CNFinance Holdings Limited
Q4 and Fiscal Year 2021 Financial Results Conference Call
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Executives:
Matthew Lou, Investor Relations
Bin Zhai, Chairman and CEO
Jay Li, Acting CFO

Analysts:
William Gregozeski, Greenridge Global

Presentation

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

I would now like to turn the conference over to Matthew Lou. Please go ahead.

Matthew Lou: Thank you. Good morning and evening. And welcome to the CNFinance fourth quarter and fiscal year of 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 Acting CFO, 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.

Bin Zhai: (Speaking foreign language).

(Translated). Thanks. Thank you, everyone, for joining us in this conference call. On today's call, we will introduce the company's financial and operational results in the fourth quarter and the fiscal year of 2021, and then me and my colleagues will answer your questions.

Our loan facilitation business maintained fast growth in the fourth quarter. We facilitated loans of RMB3.1 billion during the quarter and RMB12.8 billion for the year, representing a year-on-year growth of 15% and 45%, respectively. Such results were another proof of how the market has recognized our products and business model.

The revenue for the fourth quarter and fiscal year was RMB450 million and RMB[1,980] million, respectively.

Hitting by the fluctuation of the economy and local outbreak of Covid-19, we disposed of a bulk of delinquent loans in the fourth quarter, and were more conservative in evaluating potential losses; yet, we were still able to record a net income of RMB65 million for the year and delivered operational results that exceeded our estimations at the beginning of the year.

In 2021, the impact of external environment on our business persists to varying degrees. First, we experienced funding pressures as our major funding partners, the trust companies, were under tightened regulations; second, the government imposed strict regulations on the demand side of housing market, including introducing restrictive measures on housing mortgages and purchasing houses, and the implementation of Government Guidance Price. Such regulations have posted downward pressure on the housing market; and third, our business operations was interrupted by local outbreaks of Covid-19 during the year.

Under such environment, the company focused on business expansion and risk control. Our main work in 2021 was as follows. First, we worked on expanding funding sources to ensure funding supply. Other than the current funding model, we also worked with trust company partners to establish new funding models that are within the scopes of regulations, but not constrained by the cap of non-standard trust products.

Our partnership with National Trust was one of the examples. Since the third quarter, we have partnered with the National Trust and facilitated loans of over RMB[700] million. And we expect the loan scale under such funding model to grow continuously.

Since the third quarter, we have deepened collaboration with commercial banks. We expanded the scale of our partnership with Blue Ocean Bank and also finalized terms with Everbright Bank and HuaXia Bank. Based on our estimation, loans under the Bank Lending Model will cut a relatively large share in the overall outstanding loans by the end of 2022.

Our negotiations with insurance companies have also entered into the final stage. As of today, the deal with Sinosafe Insurance has been signed, and we are close to finalize the terms with PICC. We believe the partnership with insurance companies will be very helpful for a potential ABS product of our own.

Second, we disposed of a bulk of legacy loans under the traditional facilitation model. We started our model transformation in 2019 and stopped facilitating loans under the traditional model. Following the transformation, as the current loans under the traditional model being serviced in full gradually, the majority of loans under the traditional model are now delinquent. This has been negatively affecting the Company's financial performance, our negotiations with potential funding partners, as well as our valuation in the capital market.

In the third quarter, facing the fluctuation in the housing market, the management evaluated the relative expenses of holding and disposing of those legacy loans, and made the decision to dispose them. In the fourth quarter, we hired a professional appraisal firm and compared quotations from a few AMCs, and made a bulk sale of loans with the book value of RMB1 billion at an average discount of 65%. The sale of such legacy loans was the main drive of the losses in the fourth quarter. We plan to sell the remaining legacy loans of RMB300 million in the first half of 2022.

Third, we were more prudent in assessing the risks related to sales partners. We consolidated the business scale and operating record of each sales partner, and adjusted the repurchase policy to better suit them. We have also taken a more conservative approach in evaluating the potential credit losses under the collaboration model.

In 2022, the economic fluctuation and local outbreak of Covid-19 are likely to continue. We will focus on promoting the collaboration model 2.0 version as we believe this will lay a strong foundation for our future growth. Our work plans are as follows. We will cooperate with venture investors. Our goal is to bring in third-party investors to subscribe to the subordinated unit of new loans facilitated. Such plan was sent to our trust company partners and has already entered the stage of admission. We are also working closely with insurance companies to finalize the terms.

Second, we will diversify our loan products to cover more customers. We will continue to facilitate the current Class B trust products and expand our partnership with commercial banks. Going forward, our product combination will consist of 4 differentiated products from Class B to Class A+ to suit the needs of borrowers with different risk preferences and reduce our funding cost.

