

[FINV] - FinVolution Group
Q2 2021 Earnings Conference Call
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Officers

Feng Zhang, CEO
Jiayuan Xu, SVP, Finance
Jimmy Tan, Head, IR

Analysts

Thomas Chong, Jefferies
Alex Ye, UBS
Eric Lu, China Renaissance
Hans Fan, CLSA
Henry Liang, Gold Dragon
Harry Wu, China Securities.

Presentation

Operator: Hello, ladies and gentlemen. Thank you for participating in the Second 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 second quarter 2021 earnings conference call. The Company's results were issued via newswire services earlier today 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 <http://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: Thanks, Jimmy. Hello, everyone, and thank you so much for joining us today. We continue to provide value for both users and institutional partners in different aspects. Leveraging our cutting-edge technology, we have been providing value for users across multiple segments such as consumer finance, small business owners and different types of financial institutions. Through our platform, users are able to enjoy the convenience of finance at their fingertips, accessing credit lines in a timely and efficient manner. On the other hand, our institutional partners are able to access and evaluate quality borrowers with efficiency.

Along with the value created, we are thrilled to be reporting another set of record-breaking operational and financial results in the second quarter. As we harness our technological capabilities effectively to acquire new and better quality borrowers and constantly increase our acquisition channels, our total number of new and better borrowers acquired globally once again crossed the 1 million mark to a new record high of 1.18 million, an increase of over 500% year-over-year and 18% quarter-over-quarter.

More specifically, the number of new borrowers acquired in China reached 812,000, representing an increase of over 380% year-over-year and 31% sequentially. The number of new borrowers acquired in international markets reached 371,000, approximately a 13-fold increase compared to the same quarter last year.

Another clear indication that we are resuming high-quality growth is that our total transaction volume for the quarter reached a new record high to RMB33.4 billion, a 153% jump year-over-year and a sequential increase of 25%. Specifically, transaction volume in China climbed 148% year-over-year and 25% quarter-over-quarter to RMB32.5 billion, while the transaction volume for international markets grew exponentially by 1,780% year-over-year and 23% sequentially to RMB940 million. Simultaneously, our outstanding loan balance further expanded to RMB39.4 billion, representing year-over-year growth of 87% and a 21% sequential increase.

In order to better support the healthy growth of our facilitation operations, we have been making consistent investments in acquiring new better quality borrowers through an array of online and offline channels. We have diversified our online channels, and have also established an offline team of over 600 employees covering around 80% of China's

provinces. In the second quarter, our offline channels contributed around 10% of total new transaction volume. Offline acquisition is not only an alternative channel, but also validates our technologies can be seamlessly integrated in different scenarios to enhance efficiency. Going forward, we intend to expand the offline team to beyond 1,000 employees in a year or so.

Since 2020, we made our services available to small business owners in China, aiming to capitalize on the significant opportunity presented by this group's underserved needs for operational funds. In the second quarter, growth momentum for our small business owner segment remained robust, with transaction volume increasing 41% sequentially to RMB6.2 billion.

Notably, the total number of small business owners served in the quarter exceeded 408,000 compared to just 220,000 in total for the full year 2020. We believe serving the needs of small business owners is in line with national policies, and plays a part in meeting the needs of this segment of society.

Going forward, we will maintain our strategic focus on serving this segment, and expect this portion of our business to account for around 20% of total transaction volume in the second half of 2021.

In line with regulatory directions, we preemptively continue to lower borrowing rate in the second quarter to IRR 26.2% for our borrowers, and more recently in August, the rate was further reduced to IRR 25.4%. We are also pleased to share that the recent percentage of transaction volume with borrowing rates at or below IRR 24% has risen to around 60%. We plan to continue acquiring better quality borrowers, expanding new funding sources across regions and enhancing operating efficiency to provide more attractive rates and terms for our borrowers, while maintaining a healthy take rate and operating margin.

On the international expansion front, with our state-of-the-art technologies and swift execution, we have continued delivering strong performances. In particular, we successfully launched a pilot testing operations in Vietnam, which demonstrated encouraging growth prospects. More excitingly, this marks the fourth country in our global roadmap in addition to our international presence in Indonesia, Philippines, and Singapore.

We are very pleased with the accelerating pace in broadening our global footprint, and thrilled that our recent entry in Vietnam is already demonstrating great potential with positive user feedback. We attribute our success in building out our first-mover advantages in emerging markets to our fundamental capabilities, talented and efficient team with a global perspective, proprietary technologies, operational expertise and deep-rooted corporate values.

