[LU] Lufax Holding
Q2 2024 Earnings Conference Call
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Executives
YongSuk Cho, Chairman and CEO
Peiqing Zhu, CFO
Xinyan Liu, Head of Board Office and Capital Markets

Analysts
Emma Xu, Bank of America
Yada Li, CICC

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Lufax Holding Second Quarter 2024 Earnings Call. (Operator Instructions). After the management's prepared remarks, we will have a Q&A session. Please note this event is being recorded.

Now, I'd like to hand the conference over to your speaker-host today, Ms. Liu Xinyan, the company's Head of Board Office and Capital Markets. Please go ahead, madam.

Xinyan Liu: Thank you very much. Hello, everyone, and welcome to our second quarter 2024 earnings conference call. Our financial and operating results were released by our Newswire services earlier today and are currently available online.

Today, you will hear from our Chairman and CEO, Mr. YS Cho, who will provide an update of the recent developments and the strategies of our business. Our CFO, Mr. Peiqing Zhu, will then provide more details on our financial performance and business operations.

Before we continue, I would like to refer you to our safe harbor statement in our earnings press release, which also applies to this call, as we will be making forward-looking statements.

With that, I'm now pleased to turn over the call to Mr. YS Cho, Chairman and CEO of Lufax. Please.

YongSuk Cho: Thank you for joining us today for our second quarter 2024 earnings call. In the second quarter, the macroeconomic environment remained complex for small business owners. Despite this, we saw continued improvements in asset quality across both our Puhui and consumer finance businesses, as we continued to implement our prudent business strategies. We believe this will provide a solid foundation for our future growth.

Let me provide some updates on the macro situation before we discuss the business details. The SME Development Index trended down by 0.3 points quarter-over-quarter to 89.0 in June.

Meanwhile, the Business Conditions Index, published by the Cheung Kong Graduate School of Business, declined from 50.1 in March to 49.3 in June, falling below the 50.0 threshold, and reaching its lowest level for the first half of 2024. These indicators underscore the persistent challenges faced by the small business sector.

Now, let me provide some updates on our operating results.

First, let's take a look at our loan volume. Our total new loan sales in the second quarter of 2024 were 45.2 billion, representing a 15.5% year-over-year decline. The decline was mainly caused by a 35% year-over-year decrease of Puhui loans, which comprised 51% of total new loan sales in the second quarter, reflecting our continued emphasis on quality over quantity and sluggish demand for Puhui loans among high-quality SBOs. Meanwhile, our consumer finance business continued to grow and delivered a solid performance during the quarter. Consumer finance loans saw a 23.6% year-over-year increase in new loan sales, representing 49% of our new loan sales, as a result of our continued efforts to roll out smaller tickets and revolving product structures.

Furthermore, we are pleased to observe a notable improvement in asset quality as we adopt more stringent credit standards which focus on higher-quality customer segments and resilient geographies, bolstered by our enhanced risk assessment system. For Puhui loans, the C-M3 flow rate improved to 0.9% from 1.0% in the previous quarter, mainly driven by the improvement of the C-M3 ratio of unsecured loans. Our consumer finance loans also saw asset quality improvements, with the NPL ratio decreasing to 1.4% from 1.6% in the first quarter.

Next, let's take a look at our loans under the 100% guarantee model. As discussed previously, since the fourth quarter of 2023, all new Puhui loans have been enabled under the 100% guarantee model. As our Puhui loan balance increasingly represents loans enabled under this model, our balance take rate has trended upwards, reaching 9.3% during the second quarter, as the negative impact from high CGI premiums has been eliminated.

Thanks to this improved asset quality, our credit costs have remained stable despite increased risk exposure. However, it is worth noting that due to decreasing loan balances, our unit operating expenses have increased, which has become a key drag on our unit profitability.

