

[FINV] - FinVolution Group
Q1 2021 Earnings Conference Call
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Officers

Feng Zhang, Chief Executive Officer

Jiayuan Xu, Chief Financial Officer

Jimmy Tan, Head, IR

Analysts

Thomas Chong, Jefferies

Yiran Zhong, Credit Suisse

Hanyang Wang, 86Research

Alex Ye, UBS

Eric Lu, China Renaissance

Henry Liang, Gold Dragon

Presentation

Operator: Hello, ladies and gentlemen. Thank you for participating in the First Quarter 2021 Earnings Conference Call for FinVolution Group. (Operator Instructions). After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded.

I will now turn the call over to your host, Jimmy Tan, Head of Investor Relations for the Company. Jimmy, please go ahead.

Jimmy Tan: Hello, everyone, and welcome to our first quarter 2021 earnings conference call. The Company's results were issued via newswire services earlier and are posted online. You can download the earnings release and sign up for the Company's email alerts by visiting the IR section of our website at ir.finvgroup.com.

Mr. Feng Zhang, our Chief Executive Officer, and Mr. Jiayuan Xu, our Chief Financial Officer, will start the call with their prepared remarks and conclude with a Q&A session.

During this call, we will be referring to several non-GAAP financial measures to review and assess our operating performance. These non-GAAP financial measures are not intended to be considered in isolation, or as a substitute for the financial information prepared and presented in accordance with U.S. GAAP. For information about these non-GAAP measures and reconciliation to GAAP measures, please refer to our earnings press release.

Before we continue, please note that today's discussion will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation

Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the Company's results may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties are included in the Company's filings with the U.S. Securities and Exchange Commission. The Company does not assume any obligation to update any forward-looking statements except as required under applicable law.

Finally, we posted a slide presentation on our IR website providing details of our results for the quarter.

I will now turn the call over to our CEO, Mr. Feng Zhang. Please go ahead, sir.

Feng Zhang: Thank you, Jimmy. Hello, everyone, and thank you so much for joining us today. We are pleased to start 2021 with remarkable progress, delivering high-quality growth across all aspects of our business in the first quarter, while also achieving further improvement in risk metrics across the board.

Notably, our total loan origination volume for the quarter reached a record high to RMB26.8 billion, representing a year-over-year increase of 105%. Our loan origination volume for Mainland China increased 24% quarter-over-quarter to RMB26 billion.

Also, our international business is continuing its rapid growth, generating approximately RMB760 million of loan origination volume during the quarter, up 42% from the fourth quarter of 2020. Our sequential quarterly growth in loan volume, following the continued economic recovery from the pandemic, is a testament to the effectiveness of our strategies and our strong execution.

Also in the quarter, we continue to benefit from our successful transition toward higher-quality borrowers. We improved our delinquencies to historical lows while achieving sequential growth. Our recent day 1 delinquency rate in May was around 5.4% compared to 9.7% in the same period last year. Our vertical delinquency rate that was 15 to 89 days past due further improved to 1.24% from 1.38% in the previous quarter, while our 90-days plus delinquency rate was 1.13%, compared to 7.25% in the same period last year.

Our loan collection recovery rate continued to stabilize at 90% around. We further expect vintage delinquency rate to fall to historical lows around 2.5% in the first quarter, and key risk metrics to remain stable for 2021.

Going forward, we see continued opportunity for quality growth as we further build our strong technological capabilities and credit risk management framework. Notably, our total number of new acquired borrowers in the first quarter of 2021 exceeded 1 million, compared to 373,000 new borrowers in the same period last year, representing a 169% increase. By continuing to improve our acquisition efficiency, we were able to reduce our acquisition cost from the previous quarter. As part of our efforts to pursue financial inclusion, our average IRR for this quarter stabilized at around 26.8%.

Since 2020, we have been diversifying our loan facilitation services to serve small business owners in Mainland China as we continued to capitalize on this unique opportunity presented by their need for operational funds. In the first quarter, loan origination volume for small business owners grew rapidly to RMB4.4 billion versus RMB3.7 billion originated throughout the full year of 2020, accounting for 16% of total loan origination volume for the period.