Our technologies support us in successfully navigating our business transition in China, and also play a crucial role in our expansion across different international markets. We are confident in our global roadmap and remain firmly committed in our mission to make

financial services more accessible and inclusive for borrowers around the world. Going forward, we will continue to advance our technological capabilities and solidify our operations in these countries, while working with our local partners to explore new opportunities that will enable us to diversify our business models.

Leveraging our technologies, operational expertise and in-depth understanding of our institutional partners, we are able to provide diversified products and solutions for them in multiple scenarios. In particular, through cooperation with 8 different institutional partners, we increased the proportion of capital-light model on our platform from 2.3% in the previous quarter to 13% in this quarter. All these achievements are a further testament to the solid trust and confidence that our funding partners have in FinVolution, as we remain committed to building credibility and a strong corporate reputation amid ever-evolving market dynamics.

Supported by our enhanced credit management model built on targeting higher-quality borrowers, our delinquencies have shown further improvement across multiple risk metrics. For example, our day 1 delinquency rate remained stable at 5.4% in August, compared with 7.5% in the same period last year. We expect vintage delinquency rates to continue improving to a level below 2.3% in the second quarter, while our 90-day-plus delinquency ratio reached a historical low of 1.01% from 7.13% in the same period last year. Our loan collection recovery rate also stabilized at around 91%.

As we look ahead, our primary objectives for 2021 and beyond are to:

- Continue pursuing high-quality growth in China;
- Leverage technologies to strengthen our first-mover advantage in the international markets and diversify our business models;
- Continue empowering financial institutions through Business-as-a-service Solutions; and
- Empower a variety of businesses globally through our digitalization capabilities to create long-term value for our stakeholders.

During the past several years, we have encountered and overcome many different challenges, such as exiting the P2P business, shifting our funding sources, moving towards better quality borrowers and many more. We have the technological know-how, capabilities and resources to deliver better results and achievements in this rapidly-evolving environment. Our dynamic business models and operating strength coupled with our strategic investments in multiple sectors, will drive our success with a sustainable return for all our stakeholders in the long term.

Last but not least, I would also like to report our progress on corporate social responsibility. During the past several years, we have consistently fulfilled our duties as a responsible corporate citizen. For example, during the recent flood in Henan, we have donated RMB10 million as post disaster aid and activated our local employees to distribute food supplies for those in need. Together with our institutional partner, a low-interest loan program for small business owners has also been introduced.

Our third annual ESG report was also published recently, and for those who are interested in having more information, do visit our website for a copy.

In summary, leveraging our technologies and digitization capabilities to create long-term value for our stakeholders, we are confident in our ability to maintain our position as the leading fintech platform in China, while capturing tremendous growth opportunities globally.

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 continued improvement across multiple operations metrics in the second quarter, we delivered a non-GAAP operating income of RMB726 million, an increase of 26% year-over-year and a sequential increase of 8%, further validating the viability of our business model.

Our robust balance sheet with RMB4.9 billion in unrestricted cash and short-term investments, coupled with our strong technology capabilities, positions us well to explore opportunities both in the domestic and international markets.

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

Net revenue increased by 32% to RMB2.4 billion for the second quarter of 2021 from RMB1.8 billion in the same period of 2020, primarily due to increase in transaction volume and partially offset by the decrease in guarantee income as a result of improved asset quality.

Loan facilitation service fees increased by 135% to RMB952 million for the second quarter of 2021 from RMB405 million in the same period of 2020, primarily due to the increase in transaction volume, which was partially offset by the decrease in average rate of transaction fees.

Post-facilitation service fees increased by 96% to RMB300 million for the second quarter of 2021 from RMB153 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 RMB666 million for the second quarter of 2021 compared to RMB821 million in the same period of 2020 as result of improved asset quality.

Net interest income decreased by 7% to RMB309 million for the second quarter of 2021, from RMB333 million in the same period of 2020, mainly due to the reduction in outstanding loan balances of consolidated trusts, partially offset by the higher transaction volume in the international markets.

Other revenue increased by 61% to RMB158 million for the second quarter of 2021, from RMB98 million in the same period of 2020, mainly due to increase in customer referral fees to other third-party platforms.

Non-GAAP adjusted operating income, which excludes share-based compensation expenses before tax, was RMB726 million for the second quarter of 2021, representing an increase of 26% from RMB576 million in the same period of 2020.

Net profit was RMB620 million for the second quarter of 2021, representing an increase of 37% compared to RMB454 million in the same period of 2020.

We have a well-capitalized balance sheet, and our leverage ratio remains low. The leverage ratio across our business was only 3.8 times. And our strong liquidity position consisting RMB4.9 billion of cash and short-term investments as at the end of June 2021, positions us well in the evolving environment, and gives us significant flexibility.

