X Financial (XYF)
First Quarter 2019 Earnings Conference Call
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Executives:
Justin Tang, Founder, Chief Executive Officer and Chairman
Kevin Zhang, Chief Financial Officer
Simon Cheng, President
Jennifer Zhang, Investor Relations

Analysts:
John Cai, Morgan Stanley
Calvin Leung, Deutsche Bank

Presentation

Operator: Good day, and welcome to the X Financial First Quarter 2019 Earnings Conference Call and Webcast. All participants will be in listen-only mode. (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 Ms. Jennifer Zhang. Please go ahead.

Jennifer Zhang: Thank you, operator. Hello, everyone, and thank you for joining us today. The Company's results were released earlier today and are available on the Company's IR website at ir.xiaoyinggroup.com.

On the call today from X Financial are Mr. Justin Tang, Founder, Chairman and CEO; Mr. Simon Cheng, President; and Mr. Kevin Zhang, Chief Financial Officer. Mr. Tang and Mr. Cheng will give a brief overview of the Company's business operations and highlights, followed by Mr. Zhang, who will go through the financials and guidance. They are all available to answer your questions during the Q&A session.

I remind you that this call may contain forward-looking statements under the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements are based on 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 and 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 statement as a result of new information, future events, or otherwise, except as required under law.

It is now my pleasure to introduce Mr. Justin Tang. Mr. Tang, please go ahead.

Justin Tang: Hello, everyone. I'm pleased to report a strong start to the year with a total of RMB9.6 billion in loans facilitated during the quarter; RMB776 million in net revenues; and non-GAAP net income attributable to X Financial shareholders increasing 39.4% year-over-year to RMB255.8 million.

In 2019, we will focus on two new products, Xiaoying Wallet and Xiaoying Online Mall. Xiaoying Wallet is our revolving credit product, which enables users to use it for consumption purchases both online and offline with merchants. It is quite similar to a credit card. And Xiaoying Wallet, we have a pretty good start in our first quarter in 2019. We generated around RMB200 million in transaction revenues and around 640,000 transactions during the first quarter.

We also launched our Xiaoying Online Mall platform, which allows individuals to purchase merchandise online through loan installments. And this is also performing pretty well.

These two products will help us to attract less loan-dependent users, and will help us increase the quality of our borrowers over the long-term. So these are two very important products for us in 2019.

We also made solid progress during the quarter to strengthen our reputation in the market and improving our ability to attract more institutional investors. As of April 30, we actually secured over RMB10 billion in credit line approval from financial institutions to serve for the loans facilitated on our platform. We will continue to develop deep relations with institutional investors to fortify our position in the market as a leading fin-tech player in China.

Now I will turn over the call to Simon Cheng, our President.

Simon Cheng: Thank you, Justin. Hello, everyone. Our compliant operations and strong risk management infrastructure are allowing us to increasingly benefit from the market consolidation and the enormous opportunities present in China's personal financial industry. We will continue to work closely with relevant regulatory authorities to ensure we are fully compliant with all the new regulations.

We are very happy to see the quality of the loans facilitated on our platform improve, which reflects our strong risk management capabilities and continued investment in risk control infrastructure. We expand our funding channels and strengthen our funding cost.

We remain confident in our strategy and the solid foundation we have built in the past to drive sustainable future growth. We will continue to grow our market share and strengthen our position as a leading fin-tech player in China going forward.

I will turn the call to Kevin, who will go through our financials.

Kevin Zhang: Thank you, Simon, and hello, everyone. We have achieved solid operational and financial results in the first quarter of 2019. Our total loan facilitation amount in the first quarter of 2019 were RMB9.6 billion, representing an increase of 10.8% from RMB8.7 billion in the same period of 2018, and an increase of 1.6% from RMB9.5 billion in the fourth quarter of 2018.

We are also very strong in operating efficiency and profitability by approximately 40% year-over-year increase in non-GAAP net income. And our non-GAAP net income margin remains at a very high level of 33%.

Our balance sheet is very solid. By the end of March 31, 2019, we have around RMB1.55 billion of cash on hand.

Now, let me give a brief introduction for the financial results for the first quarter. In the interest of time, I will not go through every single line. Please refer to our earnings release for further details.

Our net revenues in the first quarter of 2019 were about RMB776 million. And our revenue take rate was about 8.1%, which is 1% lower than that of the same period in 2018. The change of take rate is mainly due to the increase of the insurance premiums, guaranty fee, and partially offset by the lower operating cost.

However, our income before income tax in the first quarter of 2019 increased by 25% to RMB 259 million from RMB207 million in the same period of 2018. The increase of income is mainly due to our strong execution of cost control, which fully absorbed the impact of the lower revenue take rate.

In the first quarter of 2019, the operating cost and expenses, as a percentage of loan volume, was about 5.2%, 1% lower than that in Q1 2018.

Income tax expense in the first quarter of 2019 decreased by around 24% to RMB49 million from RMB65 million in the same period of 2018, primarily because the corporate income tax rate of major subsidiaries of companies was just down to 15% as the subsidiaries are qualified as a high-tech enterprise after the second quarter of 2018.