The total number of small business owners we served in the quarter reached around 305,000 compared to 220,000 for the full year 2020. We believe this segment of our business supports China's economic rebound and is in line with national policies. Going forward, we will remain focused on serving small business owners, and we expect this portion of our business to account for around 20% of total loan origination volume in 2021.

Our international expansion strategy continues to be a key competitive differentiator for us, as we remain optimistic and selective in penetrating Southeast Asia emerging markets, where we have established a first-mover advantage. We currently have established operations in Indonesia, Philippines and Singapore.

Apart from our online loan facilitation services, we have also been exploring other business concepts with different partners in the Southeast Asia market. Leveraging on our expertise in online loan services and localization strategy, we are confident in our globalization process and our long-term mission to make financial services more accessible and inclusive for our borrowers. In light of the ongoing uncertainties stemming from pandemic-related economic conditions, our international expansion strategy will help diversify both user base and revenue streams, thus bolstering our ability to generate steady long-term growth for the company.

We remain focused on evolving our risk assessment and management framework with prudent principles, enhancing top-notch technology advancement capabilities while pursuing a healthy approach to diversifying our customer base, as well as expanding funding sources both domestically and internationally.

With all that being said, as we drive our industry-leading position further with these initiatives in technology, overseas markets and product diversification, I believe FinVolution will establish a significant presence in some of these new territories over the next several years. Based on our track record with our successful business transition in Mainland China and our expansion in Southeast Asia, we believe our digitalization and operational capabilities can empower a variety of businesses across multiple scenarios in different industries.

In conclusion, we are excited to get the year off to a strong start as we successfully execute our business strategy. We are confident in our ability to maximize our well-established position in China's consumer and micro-enterprise markets as well as Southeast Asia's booming digital finance market, which will unlock tremendous value for all of our stakeholders.

With that, I will now turn the call over to Jiayuan Xu, who will discuss our financial results for the quarter.

Jiayuan Xu: Thank you, Feng, and hello, everyone. With a strong and steady recovery across multiple operational fronts in the first quarter, we delivered a 45% increase in non-GAAP operating profit to RMB671 million, reaffirming the successful transition of our business model towards higher-quality borrowers.

Our balance sheet remained strong with RMB5.1 billion in unrestricted cash and short-term investments. Employing our strong technology and risk management capabilities, we will continue to explore new business models and tap into new opportunities both domestically and internationally.

Now, turning to the financial results for the first quarter. In the interest of time, I will not go through each item line-by-line on this call. Please refer to our earnings release for more details.

Net revenue for the first quarter of 2021 stabilized at around RMB2.11 billion primarily due to increase in loan origination volume and partially offset by the decrease in guarantee income as a result of improved asset quality.

Loan origination service fees increased by 103% to RMB761 million for the first quarter of 2021 from RMB375 million in the same period of 2020, primarily due to the increase in loan origination volume, which was partially offset by the decrease in average rate of transaction fees.

Post-facilitation service fees increased by 24% to RMB226 million for the first quarter of 2021 from RMB183 million in the same period of 2020, primarily due to the increase in outstanding loans serviced by the company and the rolling impact of deferred transaction fees.

Guarantee income was RMB659 million for the first quarter of 2021 compared to RMB1,150 million in the same period of 2020 as result of improved asset quality.

Net interest income decreased by 11% to RMB280 million for the first quarter of 2021, from RMB315 million in the same period of 2020, mainly due to the reduction in outstanding loan balances of consolidated trusts, partially offset by the higher loan origination volume originated outside Mainland China.

Other revenue increased by 121% to RMB185 million for the first quarter of 2021, from RMB84 million in the same period of 2020, mainly due to increase customer referral fees to other third-party platforms.

Non-GAAP adjusted operating profit, which excludes share-based compensation expenses before tax, was RMB671 million for the first quarter of 2021, representing an increase of 45% from RMB464 million in the same period of 2020.

Net profit was RMB593 million for the first quarter of 2021, representing an increase of 41% compared to RMB420 million in the same period of 2020.

We have a well-capitalized balance sheet, and our leverage is conservative. If you divide the total outstanding loans of RMB32.5 billion on our platform by our shareholder equity, the leverage ratio across our business was only 3.7 times.

And our liquidity position remains strong with RMB5.1 billion of unrestricted cash and short-term investments as at the end of March 2021. Our strong balance sheet positions us well in the current operating environment, and gives us significant flexibility.