With the COVID-19 recent resurgence in China and other regions around the world, the Company will continue to closely monitor the situation of the pandemic and remain vigilant in its business operations. As such, the Company holds a cautious view on its operations, and anticipates steady growth in its transaction volume for the third quarter of 2021, which is expected to be in the range of RMB35 billion to RMB37 billion.

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

Questions and Answers

Operator: (Operator instructions). Thomas Chong, Jefferies.

Thomas Chong: Congratulations on the strong results. So first, I have 2 questions here. So first, could you please share some updates about the regulatory environment? And how much of our loans already have an APR below 24%? And how should we think about the trend in APR going forward?

And my second question is what about our outlook on loan origination volume in the second half and 2022?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Okay. Let me do the translate for Mr. Xu. From our understanding, the cap on IRR 24% is a window guidance from the CBIRC for consumer finance companies. Plus, it is not evenly implemented across the country, as there are different timelines for different institutions. For example, some determined that the outstanding loan balance of all loans above 24% will be reduced to zero by the end of next June, while rates for some

institutions will follow the guidelines that there will be no new originations above 24% by the end of next June.

This is actually something within our expectation. And we have been preemptively been reducing interest rate for our borrowers. For example, in the call earlier, our CEO, Mr. Feng Zhang, has mentioned that in the first quarter, our borrowing rate was 26.2%; and in the second quarter, this borrowing rate was reduced to 26.2%. I mean, in the first quarter, it was 26.8% and it has been further reduced to 25.4% in August. And also, the proportion of loans facilitated at or below 24% has reached 60% in August.

Okay. We have been within the preparations, and we believe we are close to shifting our loans to under 24%. And based on the static assumptions stress test, we believe the impact will be around 0.5% to 1%, and our take rate will be reduced to around 3.5% from the current level of 4.4% in the second quarter when the cap has been fully implemented.

And do you know that this is based on a static assumption, and we are confident to further improve our funding costs, delinquency rate and operating efficiency going forward. And all this will actually have to make an improvement in our take rate going forward.

We believe that the grace period involved over here and based on these assumptions, we are very confident in achieving our full year guidance that we have given out at the beginning of the year. And we are confident in beating the upper end of the guidance that we have given out, which is RMB120 billion.

Operator: (Operator Instructions). Alex Ye with UBS.

Alex Ye: I have a few questions, first also on the margins or impact on the price-cutting. So after you have implemented a lower price recently in August, so how has that affected your take rate so far? And how is the outlook for the next year?

And then second question is on your sales and marketing trends. So I saw that it has continued to go up quite substantially and outpace your overall loan growth. I'm wondering can you share more color on what's the drivers behind your sales and marketing trend? And when could we sort of start to expect some sort of a stabilized trend in terms of the sales and marketing as a percentage of your loan volume?

And then the third question is about your overseas market strategy. It's always quite encouraging to see further progress on that front, and it currently accounts for around 3% of your total loan volume. So I'm wondering if you could share with us if you have any your targeted loan volume contribution from overseas market in the next 2 to 3 years?

Jiayuan Xu: (Speaking foreign language).

(Translated). This question is still related to the earlier question of interest rates being capped at 24%. Our current rate is around 4.4%. And based on the static stress test, we believe our take rate will be reduced by 0.5% to 1% to around 3.5%. And as for the pace

of the reduction, we will still need to discuss with our partners in order to determine the right pace for this reduction.

Okay. Although there are challenges in the take rate in the future, I would also like to update that we have achieved significant progress in our ABS application. And in the future, we believe that ABS will diversify our funding sources.

Okay. In the second quarter, our customer acquisition cost was around RMB400. The CPS in China was about RMB470 in the second quarter versus RMB450 in the first quarter. And for our CPS for the international market, it was around RMB230 in the second quarter.

And in the future, we believe this trend will be stable. In China, we expect our customer acquisition costs to be in the range of RMB400 to RMB450. For the international market, it will be around the range of RMB200 plus.

Okay. I would also like to update on my different customer acquisition channels. For example, our information feed channels consist about 60% to 70% of new customer acquisition. Our app stores has about 15%, and our offline customer acquisition team has been making very fast progress, and it consists of about 10% of our new customer acquisition today.

In the second quarter, our loan origination for our international markets was about RMB940 million. On a quarter-on-quarter growth, it has increased by about 24%. And we have also penetrated and began operations in our fourth country, Vietnam.