Let me now provide some business updates on our newly acquired PAObank. By leveraging strategic synergies with Lufax following the acquisition, PAObank delivered solid growth in the first half of 2024. Its total loan balance stood at 2.4 billion by the end of the second quarter, representing a 45% year-over-year increase. Going forward, PAObank is planning to roll out new initiatives, including insurance and wealth management products, to better serve SME and retail customers.

To reinforce the strong license strategy we have discussed in the past, we recently acquired a nationwide small lending license. We believe this new license will help further reduce our funding costs, diversify our products, and improve our capital management efficiency.

Now, turning to the progress of our special dividend, I'm pleased to announce that we completed the distribution of the special dividend at the end of July as scheduled. After receiving the scrip dividend, Ping An Group's ownership increased to 56.8%, and Ping An Group now consolidates our financial results. Lufax will remain an independent entity listed on the New York Stock

Exchange and Hong Kong Exchange. Meanwhile, we will seek to enhance synergies with Ping An Group, primarily in the following three key areas.

First is branding. Ping An Group is a Fortune 500 company and a leading global financial institution. Its strong global reputation and financial standing will serve as a powerful endorsement for Lufax, deepening trust among our customers and funding partners. This enhanced brand association will improve our domestic and international standing, and can potentially help lower funding costs.

Second is technology. We will leverage Ping An Group's extensive technological resources, including its advanced AI systems, to further strengthen our risk management and fraud prevention measures. Our goal is to provide small business owners and consumers with efficient, secure, and cost-effective financial services.

Third is channel resources. While adhering strictly to applicable laws and regulations, we aim to expand our reach by tapping into Ping An Group's extensive nationwide network of online and offline channels. This expansion will complement our efforts to strengthen our direct sales force.

In summary, our expanded relationship with Ping An Group will help us better serve our SBO customers, easing their difficulty and expense of financing. With our strengthened capabilities, we will strive to be a benchmark company with a unique role in supporting the growth of China's vital small and micro enterprise economy.

While the macro environment remains complex, we are encouraged by the improvements in our asset quality and the progress of our strategic initiatives. We remain committed to our deliberate strategic approach as we continue to navigate the economic landscape, and have set our sights on achieving sustainable, quality growth.

I will now turn the call over to Peiqing, who will provide more details on our financial performance and business operations.

Peiqing Zhu: Thank you, YS. I will now provide a closer look into our second quarter results. Please note that all numbers are in Renminbi terms, and all comparisons are on a year-over-year basis unless otherwise stated.

In the second quarter of 2024, our total income decreased by 35.5% to 6 billion from 9.3 billion in the second quarter of 2023, mainly due to a decrease of outstanding loan balance by 44.8% from 426.4 billion as of June 30, 2023 to 235.2 billion as of June 30, 2024, partially offset by our increased take rate as loans enabled under the 100% guarantee model constitute a higher proportion of our total loan book.

Meanwhile, our total expenses decreased by 20.3% from 8 billion to 6.3 billion, among which the total operating expenses declined by 29.7% from 5 billion to 3.5 billion, and credit impairment losses decreased by 14.6% from 3 billion to 2.6 billion.

The gap between the decreases of revenue and operating expenses was mainly caused by the decreased economy of scale, which resulted in an increased fixed expenses-to-income ratio. The decrease of credit impairment losses was mainly due to the decrease in actual losses of loans as a result of the improvement of credit performance, partially offset by the upfront provision from loans under the 100% guarantee model. As a result, we recorded a net loss of 730 million for the second quarter.

Turning to our unit economics for the Puhui business, our APR by balance decreased from 20.3% in the second quarter of 2023 to 19.6% in the second quarter of 2024, primarily due to the change of customer mix as we continued to prioritize higher quality customers.

Despite the decrease in APR, our take rate by balance increased to 9.3% from 7.0% in the second quarter of 2023 due to our successful transition to the 100% guarantee model. We expect the take rate will further increase as the percentage of loans enabled under the 100% guarantee model continues to increase. In addition, our funding costs also decreased slightly, thanks to the favorable monetary policy and support of our funding partners.