As China's economic environment gradually recovers from the aftermath of the COVID-19 outbreak, the Company has been experiencing progressive improvements across numerous operational metrics. The Company will continue to closely monitor the situation of global pandemic and remain agile in its business operations. As such, the Company holds a cautiously optimistic view on its operations and anticipates a steady growth in its loan origination volume in the second quarter of 2021, which is expected to be in the range of RMB29 billion to RMB30 billion.

Last but not least, we continue to return value to our shareholders through dividends and share buybacks. As of March 31, 2021, we have cumulatively deployed USD131 million for buybacks and USD143 million for dividend distributions.

With that, I will conclude my prepared remarks. We will now open the call to questions. Operator, please continue.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Thomas Chong with Jefferies.

Thomas Chong: (Speaking foreign language). Thanks, management for taking my questions. Can you comment about unit economics as well as the trend in coming quarters? Thanks.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan (Translated): Okay. Let me do the translation for Mr. Alex, please. The composition for our unit economics is pretty straightforward. Our IRR on average is between 26% to 27%. And our funding cost is about 7.5% and our vintage delinquency rate is 2.5%; on an annualized basis, it's around 7%. So on average, the IRR is around 12%, and when we convert to a take rate of 4%, it's in line with what we have been guiding with the market along the past few quarters.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan (Translated): Okay. Next, we'll elaborate more on our development phase . We will explain in 2 different stages, yes.

Our loan facilitation business in China has shown improvement in all our key metrics for our loan facilitation business. All metrics are showing a healthy sign. For example, our risk metrics have continued to improve. And in the second quarter, our expected loan origination volume is expected to be in the range of RMB29 billion to RMB30 billion. And we are continuing to show healthy growth in all key metrics going forward.

In the first quarter, our total number of new customers exceeded one million and in the domestic market alone, our new customers exceeded 600,000. And all this increase in new customers actually provide growth for the future. And based on the current situation and the current performance of our key operation metrics, we are confident to deliver our full year loan guidance of RMB100 billion to RMB120 billion.

Okay. For the Southeast Asia market, we are still maintaining very rapid growth, although there has been some impact caused by the rebounding of the pandemic in the Southeast Asia. In terms of new customers and loan origination volume, we are still seeing very rapid growth in both of these metrics. And beside Indonesia, we have also penetrated into a new country, Philippines. And we have also begun operations in Philippines.

Operator: Yiran Zhong with Credit Suisse.

Yiran Zhong: (Speaking foreign language). Thank you management for taking my questions, and congratulations on your strong results. I have 2 sets of questions. One is on the loan facilitation. It seems the exposure to the on-balance sheet lending and lending by trust structures have been rapidly reducing. And so I wonder what's the latest split between the on-balance sheet and off-balance sheet origination volume?

And related to loan facilitation, what's your assessment of the regulation over the loan facilitation business model going forward? Would it be regulated under a license regime for example, under the personal credit reference law? Any feedback you can share from the funding partners or regulators would be appreciated.

And secondly, regarding the overseas business, following up on your earlier comments, can you share more details on the Southeast Asia expansion and what's the economics there? Any guidance on what you expect the volume to make up, when the volume would make up a meaningful contribution of your volume going forward?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan (Translated): Okay. On the balance sheet, the trust contribution that's on the balance sheet is currently less than 10%. Our loan facilitation model mainly cooperate with the banks and consumer finance companies, which is off-balance sheet.

Let's further understand the regulator's intentions. The regulators is in the process of building a comprehensive framework. And over the last 1-year-plus, the regulators, is in the process of establishing a comprehensive framework. From our observation, the regulator is in the process of establishing a comprehensive framework, plus many different aspects such as data protection, funding restriction, customer privacy are being reviewed.

And based on our observation from March 2021 onwards, the regulatory environment seems to be much more stable and it is less likely for any new regulatory framework to be introduced. In the future, it is less likely for any new regulatory framework to be introduced. However, modifications on the current regulations will still continue.

Within the credit scoring, consultation coverage is very broad. Our business is based on the loan facilitation model, providing comprehensive solutions on multiple aspects such as customer acquisition, risk management, after-loan management and loan managing, etc.