There has been some resurge of the Covid-19 in the Southeast Asia recently. And we believe we are still confident we're able to achieve about 4 times growth compared to last year, which is about RMB4 billion of loan volume in Southeast Asia market.

Feng Zhang: This is Feng. I would just add that Southeastern Asia market, in terms of total population size, is roughly half of Mainland China. But in terms of GDP growth and financial market, it's at an early stage. So our business is also at a much earlier stage compared to where we are in Mainland China. So if we look at a 3 to 5 years horizon, we definitely expect our growth rates in Southeast Asian markets to be faster than the domestic market.

So it's hard to predict that because it also depends on how much growth we get in the domestic market, which does have uncertainties, given the regulatory environment. But we would certainly hope that within 3 to 5 years, our international business can account for maybe in the range of 20% for our total transaction volume.

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

Eric Lu: Congrats on a great performance in the second quarter. So I got 2 questions. The first question is about overseas explanation. So we know the company has expanded in 4 countries in Southeast Asia. So can you please provide more color about the business

model in each country; for example, the funding source, the asset quality and the product nature?

And the second question is for the capital-light loan facilitation model. So can you please provide some color about the future plan of adopting a capital-light business model?

Jiayuan Xu: (Speaking foreign language).

(Translated). The unit economics for our international business is actually very different from our business in China in terms of pricing, in terms of risk performance. And we can give for the international market, the take rate is around 10% to 12%.

We have actually achieved a breakeven point for our international business, but at the moment, our priority is not in turning a profit; but instead, our focus is on acquiring more customers to have a faster growth.

Our CEO has actually mentioned that we have made significant progress in our capital-light progress from 2.3% in the previous quarter to 13% in this quarter, and contribute about RMB4.3 billion.

And for the quarter, we have worked with 8 different institutions under the capital-light model. And in our potential pipelines, we have another 6 more institutional partners willing to work with us on the capital-light model.

If you compare the capital-light model to the capital-heavy model, there's a 1% additional cost involved.

And for the rest of the year, our focus on the capital-light model is actually on the quality of the capital-light model, meaning that we will continue to work with more partners on this model. And as you know, our leverage ratio is also relatively low at only 3.8 times.

Operator: Hans Fan with CLSA.

Hans Fan: I have 2 questions. One is about the regulation and the other one is on asset quality. So about regulation-wise, I think some other callers asked about the APR. I want to ask about the loan facilitation in terms of breaking up the link between the fintech platform and the bank, right?

So there was a regulation asked the fintech platforms to pass data through the licensed credit scoring companies first, who can in turn pass data to banks? So based on this regulation, how do we plan to be compliant and what are the impacts on our business, especially on the take rates? And what are the potential sort of change in the model? That's number one.

Number two is on asset quality. We noticed that our asset quality trend was very good. So just wondering, looking at the most recent 2 months, what are the trends there? Do we expect continuous improvements in delinquency ratios?

Jiayuan Xu: (Speaking foreign language).

(Translated). The regulator's view on data collection is actually based on minimum required standard.

And our company has been working along in this direction. And based on the past reviews, right, we believe we have fulfilled the requirements. Our app has actually received the app security certification and app information security certification from the China National Computer Virus Emergency Response Center.

I would also like to stress that our core capability is actually based on the data utilization, and not based on the amount of data collected and passed. The regulation's direction of the minimum required standard will not actually affect us a lot.

And based on our understanding on breaking up the link, all credit-related activities need to be supervised under licensed regulatory bodies. This means that such activities need to go to licensed institutions, and credit bureau agency is actually one of the channels.

And going forward, we will strengthen our cooperation with the credit bureau agency. And we have been working with Baihang since 2018, and we have been developing products together with their teams.

As mentioned earlier, all credit-related activities need to be supervised under a licensed regulatory body. And we're also exploring the possibilities of using our current licenses, such as our micro-lending license and financial guarantee license to process data.

And we also actively explore the possibilities of participating in a stake in one of the credit bureau agencies.

In conclusion, we think the indirect data transfer only changed the protocol of the process, and it will add some cost, but the cost is not going to be material. And it doesn't impact the outcome of the business and the risk assessment results.

As data management becomes more standardized and transparent, we believe we have the opportunity to secure higher and better data quality sources to further improve our operation efficiency.

And throughout the year, our asset quality has been improving progressively. And in the second quarter, we expect our vintage delinquency to be around 2.3%.

In the future, we have the confidence to maintain our delinquencies at this level. As you know, lowering the pricing will also help to improve the risk level, like what we have experienced from our P2P transition.

Operator: (Operator Instructions). Henry Liang with Gold Dragon.