On the other hand, while sales and marketing expenses remained stable, credit costs and other operating expenses dragged on our net margin. This was primarily due to the contraction in our loan balance.

Furthermore, while the actual losses decreased as a result of improvement in asset quality, we recorded more upfront provision for loans enabled under the 100% guarantee model. As discussed before, while we anticipate loans under the 100% guarantee model will be lifetime profitable, it is important to note that these loans may incur accounting losses in their first calendar year due to higher upfront provisions. This accounting treatment affects our short-term profitability, but is expected to lead to improved long-term financial performance as the loan portfolio matures.

Now, let me highlight a few of the key P&L items.

During the quarter, our technology platform-based income was 2.0 billion, representing a decrease of 51%, mainly due to the decrease in retail credit service fees as a result of the 44.8% decrease in outstanding loan balance. In addition, it was also negatively affected by the cessation of the Lujingtong business in April 2024.

Our net interest income was 2.7 billion, a decrease of 19.3% from the same period last year. The relatively lower decrease in net interest income was the result of an increase in consumer finance revenue.

Meanwhile, our guarantee income was 850 million, a decrease of 26%.

In terms of revenue mix, technology platform-based income accounted for 33.4% of our total revenue, down from 44% in the same period last year.

Net interest income and guarantee income accounted for 45.4% and 14.2%, respectively, of total revenue in the second quarter, as compared to 36.3% and 12.4% in the same period last year.

In terms of expenses, our credit impairment losses decreased by 14.6% to 2.6 billion. Our total sales and marketing expenses, which include expenses for borrower acquisition costs as well as general sales and marketing expenses, decreased by 46% year-over-year to 1.4 billion in the second quarter. The decrease was mainly due to reduced loan-related expenses resulting from the decrease in new loan sales and outstanding loan balances, as well as the elimination of the expenses associated with our Lujintong business.

Our operation and servicing expenses decreased by 15.8% year-over-year to 1.3 billion in the second quarter, as a result of the decreased loan balance and our continued efforts to control expenses, partially offset by increased commissions associated with improved collection performance.

Our finance costs decreased by 90.2% to 13 million in the second quarter from 136 million in the same period of 2023, mainly due to the decrease of interest expenses after the repayment of our C-Round Convertible Promissory Notes and other debts, partially offset by the decrease of interest income from bank deposits.

In terms of capital, as of the end of June 2024, our main operating entities remained well-capitalized. Our guarantee subsidiary's leverage ratio stood at 2.4x, and our consumer finance subsidiary's capital adequacy ratio stood at 14.7%, well above the 10.5% regulatory requirement.

As we deal with the complexities of the broader economic environment and our strategic shift to the 100% guarantee model, we are seeing encouraging signs in terms of asset quality, and in the growth of our consumer finance business. We will remain committed to our prudent strategy as we seek to build a solid foundation for long-term, sustainable future success, and will uphold our commitment to bring value to our investors.

That concludes our prepared remarks for today. Operator, we are ready to take questions.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Emma Xu with Bank of America Securities.

Emma Xu: Actually, I have two questions. So the first question is about the loan demand. So how is the overall loan demand currently? So we see that in second quarter, you granted RMB 45.2 billion new loans, and the cumulative amount of the new loans issued in the first half reached RMB 93.3 billion, accounting for around 42% to 49% of your full year guidance at the beginning of the year. So do you think you are still on track to meet your full year target? And when will we see the turning point of the loan growth recovery?

And the second question is that congratulations on the continued improving asset quality. So your C-M3 flow rate has declined 2 quarters in a row, and down to 0.9% in the second quarter. So do you think you can continue to see the improvement in the flow rate? And how will management try to sustain this good trend?

