CNFinance Holdings Limited
Q2 and Second Half 2022 Financial Results Conference Call
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Executives:
Jane Jenn, Manager, Capital Market Department
Jun Qian, Director and Vice President
Jing Li, Acting CFO

Analysts:
William Gregozeski, Greenridge Global

Presentation

Operator: Good day, and welcome to the CNFinance Announces Second Quarter and First Half 2022 Unaudited Financial Results. (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 Jane Jenn, Manager of the Capital Market Department. Please go ahead.

Jane Jenn: Good morning and evening, and welcome to CNFinance second quarter and first half of 2022 financial results conference call. In today's call, our Director and Vice President, Mr. Qian Jun, will walk us through the operating results, followed by the financial results from our acting CFO, Ms. Li Jing. 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 Mr. Qian Jun.

Qian Jun: (Speaking foreign language). 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 second quarter and first half of 2022, followed by a Q&A session.

In the second quarter of 2022, our business was continuously impacted by the pandemic prevention and control measures, but we were able to maintain stable business volume. During the quarter, we originated loans of 3.1 billon under our collaboration with trust companies and introduced loans of 200 million to the commercial banks. The interest revenue under the Collaboration Model for the second quarter was slightly higher than the same period of 2021, and the interest expense decreased marginally.

As we adjusted our commission policy, our collaboration cost decreased significantly year-on-year, which drove up the Company’s gross profit margin. However, given the impact of pandemic prevention and control policy, as well as the uncertainty of China’s real estate market, we continued to be conservative in evaluating potential losses and recorded a provision for credit losses of 80 million for Q2. And this was the main reason for the net income to be lower than the same period of 2021.

Now, I would like to give a more detailed introduction of the challenges we faced and the measures we have taken, and also share the management’s thoughts on our future development. Our business continued to be challenged by the pandemic prevention and control. A number of cities, including Shanghai, were locked down during the quarter, and China's GDP fell by 2.6% as compared to the first quarter of 2022.

At the same time, there were still uncertainties in China’s real estate market. The economic downturn has negatively affected our business growth, and the increase in delinquency rate has also affected the liquidity of our sales partners. Under such condition, we focused on stabilizing business volume, reducing financing cost, managing risks and empowering our sales partners during the second quarter. The work we have done are as follows.

First, in order to better meet the needs of borrowers and help MSE owners, we started our cooperation with two new trust companies and successfully originated loans of 39 million during the quarter. We have lowered the interest rate of our loan products this quarter. Second, we continued to promote our partnership with commercial banks, and recommended loans of 200 million to them. We have also started to facilitate loans under our collaboration with PICC.

Second, cost control: we maintained dialogues with major funding partners and have reached consensus on reducing financing cost and optimizing the repayment policy. The adjusted policy is expected to be adopted in the third quarter of 2022. Third, risk control: in the second quarter, several trust companies have signed agreements with the third-party subordinated units subscriber recommended by us, allowing this institution to directly invest in the subordinated units of the trust plans. By growing these third party investors, we further reduced the amount of own funds needed and also lowered our risk exposure.

Fourth, in terms of empowering sales partners: we continued to allow more sales partners to repurchase delinquent loans by installment, with the Company charging a certain fee based on terms. We also plan to bring in an asset management company to provide our sales partners with post-loan management services including bad debt collection, arbitration and judicial proceedings. We hope that by collaborating with such asset management company, our sales partners could bear less risks and receive rather stable returns on delinquent loans.

We will be presented with both challenges and opportunities in the future. According to the data recently released by the People's Bank of China, July's new RMB loans was 679 [billion], falling by 404.2 billion year-on-year. This indicates that the financing needs of both enterprises and consumers have shrunk. This means we will need to put out more efforts to maintain growth. However, we believe our as more macro-policies to stimulate the economy and support MSEs take effect, there are still vast opportunities in China's inclusive financing industry.

In order to seize such chances to expand our business and provide affordable and accessible financing services to more MSE owners, we will work on enhancing sales, reducing funding cost and improving post-loan management. Our plans are: First, with the change of the market condition, the Company will focus more on the demand side and build a system that is sales-oriented. We will establish an all-around sales partner system based on the data collection and resource coordination, and use technology as a tool to improve the overall efficiency.

Second, we will continue to promote our partnership with commercial banks and with PICC. We believe such partnerships will be an important supplement to our collaboration with trust companies as it could improve our product mix and the customer coverage. In the future, we will not only set promotion plans to incentivize the sales staffs of commercial banks with PICC, but also cooperate with third-party sales channels to jointly expand the customer base and increase the sales volume.

Third, reducing funding cost will continue to be one of our long-term strategic goals. We will maintain dialogues with funding partners, mainly focus on addressing the mismatch between funding supply and the loan applications. Our goal is to cut the overall cost of our loan products by reducing the balance of the idle fund.