For the loan facilitation model, we do not offer standalone credit scoring services . We refer the customers to our financial institution partners. Whether a loan is being approved or not is dependent on their independent assessment. And from this view and our current assessment, we believe we are not within the scope of the current credit scoring consultation paper. As the Southeast Asia business contribution is still very small relatively to our overall business, we intend to share more updates with you when this portion of the business grow bigger in the future.

Operator: Hanyang Wang with 86Research.

Hanyang Wang: (Speaking foreign language). So let me translate my questions. Congratulations on another great quarter. My first question is regarding on the privacy protection. So recent days, some smartphone makers changed its privacy policies, for example, like the new IDSA policy by Apple. So will this policy change affect our advertising effectiveness and the borrower acquisition cost?

And in addition, regulators clarified some necessary personal information for online lending apps. So will this adversely impact our data collection and risk assessment model?

My second question is on our technical service. So we launched the bus service last month. Can you share more color on how many institutions have adopted the service and how we charge them?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan (Translated): It actually belongs to the same question. The regulators have increased the barrier on data privacy and customer protection. From the current situation, the impact is minimum. As we are a technology company, we are using our technology capabilities to solve all these problems. And also compliance is a top priority for us. And if you actually notice, the company is actually not on the lists highlighted by the

regulators.,

Regarding our BaaS progress, with our 14 years of digitalization capabilities, we are helping our financial institution partners in terms of increasing their efficiency. And our partners actually agree with our views on the BaaS services, and we are currently working with 3 of them to introduce the various stage of the BaaS services. We are actually providing services such as after-loan management, risk-related services and the fees collected will be based on the actual results of the performance.

The BaaS is a ToB model, and during this process of permitting the BaaS services, our intention is to allow us to have more time to enhance our products before sharing it with more of our institutional partners.

Hanyang Wang: (Speaking foreign language). Thanks, very helpful.

Operator: Alex Ye with UBS.

Alex Ye: (Speaking foreign language). So I have 2 questions. First one is on any updates on the earlier, the national micro-loan license. Is there any update on that front? And earlier, one of your peers had mentioned that they might be doing some preparation work on applying such a license.

Second question is on your international business. I'm wondering would you have any specific guidance in terms of the full year loan volume contribution from that business? And also as you ramp up your international business, what's the implications on your sales and marketing expense? And in particular, I'm wondering if you could share with us some color on the customer acquisition cost for your international business?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan (Translated): With regards to the nationwide micro-lending license programs, we are still in the process of evaluation and understanding the regulators' requirement, as there has been no update from the regulator since the previous consultation paper. We will share more details with the market when there is more information from the regulators.

Although the pandemic is rebounding in Southeast Asia, we are still confident to achieve 3x to 4x growth on a year-on-year basis in Southeast Asia this year. As we have disclosed, we have acquired over 300,000 new customers in Indonesia and our lending app is known as AdaKami. Our app in Indonesia is very popular. And between the last 6 months ranging from 1 October to March 31, in terms of fintech lending debt, we are ranked #1 in terms of downloads.

The cost of customer acquisition in Southeast Asia is relatively low. But as the business and situation change, the cost of acquisition is expected to change as well. In the first quarter, the cost of a successful new borrower in Mainland China is about RMB450 and this has shown improvement compared to the previous quarter. As you know, we have also become an important partner with many leading information feed standards. And our

cooperation with these partners has become closer and leading to more strategic partnerships. As our risk metrics have been constantly improved, this has also led to a decrease in our customer acquisition costs.

Operator: Thank you. (Operator Instructions). Eric Lu with China Renaissance.

Eric Lu: (Speaking foreign language). So my question is we thought the asset quality had been largely improved. So just want to know is there any change to our current client profile?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan (Translated): Our customer profile has actually changed a lot. During the P2P era, only about 15% of our borrowers have PBOC records, and today, over 95% of our borrowers have PBOC records. And we would also like to share more color on how we are able to gain such a significant change in our asset quality.

The reasons for improvement are largely due to 2 of our capabilities: #1, our digitalization capabilities, and #2, constant data accumulation, enabling us to upgrade the effectiveness of our model. Our digitalization capabilities can be proven in many situations. For example, during the last 14 years, we have track record in customer acquisitions, risk management and after-loans management, etc. These capabilities have been proven during our P2P era.