YongSuk Cho: Thank you, Emma, for your question. The first question, loan demand. Yes, loan demand overall is still weak. For loan growth recovery, it largely depends on macro environment improvement. So while we keep our prudent strategy on SBO lending, we see that from our CF business, the consumption loan demand is actually more and stable. So we focus more on consumer finance a loans to cope with declining SBO loan demand in near term,

And for your second question, we all know that it is not easy to improve C-M3 flow rates while loan balance keeps declining. But with continuous portfolio mix improvement, what I mean is, now we see that more and more accounts from 2023 and 2024 vintage takes a bigger part of the whole portfolio, which is better quality account. So we believe our asset quality measured by C-M3 flow rate with continuous improvements.

And also, we put tremendous efforts in our risk model, underwriting model, and also collection model upgrade, and then asset quality management process. So all in all, we are confident about sustainability of our asset quality going forward. Thank you.

Operator: Yada Li with CICC.

Yada Li: I have four questions today. Firstly, I was wondering in what areas do we see more collaboration potential in the future with the Ping An Group? And secondly, I'd like to ask do we have any plans to further increase the shareholder returns? Looking at the cash at hand and the future loan size, what could be the potential amount available to distribute to the investors?

Third, we notice that the funding cost decreased slightly in the second quarter. And I was wondering what's the outlook for the future funding cost? And last, I want to ask why the OpEx to income ratio hike in the second quarter? Do we see any room to further improve this ratio? That's all.

YongSuk Cho: Okay. Let me answer this question 1 to 3. Thanks, Yada, the -- let me see my notes. So after special dividends, Ping An Group's ownership increased much closer to 57%, to 56.8%. And we have been working closely with Ping An Group from the very beginning in a few key areas like customer sourcing, using their online and offline channels and technology developments and then branding

But with increased Ping An Group ownership now, we expect it will help us to reduce funding cost, in light of their good reputation and financial standing. So actually, your third question is about funding costs. We believe funding cost is actually decreasing or optimizing. We believe this trend will continue. And also with the acquisition of that nationwide small loan lending license (Speaking foreign language), that lending license, that comes with better, lower funding cost going forward. So we are confident about the funding cost further improvements.

And then about the second question, although the Board of Directors has determined that no semiannual dividend will be paid at this time, because we made a net loss recorded for the first half of 2024, but management is dedicated to returning value to shareholders. We always seek out potential ways to increase shareholder returns, as demonstrated in this special dividend this time. And our annual dividend policy, which is 20% to 40% of net profit, and we pay semiannually, that policy does not change; it remains unchanged.

Peiqing Zhu: Okay. About the funding cost, I would like to share some of my view. For our Puhui loan, we expect that just because of the APR policy, the Central Bank released the variable monetary policy to the market, and to support -- that will definitely support our partners. And of course, they were partnered to our companies. So together with the synergy of the Ping An Group, which will enable us to enjoy a low funding cost.

For consumer finance loans, I believe that we will continue to fetch a lower interest rate in the interbank market. Actually, you can see the trend also in the interbank market, right? The rate was led by the Central Bank to going down, and we expect that funding cost will remain at a relatively low level. And generally, we will say that we are optimistic to our overall funding cost, that will continue to decrease.

And about the question about our OpEx-to-income ratio increased in the second quarter. Although we remain committed to the cost optimization, our OpEx-to-income ratio trended upwards during this quarter. This was mainly due to our loan scale contraction, that led to a decline in economy of scale. In addition, some of the fixed expenses contributed to the increase.

Looking forward, we will continue to improve our operational efficiency by leveraging the technology and synergy and the digitalization and the work together with the Ping An Group and our internal efforts. Thank you.

Operator: Thank you. That concludes our question-and-answer session for today. I will now turn the call back over to our management for closing remarks.

Xinyan Liu: Thank you. This concludes today's call. Thank you all for joining the conference call. If you have more questions, please do not hesitate to contact Lufax's IR team. Thanks again.

Operator: Thank you. This conference has now concluded. You may now disconnect.