Third, we will adopt digital and smart technologies in our platform. We will refine the automatic evaluation and approval of loan applications by increasing the capacity of data storage and the efficiency of data analysis. We expect to better manage our process and make it more efficient. We also expect to better coordinate the loan applications we receive and the fundings we obtain. We will also continue to maintain and upgrade the sales partner's service platform to make it more friendly to users. We will keep communicating with regulators at all levels, and make sure our operation and business model are in full compliance.

The year of 2021 was very important in our history. We faced many challenges and scored many achievements. In 2021, our service system was refined, our management was more efficient, we stayed true to our mission of providing affordable, accessible and efficient financial services to MSE owners, and we are now more confident in the meaning of our work. As I have introduced on many occasions, CNF, and many other enterprises like us, have formed an important part in China's inclusive financial system. In 2022, we will keep refining our model and growing our business, while shoulder more responsibilities to provide MSE owners with financing services that are more convenient and with solid fee cut.

Now, I would like to hand the call over to Ms. Jay Li, the acting CFO of the Company, and she will walk you through the fourth quarter and fiscal year 2021 financials. Thank you.

Jay Li: Thanks, Mr. Zhai, and thanks again to everyone for joining us today. I will walk you through our fourth quarter of 2021 financials followed by that of fiscal year of 2021. 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.

In the fourth quarter of 2021, total loan origination volume was RMB3 billion during the fourth quarter of 2021, representing an increase of 15% from RMB2.7 billion.

Interest and financing service fees on loans increased by 7% to RMB448 million as compared to RMB417 million, primarily due to the increase in the balance of average daily outstanding loan principal.

Total interest and fees expenses increased by 29% to RMB205 million as compared to RMB159 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, representing sales incentives paid to sales partners, increased to RMB120 million as compared to RMB104 million, primarily due to the increase in average daily outstanding loan principal under the collaboration model as compared to the same period of 2020.

Provision for credit losses recorded a reversal of RMB308 million as compared to a reversal of RMB31 million, primarily due to the combined effect of, first, higher loss given default, LGD, under the current expected credit loss, CECL model, which takes into account the company's historical data of actual loss in the past few years; and second, the fact that the company transferred loans under the traditional facilitation model to third parties in bulk during the fourth quarter of 2021 and the allowance of such loans was reversed.

Net losses on sales of loans was RMB450million, compared with a net gain of RMB44 million, primarily attributable to the fact that the company transferred loans under the traditional facilitation model to third parties in bulk during the fourth quarter of 2021. Such loans were all facilitated prior to 2019, and the majority of them were long past due and therefore, sold at a large discount.

Total operating expenses decreased by 8% to RMB[107] million, compared with RMB115 million.

Income tax expense was RMB15 million as compared to an income tax expense of RMB24 million, primarily due to the fact that the company recorded a loss before income tax for the fourth quarter of 2021. Such loss was due to the loss associated with the sale of loans under the traditional facilitation model in bulk during the fourth quarter of 2021.

Net loss was RMB105 million as compared to a net income of RMB105 million.

Now let's move on to the financials of 2021 as a whole. Total loan origination volume was RMB[13] billion, representing an increase of 46% from RMB9 billion.

Interest and financing service fees on loans decreased by 3% to RMB1,770 million as compared to RMB1,829 million, primarily due to the lowered interest rate on loans facilitated in an effort to comply with rules and regulations issued by relevant PRC regulators, including the Decisions of the Supreme People's Court to Amend the Provisions on Several Issues concerning the Application of Law in the Trial of Private Lending Cases issued in August 2020.

Interest and fees expenses increased by 6% to RMB776 million as compared to RMB731 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 increased to RMB426 million as compared to RMB415 million, primarily due to the increase in average daily outstanding loan principal under the collaboration model as compared to the same period of 2020.

Provision for credit losses recorded a reversal of RMB279 million as compared to RMB278 million, mainly due to the combined effect of, first, the fact that the company transferred loans under the traditional facilitation model to third parties in bulk during the fourth quarter of 2021, and the allowance of such loans was reversed; second, the higher loss given default under the current expected credit loss model, which takes into account the company's historical data of actual loss in the past few years, partially offset by, [third], the lower probability of default under the current expected credit loss model, which takes into account the outlook of a more positive economy growth of China in the fiscal year of 2021, as compared to that of the same period of 2020 under the impact of Covid-19 pandemic.

Other gains were RMB50 million compared to RMB20 million. When a loan defaults and the sales partner chooses to repurchase such loan in installments, the company would charge certain percentage of the loan as the fund possession fee. The increase in other gains for the fiscal year of 2021 was mainly due to the fact that there was a larger number of cases where delinquent loans were repurchased by the sales partner in installments, which led to an increase in fund possession fee received by the company.

Total operating expenses decreased by 15% to RMB381 million as compared to RMB449 million.

Income tax expense decreased by 40% to RMB29 million as compared to RMB48 million, primarily due to [decrease] in the amount of taxable income.