Non-GAAP net income in the first quarter of 2019 was RMB256 million, an increase of about 40% with a year-over-year basis.

Next, I will give an update about the diversion of our insurance model. We've made significant progress in diversifying our credit insurance model deployed for our loan products and convincing our investors with different models. The proportion of loan products guaranteed by ZhongAn decreased to 82% in the first quarter from 90% in 2018 and 95% in 2017. Diversifying our product structures allows us to better serve and reward the investor as we reduce our reliance on a single insurance provider.

At this time, I would like to give brief guidance that in the Q2 of 2019, our total loan facilitation volume will be approximate to that of Q1 2019.

And this concludes our prepared remarks. Now we'd like to open the call to questions. Operator, please.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). John Cai of Morgan Stanley.

John Cai: I have three questions. The first one is on the product. Can you share some more details on the product mix for the first quarter of 2019? How much portion is to the car loan; how much is for the loans to the other online platforms? And also I noticed that the ticket size has declined sequentially in the first quarter. So I just wonder what's the reasons behind that. That's the first question for the product side.

The second question is on the cash. I noticed that we have a very strong Q-on-Q increase in cash. I just wonder what's driving that?

And the third question is on the risk and the asset quality. What are the latest trends we are seeing, and how does that impact our growth outlook? Because I noticed that in April, our institution funding has already accounted for 25% versus 10% in the first quarter. And are we ramping up the facilitations on a month-on-month basis?

Justin Tang: Kevin, could you answer first the two questions? And Simon, you answer the third question, please.

Kevin Zhang: Yes, I will give the structure of product mix. Among the RMB9.6 billion of loan volume, card loans were still our main products and that's about RMB7 billion, and it's about a 10% increase compared to that in Q4 2018. And besides that, we also have RMB1.5 billion of loan facilitation service to other platforms. That's about a RMB200 million decrease compared to Q4 2018, and that's about our major product mix. That means our car loan and the loan facilitation to other platforms are still our core products.

And now, I would still like to draw your attention that we have around RMB200 million of loan facilitation for our Xiaoying Wallet product, and that gained such volume, in Q4 2018, it was only about RMB77 million. But that will be our major product mix for the product.

And with regard to our ticket size, in Q1, we have tremendous volumes of Xiaoying Wallet. That means that the ticket size for Xiaoying Wallet was only about RMB300. That decreased our average ticket size.

But when you go back to our card loan, our card loan average ticket size is about RMB12, 000. Actually, it's a 25% increase compared to that in Q4 2018. In Q4 2018, our average ticket size for card loan is about RMB9,500. I hope this will be helpful to your first and second questions.

Simon Cheng: Basically, the ticket size decreased -- just to follow up on Kevin's question, the ticket size decrease was primarily due to the mix change. We have Xiaoying Wallet, which is a very small ticket; it's a consumption transaction. And also in addition to that, our preferred loan which has higher ticket size, the volume of that business keeps dropping. So that's for your question two.

For the question three, the credit quality, actually, during Q1 2019, we see our credit quality actually improved, and quite stable. So this is the current situation.

Justin Tang: Kevin, did you answer the increase in cash in the first quarter?

Kevin Zhang: Yes. We now have RMB1.55 billion of cash on hand. And the increase actually consists of, first, our general operating cash flow in; and second is , at the end of March 31st, 2019, our loans held for sales decreased by around RMB480 million. That means because in the first quarter, we had more than RMB530 million on hand. We actually released lots of the loans held for sales from our balance sheet. Actually, it's subtraction of the loans held for sales; that's why our operating cash flow generally increased about RMB500 million.

John Cai: Okay. Thank you.

Operator: (Operator Instructions). Calvin Leung of Deutsche Bank.

Calvin Leung: I have two questions, actually. The first one is about P2P trial registration. I want to know if management has any view on the trial registration going forward, and if that has any impact on our business. And the second one is about institutional funding. Can we get the funding cost of such channel, and how many partners are you currently cooperating with?

Justin Tang: Sure. Thanks, Calvin. For P2P registration, it seems it's moving ahead slowly. So over the last couple of months, there has been discussion, we're going to move to some kind of a trial. So the key cities, obviously, still is Beijing, Shenzhen, Shanghai, and Zhejiang to move into trial. But I think at this moment, I think the issue is still kind of pending the division of duty between the central government regulator and the local regulators. I think the central government issued a guideline, but local regulators need to take the responsibility.

So again, I think it's still moving ahead, but exactly when we expect the first company will receive actual registration, I think it remains unclear. I think internally, the government still also has some difference of opinion at this moment. This doesn't really have much influence on our operating business. Obviously, starting from Q4 last year, we already have a cap on our online loan facilitation platform, but this is in line with our strategy to move our funding source more towards institutions in any case.

So at this moment actually, combining between our platforms, individual investors and the institutional funding, we actually have sufficient -- more funding than we could supply to quality assets. So again, I would say the progress of registration does not have any impact in our business.