Henry Liang: Congrats on the very strong results. Just 2 very quick questions to follow up. The first one is can you provide some more color on the breakdown for your international business, like the loan facilitation volume for different countries?

And the second thing is like I know that we just talked about the test of your profitability under 24%. Just like to know, do you have a concrete guidance or rough earnings estimate like how much earnings downside-upside will we have next year when everything is under 24%? (Speaking foreign language).

Feng Zhang: Thanks, Henry, this is Feng. Yes, just quickly, in terms of country, international market country breakdown, our Indonesia market accounts for about 3/4 of our volume roughly. And the Philippine and Vietnam in total, account for the rest and Vietnam is just starting, so at a very early stage.

Now, in terms of the profit impact for the price regulatory change shift, I think we can just do a quick math. As we mentioned, currently, our average IRR is about 25.4%. And we have the loans, they are facilitated by us, outstanding is about RMB40 billion. So if you do the math, RMB40 billion times, let's say like if we reduce to 24%, that's a drop of roughly 1.5%, so that's like RMB600 million pretax profit impact.

Now, in reality, we may maintain some of our volume at a rate below 24%, so the impact may be a little bit more than that. But again, that's the static version, as we mentioned. Now, in reality, what we think will happen is we will continue to drive down our loss rate. And we think there's a very good opportunity now with the market, we'll have much more limited asset supply for this sector.

There are lots of players, they operate between 24% and 36%, in fact, very close to 36%. It's going to be very, very difficult for them to adjust their business to 24%, to below 24% or either will not be able to do that, or they will do that, but with a huge impact on their volume. So the asset supply for this sector is going to be very limited.

And with that, I think there's a great opportunity for us to further improve our funding costs with better negotiation power with our funding partners, with our institutional partners.

And then lastly, as we increase our business volume, the size of our business, the fixed-cost component, which is a big chunk of our total cost, as we are such a research-heavy company, it's really a lot like human capital cost, the efficiency is going to be higher. The fixed cost is going to be a smaller percentage of our total revenue. So with all these improvement opportunity ahead of us, we actually think we can limit the profit impact to a significantly smaller impact than the number I just indicated. Hope that helps.

Henry Liang: Yes. So basically, under that math, it looks like we will still have a very material growth. Like if everything holds constant, we'll still have a material growth of earnings at 2022 from like last year's level. But this year is still like above 24%, but yes, so next year versus last year, it's still material growth.

Feng Zhang: Oh, we certainly hope so, but I think that people may have a different understanding of the material.

Henry Liang: Yes, I think so.

Feng Zhang: I do think that the 24% cap is going to have some impact in the short term in terms of profitability. But I think that the key message here is from all these aspects, we believe the impact is going to be fairly manageable for the short term. And we think if we look at the medium to long term, it's going to be a good thing for the industry and for our company.

Henry liang: Just one very quick follow-up. On the international business, have we like been considering U.S. as a potential area to enter because given how strong Upstart has been doing, both on their business, on the share price in that market, are we like under any future plan of answering that and share some of economics there?

Feng Zhang: Yes, I think we've been paying some attention, but as of now, we don't have a concrete plan to enter U.S. market. I think we mostly are focusing on developing worlds. One of them, Upstart, has a very high valuation, but it's still something we're trying to figure out. But I think when we look at medium to long term, we are pretty happy with the Mainland market and the developing world, particularly the Southeast Asian market; we think it's big enough for us to play for the years to come.

Henry Liang: Yes, thank you, thank you.

Operator: (Operator Instructions). Harry Wu with China Securities.

Harry Wu: (Speaking foreign language). Will there be any further change to the regulatory policies on user privacy, especially user data collection? And what kind of response the Company would do to ensure that business is not affected?

Jiayuan Xu: (Speaking foreign language).

(Translated). Okay. Last Friday, there was an introduction paper on the scope of personal data protection, and also the consultation paper on cross-border data transfer.

On the personal data protection front, there hasn't been much change; the focus is always on the minimum required standard. And we have also received the App Security Certification and App Information Security Certification with Level 3 rating from China National Computer Virus Emergency Response Center.

On cross-border data transfer, we have maintained all the information collected in China to remain in China; whereas all the information collected in the international markets remain in their respective countries.

This regulation is still relatively new and still evolving, and we will continue to closely monitor the developments of the regulations.

Harry Wu: Thank you.

Operator: (Operator Instructions). As there are no further questions, now I would like to turn the conference back over to the Company for any closing remarks.

Jimmy Tan: Thank you once again for joining us today. If you have further questions, please feel free to contact our IR team. Have a nice day, good night.

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