Net income decreased by 43% to RMB65 million as compared to RMB115 million.

Total outstanding loan principal was RMB10 billion as of December 31, 2021, as compared to RMB10 billion as of December 31, 2020.

As of December 31, 2021, the company held cash and cash equivalents of RMB2.2 billion, compared with RMB2 billion as of December 31, 2020, including RMB1.5 billion and RMB1.5 billion from structured funds, which could only be used to grant new loans and activities.

The actual delinquency rate for loans originated by the company increased to 24.1% as of December 31, 2021 from 22.6%. Under the collaboration model, the actual delinquency rate for first lien loans increased to 29.1% as of December 31, 2021 from 18%; and the actual delinquency rate for second lien loans increased to 19.5% as of December 31, 2021 as compared to 15.6%.

The actual NPL rate for loans by the company decreased to 9.4% as

of December 31, 2021 from 11.7%. Under the collaboration model, the actual NPL rate for first lien loans increased to 12.5% as of December 31, 2021 from 6.7%. The actual NPL rate for second lien loans increased to 6% as of December 31, 2021 from 4.6%.

With that, we would like to open up to the Q&A session. Operator, please begin.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). William Gregozeski with Greenridge Capital.

William Gregozeski: With regards to the commercial bank lending, can you disclose the amount you went from commercial banks in the fourth quarter? And in regards to your target for the year-end of this year, is that incremental to the trust lending or replacing that amount of trust lending?

Bin Zhai: (Speaking foreign language).

(Translated). Thank you. We actually started negotiating with the commercial banks since the beginning of 2021. And the main reasons are, first of all, our main fund funding providers, which are the trust companies, were under tightened regulations throughout the year. And we think we'd like to take one step ahead and kind of expand our funding sources.

And our second thought was to just cover more customers with different risk preferences. As you know, the funding cost with the trust companies are high as compared with commercial banks. And this has limited our ability to reduce our interest rate card in our loan product, which has also limited our customer [reaching]. And in 2021, we were mainly negotiating with the commercial banks and entering into the stage of admission that the [main work] into 2021. So the overall loan facilitation under the [bank lending] model wasn't as high. Yet, in the first 2 months of 2022, we have maintained a facilitation under the [bank lending] model of over 10 million each month.

To answer your second question, we don't think the bank lending model is going to replace the current [cost] lending model. We think in 2022, the partnership with trust companies will still made up the majority of our loan facilitation. So our most updated estimation is that to make the loans under the bank lending model to around to 10% to 15% of the total outstanding loan principal by the end of 2022.

That's the answer to your question. Thank you.

William Gregozeski: Okay. Thanks. My next question is about the investment in technology and the platform you talked about on the call. How much are you looking to spend? And is that investment going to change at all, depending on how much you do on a share repurchase?

Bin Zhai: (Speaking foreign language).

(Translated). Okay. So first of all, we have to admit that the investment in technology is on the, I'll say, very small proportion of our expenses at this moment. And I think one of the reasons is that the development of the technology has [flat] down the overall cost of the information technologies, and no matter it's hardware or software. And I think what (indiscernible) and a part of the current expenses at this moment are the [psychological] talents. And I think our plan is to cooperate with them in the future. So I don't expect this to take out a whole lot of our cash, and I don't think the repurchase program is going to interfere with our investment in technology. Thank you.

William Gregozeski: Okay, great. And last question is about the property market. Has the uncertainty with that affected your ability to assess borrower risk or facilitate loans? I know loans are obviously up, but is it impacting what you guys are able to do going -- this year, based on how the market is right now?

Bin Zhai: (Speaking foreign language).

(Translated). To answer your question, so starting from the fourth quarter of 2022, we have been rather conservative when it comes to the estimation of housing market in China. So as I have introduced, we disposed of certain legacy loans in bulk during the fourth quarter of 2021, and also to pay more conservative approach too in the valuation of potential credit losses.

Right. We are [confident] of the government -- we are positive and confident in the government's ability and anticipation to stabilize the economy and future growth economy. So based on my estimation, I think the [plans] of properties and houses will stop the downward churn and remain rather stable in 2022.

So in terms of loan applications and risk assessments and the evaluation of borrowers, our standards didn't really change a whole lot in this year. And one of our intentions is to roll out cheaper loan products to the high-quality borrowers whose collaterals are also with high quality. So as I introduced, one of our goals is to be very customized loan products to each customer depending on the condition of their collateral, as well as their credit reference. Thank you.

William Gregozeski: Okay, great. Thank you. Congratulations on a good quarter.

Operator: (Operator Instructions). And ladies gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to management for any final remarks.

Matthew Lou: Thank you again. Thank you for joining us in today's conference call. If you have any further questions, please feel free to reach us at any time at ir@cashchina.cn. Thank you.

Bin Zhai: Thank you.

Matthew Lou: Thank you.

Operator: Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.