In terms of institutional funding, actually, I would say in Q1, where we started to see funding costs actually come down quite a bit. So initially, when we start pushing the institutional funding, like Q4 last year, a lot of funding will come in at around 9.5%, even 10%, which was higher than -- at that time, our platform funding cost around 8%-plus. Recently, we started getting institutional funding coming down to anywhere between around 8.5%, less than 9% level, but we are very strong. We see very strong institutional funding demand.

Like we mentioned, as of April 30th, we have the written approval of credit lines from financial institutions already over RMB10 billion, and we have much more is on the way. A typical credit line is anywhere between RMB500 million to RMB2 billion for each financial institution. So you're basically seeing we have approximately 10 financial institutions-- at this moment, and we see many more coming.

Calvin Leung: Sure, thanks a lot.

Operator: John Cai of Morgan Stanley.

John Cai: So I think I want to follow up on the growth. So basically, given the stabilizing asset quality and the institutional funding, so do we see any potential to ramp up the growth, in particular, the balance and loan outstanding balance? Do we expect that to have sequential growth from this level?

And then, the second question is on the new focus on the Xiaoying Wallet and the Online Mall. So just wonder do we expect any financial impacts in terms of the cost here? Because I'm not sure if we offer the interest-free period for the Wallet product. And do we need to subsidize the funding partners if we have that? And for the Online Mall, do we have more details on the products we offer? Do we offer discounts to them? So basically, what would be the cost for us to launch the products?

Justin Tang: Sure, yes. Thanks, John. The first question is in terms of loan balance growth. In first quarter 2019, we actually see our loan balance remain stable or even decline a little bit. One of the key reasons is basically, it is almost a continuation of our preferred loan. So over the last couple of years, preferred loans was one of our key products and a lot of these served for the small and the medium enterprises. And then that segment, over the last year, the risk for was higher than expected. So we literally discontinued that product line except to only serve for some of the higher-quality repeated borrowers. So that basically drive to no growth in our loan balance.

Going forward -- again, at this moment, I don't want to give very aggressive expectation of the loan volume growth, again, because also, the macroeconomic environment, we still want to be relatively conservative on the credit quality. So actually, if you look at in Q1, the approval rate for our credit card related loans actually came down from the Q4 last year; it came down quite a bit. So again, at this moment, I would say if you look at last year, we had about a total of RMB36 billion in loan facilitation. This year, I think we will see some growth, but I don't want to project aggressive growth in our loan volume or loan balance at this moment.

And your second question is our two new products, Xiaoying Wallet and Xiaoying Online Mall. Like I mentioned, one of the key reasons we started these two products is traditionally, our borrowers, they tend to be more heavily loan-dependent customers. And these customers tend to have relatively lower credit quality, and also, the loan typically tends to be more low-frequency product. So it's harder to build, I would say, a closer relationship with our users. So this year, we introduced this more consumption-focused Wallet and Online Mall. So this targets, number one is the more consumption-oriented customers; second is more high-frequency users help us to build a closer relationship with them.

And for our Wallet product, our standard product, we do have a 7-day basic grace period, no-interest grace period. Obviously, we need to subsidize, but I think their sales are included in the revolving credit model. So at the end of the day, the interest carry balance will be able to pay for that anyway.

I think what we will invest on really is customer acquisition. So we will need to spend some money to acquire the customer early on for both the Wallet customers, as well as the Online Shopping Mall customers. But these customers tend to have longer lifespans than the average loan customer, and will also have arguably longer lifetime customer value than loan customers. But in the beginning, we do need to make some investments, which we believe is very strategic important investment we need to make.

Then also, you mentioned the subsidized (model). If you look at our Company's culture, we try to build a very competent product. Historically and now, we really used too much subsidized products to attract customers. So even for this, we will still invest in the sales and marketing to acquire good-quality customers, but our tendency is we don't want to use that over-aggressive subsidized policy to attract lower-quality customers coming mainly for the subsidy.

John Cai: Yes, thank you. So a quick follow-up on the Online Mall. What products are we offering now like 3C or others? And do we make a positive margin on the GMV sold on the online shopping mall

Justin Tang: Yes, sure. Right now, obviously, for this type of Online Mall, the best-selling product for male customers is the 3C, and for female customers, those are cosmetics, like lipsticks, facial cover, etc. So ours is no different. We do make a positive gross margin on merchandise sales.

John Cai: Thank you very much.

Operator: (Operator Instructions). Ladies and gentlemen, this will conclude our question-and-answer session. At this time, I'd like to turn the conference back over to Jennifer Zhang for any closing remarks.

Jennifer Zhang: Thank you, operator. Thank you, everyone, for joining us on the call today. If you haven't got a chance to raise your questions, we will be pleased to answer them through a follow-up contact. We look forward to speaking with you again in the near future. Thank you.

Operator: The conference has now concluded, and we thank you for attending today's presentation. You may now disconnect your lines.