Lastly, we will deepen our cooperation with third-party institutions to accelerate the disposal of delinquent loans and recover cash. By doing that, we hope to release the liquidity of sales partners, so that they can use more resources in business expansion.

With that, I would like to hand the call over to Ms. Jay Li, the acting CFO of the Company, who will walk you through the second quarter and first half 2022 financials.

Jing Li: Thanks, Mr. Qian, and thanks again to everyone joining us today. I will walk you through our second quarter and first half of 2022 financials. We believe year-over-year comparison is the best way to review our performance. Unless otherwise stated, all the percentage changes I'm going to give will be on that basis. Also, unless otherwise stated, all the numbers I'm going to give will be in RMB.

We will go through the figures for second quarter of 2022 first, followed by that for the first half.

As of June 30, 2022, the total outstanding loan principal decreased to 9.4 billion, compared to 10.4 billion RMB as of December 31, 2021.

The total loan origination volume was 3.1 billion, compared to 3.8 billion in the same period of 2021.

Interest and financial service fees on loans was 408 million, a decrease of 9%, primarily due to the decrease of average daily outstanding loan principal in the second quarter of 2022 as compared to the same period of 2021. The decrease in average daily outstanding loan principal was due to the lower loan facilitation volume in the second quarter resulted from the lockdowns due to the local outbreaks of Covid-19 in multiple cities within China.

Interest expense was 187 million, compared to 195 million in 2021, primarily due to the decrease in the principals of other borrowings.

Collaboration cost for sales partners decreased to 77 million in the second quarter of 2022, compared to 107 million in the same quarter of 2021, primarily due to the lower fee rate the Company paid to the sales partners in the second quarter of 2022.

Provision for credit losses was 80 million, compared to 15 million in the same period of last year. The [decrease] was due to the increased economic uncertainties caused by lockdowns in reaction to local outbreaks of Covid-19, as well as the downward pressure faced by China's real estate market during the second quarter of this year.

The total operating expenses were 91 million, an increase of 5%, compared to 87 million in the same period of last year.

Income tax expense was 3 million, a decrease from 8 million in the same period of 2021.

Net income was 18 million, a decrease of 72 [million] from 65 million in the prior year.

Now, we are moving on to our financials for the first half of 2022. The total loan origination volume was 5.4 billion, compared to 6.7 billion in the same period of last year.

Interest and financing service fee on loans was 823 million, a decrease of 6%, primarily due to the decrease of average daily outstanding loan principal in the first half of 2022 as compared with the same period of last year. The decrease in average daily outstanding loan principal was due to the lower [loan] facilitation volume in the first half this year, result from the lockdowns due to the local outbreaks of Covid-19 in multiple cities within China.

Interest expense was 388 million, compared to 351 million in the same period of last year, primarily due to the increase of the funding costs from the trust companies.

Collaboration cost for sales partners increased to 156 million in the first half of this year, compared to 205 million in the same period of last year, primarily attributable to the increased loan balance under the collaboration model.

Provision for credit losses was a provision of 112 million, compared to the recovery of 3 million in the same period of 2021. The increase was due to the increasing economic uncertainties caused by the lockdowns in reaction to local outbreaks of Covid-19, as well as the downward pressure faced by China's real estate market during the first half of 2022.

Total operating expenses were 171 million, a decrease of 6%, compared with 182 million in the same period of 2021.

Income tax expense was 19 million, compared to 38 million in the same period of last year, primarily due to the [increase] in taxable income in the first half of 2022 as compared to the same period of last year.

Net income was 61 million, compared to 151 million in the same period of last year.

As of June 30, [2021], the Company had cash and cash equivalents of 1.4 billion, compared to 2.2 billion as of December 31, 2021.

The delinquency ratio, excluding loans held for sale for loan origination by the Company, decreased from 16.2% as of December 31, 2021 to 14.9% as of June 30, 2022.

And the NPL ratio, excluding the loans held for sale for loan originated by Company decreased from 2.1 percentage as of December 31, 2021 to 1.9[%] as of June 30, 2022.

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

Questions and Answers

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

William Gregozeski: You talked about trying to do different things to help the sales partners, and you obviously need the sales partners to grow the loan origination. You talked about some of the -- bringing in an asset management company. What's the financial health of your sales partners? Are they liquid enough to source new loans, or are they just trying to manage what they have now?

Unidentified Company Representative: (Speaking foreign language).

Unidentified Company Representative: (Speaking foreign language).

(Translated). Okay. So under the current condition, the liquidity pressure of our sales partners have been, I think, higher than before. And I think that's mainly because of the increase of the delinquency ratio because under our collaboration with the sales partners, they will have to bear the obligations to repurchase the default loans. So that has put a lot of pressure on their liquidity.

So ever since the beginning of 2022, we have remained very supportive to our sales partners. And I think the first thing we did is to allow them to fulfill their repurchase obligations by installments.