And after our strategic transition to better-quality borrowers, we have also seen multiple improvement across operational metrics, as we leverage on our digitalization capabilities. And these capabilities have also been leveraged onto our Southeast Asia business, where our business is expanding rapidly. And in the future, we believe our digitalization capabilities can also be leveraged in non-finance industry across multiple scenarios.

Another very important factor is the constant data accumulation. Constant data accumulation, coupled with the digitalization capabilities, double the results, as more data are being collected leads to a more accurate model, hence, increasing our capabilities; as you can see, from our transition to higher-quality borrowers, driven by the increasing number of new customers, and resulting in higher loan origination volumes.

As the number of new quality borrowers increase on the platform with a higher loan origination volume, all this will become a positive impact. And we are confident that with all these capabilities as our key operational metrics, such as our risks improvement, we are able to have a healthy growth for the business.

Eric Lu: Thank you.

Operator: Henry Liang with Gold Dragon.

Henry Liang: (Speaking foreign language). So just congrats on such a strong result. And as we see, FinVolution has been doing very well in Southeast Asia market, especially Indonesia and like outperforming all the local players after COVID and like even for our

peers, who have been like doing a better and larger business in Mainland China, like none of them have been as successful in overseas market as our company.

Can you please share like what kind of core moat or competitiveness we have to be able to lead in the Southeast Asia market? And would you please also share your plan on the overseas expansion and the total addressable market over the long term?

Feng Zhang: Thanks, Henry. This is Feng. I'll try to give a brief view on your question; I think it's a very good question. I think our core capability, core strength of the company, are really twofold. One is after so many years, we are really good at leveraging data and technology to improve efficiencies in a business process. And particularly, I think in the past, our main business has been on this loan tech business in our view.

And secondly, I think the company has a really strong value system and reflecting in our business. I think we have the very strongest culture, and we really respect risk and we treat it very seriously. We don't sacrifice risk for achieving short-term growth. And we really look at things in a very long-term way. So I think these are the 2 core strengths of the company and I think the company has experienced up and downs.

I think before we went IPO, we had a period of rapid growth. And after IPO, due to a very severe regulatory environment and external environment shift, we had a couple of tough years. But I think what's inside the company are the fundamentals of the company, really were able to enable us to go through that tough period. I think our track record during good years and tough years has been it really says a lot about our fundamentals.

And to the second part of your question, I think we are really bullish about the Southeast Asian market. I think roughly, it's half the size of Mainland China. So I think even for Indonesia, Philippines, these 2 countries combined, we are very small. We are very early stage, though we are developing very fast, but we think the market is huge. So we think just like in this market, we have a lot of opportunities there. We're very bullish about that.

And I think I will also add we will continue to explore getting into other markets when opportunity presents. But I also want to like take a step back, coming back to what we believe is the core strengths and fundamentals of the company. And I want to call that it's actually not limited to only loan facilitation model or loan tech. Think about that; it's really leveraging data and technology to improve efficiencies, right? And our long-term based value system, we believe there's a lot of opportunity for us to leverage the core strength of the company to improve efficiency.

And so we are also exploring how do we leverage this core capability to enter different markets and different businesses. And we will share with the market, share with you guys, when they are more meaningful processes. But there are a bunch of things in the incubation stage in the company. Thank you, Henry.

Henry Liang: Yes, just a very quick follow-up. Our investors, shall we expect sort of to share a meaningful like update of the overseas business both on their top line contribution and also the bottom line contribution towards the end of this year and the next?

Feng Zhang: Yes, possibly, yes. I think as the business size continue to grow, some of our new businesses, namely like particularly the international business. And we are very careful because for example, like this is the first time we disclose the international business. But internally, within the company, we started the business several years ago, right? So but like no, we decided like no, until we feel fairly comfortable, and then we will start to share some information.

And I think as the business becomes more meaningful, we're very bullish about the business. The business is in a very healthy stage, very healthy in both growth as well as unit economics. And as it becomes a more meaningful part of our entire business, we will share more color, more insights, and more numbers with the team. Thank you.

Henry Liang: Thanks.

Operator: As there are no further questions now, I'd to turn the call back over to the company for closing remarks.

Jimmy Tan: Thank you once again for joining us today. If you have further questions, please feel free to contact the FinVolution Investor Relations team. Good night.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.