreign language).

(Translated). Thank you for the question. So when we say legacy loans, we are referring to those loans that were facilitated before the model transformation, which is under the traditional model (indiscernible) to the sales partners' model. So the carrying value of such loans, we're talking about the current loans and the loans that are delinquent or nonperforming, is around RMB590 million right now at this moment. So by disposing off such loans, we are hoping to accelerate our transformation into an asset-light platform, which focuses on operations and bears minimum risks.

So in many years of our development, especially when we transformed to the sales partners' model, which is the collaboration model, there have been, and there still are, many third-party investors who understand our product, and is interested in participating by investing to us. So we have been in touch with them and we have reached a couple of consensus. We hope to address the deal in the coming quarter, which is the fourth quarter of 2021.

So to sum up, just by doing another upgrade in our model, we are hoping to create to build a platform that is asset-light, which focuses on servicing and operations. And we are also hoping to improve our financial performance on the financial statements. Thank you.

William Gregozeski: Okay. Thank you for that. And then the next question is with regards to the availability of capital. Has there been any change in what's available from trust companies to you guys since the last conference call? And then how much have you gotten from commercial banks so far to lend out?

Bin Zhai: (Speaking foreign language).

(Translated). To answer your first question, the regulatory pressure is still there; we don't see any signs of loosening up yet. It is worth noticing though, our trust company partners strive, no matter how hard it was, to supply us with very sufficient funds during the quarter. I was rather concerned, by the end of the second quarter, about our funding supplies in the coming third and fourth quarter. However, as I mentioned, our trust company partners start of every aspect, and they strive to still supply us with sufficient funds during the third quarter. We experienced the rise of the financing cost in the quarter though due to such conditions.

So all-in-all, we don't expect the regulatory pressure to loose, especially on the non-standard trust products. I think their [type] is still going to be very limited. However, from what we see in the third quarter, we are still the first priority of our trust company partners. They will first satisfy all our funding needs. So I think that's also a proof of our leading position in the industry, as well as our strong brand recognition of the market. We could have just simply transferred the rise of our financing costs to the market, which will make things much easier. However, we felt like that's not the really responsible thing to do.

So we did lift the interest rate of our loan product a little bit, but not by much. We think we feel like by doing that, our revenue and net income in the near term will probably be a little bit lower than we estimate. But in the long run, this is to our best. And what brought us more confidence is that our trust company partners promised to satisfy our needs, and put it in the priority or two in next year, when there is enough money supplies.

As for your second question about the fundings from commercial banks, so this year we mainly was negotiating the terms and finalizing them. So just as I introduced in my speech, I hope that the funding -- that the loan's principal under the bank lending model will cut a relatively large share by next year.

So I'd also mention one thing. Except for commercial banks and the current trust companies, we have already -- we also made several constructive negotiations with insurance companies. So maybe in the near future, not only can we cooperate with trust companies and banks, the insurance companies will also be on our book. Thank you.

William Gregozeski: Okay, great. And last question -- and I appreciate all the detail you're providing in the answers. You touched on the property prices with the uncertainty with the developers. Do you think those fluctuations in property prices are going to be nationwide, or more geared toward kind of the smaller cities?

Bin Zhai: (Speaking foreign language).

(Translated). Well, first off, we have strong faith and confidence in the Chinese government. So we feel like there are still plenty of tools in the toolkit of the Chinese government to prevent systematical and regional risks. So for the short term, there is a potential decline of the property price. But if we look at the long run, we believe the Chinese government is capable to keep the property price in a stable range.

So let me address this again. The whole purpose of dispose of the legacy loan, so the first reason is that to avoid the short-term fluctuation of the property price. And the more important thing is that we don't want our business to be fluctuating, if there is fluctuation in the property market and stuff. And again, we just want to finish our transformation and focus on servicing and operations. Thank you.

William Gregozeski: All right. Thank you very much.

Operator: (Operator Instructions). There are no further questions. This concludes our question-and-answer session. I would like to turn the conference back over to Matthew Lou for any closing remarks.

Matthew Lou: Thank you again for joining us today. If you have any further questions, please feel free to contact us or log onto our website at ir.cashchina.cn. Thank you.

Bin Zhai: Thank you. (Speaking foreign language).

Matthew Lou: Thank you again for joining us. That's from our CEO.

Operator: The conference has now concluded. Thank you for your participation. You may now disconnect.