And also, entering the second quarter of 2022, we have been giving them extensions, so that they can pay smaller installment every month. And also, we have been negotiating with the third-party asset management companies to see if they could provide post-loan services for the sales partners, so that way, they could have their cash recovered faster, and so that way, they could also release their liquidity and spend them on the business expansions. Does that answer your question?

William Gregozeski: Yes. Could you also just talk about the quantity of sales partners you have? Are you seeing more interest, or are sales partners shrinking down in the quantity they're trying to source?

Unidentified Company Representative: You mean the quantity for --

William Gregozeski: Yes, so the total number of sales partners you have, is that number increasing or decreasing? And are you seeing them being more active or less active?

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

Unidentified Company Representative: (Speaking foreign language).

(Translated). It is still going up slightly. And also, in terms of the numbers I can give, the numbers of sales partners, here's the data. So the sales partners who have signed the collaboration agreement with us have went up slightly to 90,000 as of the end of the second quarter. And we have also seen a rising number of active sales partners and that would be around 1,200 as of the end of the second quarter of 2022, which is a 9% increase as compared to the same quarter of 2021. So as for your question, the number has gone up, as well as the number of active sales partners.

William Gregozeski: Okay, perfect. There's been a lot of news in the media about the real estate market from developers having cash shortfalls, the number of unfinished unlived-in homes, the interest rate cuts. How do you guys view the real estate market as a whole and how it impacts CNF going forward?

Unidentified Company Representative: (Speaking foreign language).

Unidentified Company Representative: (Speaking foreign language).

(Translated). Okay. So after nearly 20 years of high-speed growth of China's real estate market, I think it seems like [even into on that end]. And I think that mainly affected people's, especially the consumers', view towards the housing market. And as for us, like you mentioned, there are a number of problems in the real estate market, including the insufficient cash of the developers and as well as the unfinished homes and stuff. And particularly to us, I think first of all, the development of the home equity loans depends on the price of the properties, and that's for sure. And that mainly affects our business volume and stuff.

And also for us, if the liquidity of the houses went down and the housing market is less active, it might influence our efficiency of disposing delinquent loans and the collaterals. But we are still positive towards the future development of the real estate market because we believe that our government is going to put more macro measures to stimulate and control the real estate market in China. And in the long run, the price and the liquidity of houses will be more and more stable.

And also, we have observed one thing. Even in the fluctuation of the real estate market, the houses in the major blocks in tier-1 and tier-2 cities remained rather stable in terms of prices and liquidity, and our collateral are mainly located within such areas. So we think our collateral and our business is more resilient to the fluctuations of the capital of the real estate market. Does than answer your question?

William Gregozeski: Okay, yes. Can you just -- you said most of the loans are in tier-1, tier-2 cities. What percent of your portfolio is in tier-1, tier12?

Unidentified Company Representative: (Speaking foreign language).

Unidentified Company Representative: (Speaking foreign language).

(Translated). Okay. So we're lucky that because of our experience in the home equity loan industry, our collaterals are mainly located in the major blocks in tier-1, tier-2 cities. As for the detailed percentages, so over 90% of our collaterals are in tier-1 and tier-2 cities. And in that, about 30% of the collaterals are in tier-1 cities, and that's in terms of the loan origination and that's under our collaboration with trust companies.

And I also want to give you the numbers associated with our partnership with commercial banks. So that is rather the loans under the commercial bank partnership, which is around 7% that is facilitated in tier-1 cities, which is rather lower than that of our partnership with trust companies. But there are around 70% of the collaterals that is located in tier-2 cities under our partnership with commercial banks.

William Gregozeski: Okay, perfect. And last question is you've talked in the past about some technology upgrades you wanted to make. Can you just outline where you are on that process? What's the focus for the remainder of this year and next year? And what's the cost going to be for that?

Unidentified Company Representative: (Speaking foreign language).

Unidentified Company Representative: (Speaking foreign language).

(Translated). So in the past 3 years under the Covid-19 pandemic, we have seen that how important it is for a company could do their business online. And as our business volumes kept going up, we have been investing more into the technology. And I think I want to make one thing clear, that to improve our technological capability is to support the sales by coordinating data, so that we can provide better services to the sales partners and the borrowers. So as of this moment, as of today, the cost was not very significant as the major project was done by our in-house staff.

But as for the future, we do not really have a certain plan for right now. But our thought is that to make the investment towards technology a certain percent of revenue. That means if the revenue goes up with the investment, the technology will also go up. And our long-term goal is to make CNFinance a company that could promote business both online and onsite.

William Gregozeski: Okay, perfect. Thank you.

Operator: Okay. (Operator Instructions). This will conclude our question-and-answer session, as well as our conference call for today. You can view the company's information at ir.cashchina.cn.

Thank you for attending today's presentation. You may now disconnect.