

X Financial (XYF)
Q4 2021 Earnings Conference Call
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Executives:

Tanya Wen, Investor Relations
Kent Li, President
Frank Fuya Zheng, Chief Financial Officer

Analysts

Mason Bourne, AWH Capital
Matthew Larson, National Securities

Presentation

Operator: Hello, and welcome to the X Financial Fourth Quarter 2021 Earnings Conference Call. (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 Tanya Wen. Please go ahead.

Tanya Wen: 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 our call today from X Financial are Mr. Kent Li, President, and Mr. Frank Fuya Zheng, Chief Financial Officer. Mr. Li will give a brief overview of the Company's business operations and highlights, followed by Mr. Zheng, who will go through the financials. 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 the management's current expectations and current market and operating conditions, and related 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. Kent Li. Mr. Li, please go ahead.

Kent Li: Hello, everyone. We are very pleased to conclude 2021 with another solid quarter of financial results, delivering profitability for the full year. Both our top and bottom lines for the fourth quarter significantly improved over the same period of 2020. Despite a challenging macro economy and regulatory environment in 2021, we have successfully turned our business back on track and maintained steady growth momentum compared with 2020.

The total loan amount facilitated and provided in 2021 increased by 75% year-over-year to RMB52 billion from RMB30 billion. With a very focused product strategy and effective cost control initiatives, we turned profitable in 2021, and our bottom line outperformed the full year of 2019, the year before the Covid-19 outbreak.

During the fourth quarter, our total loan amount facilitated and provided reached RMB13 billion, an increase of 51% year-over-year. As mentioned in our previous guidance, we saw a moderate sequential decline in the loan volume in the fourth quarter, which was mainly attributed to the year-end outstanding loan balance requirements of our institutional funding partners.

In the first quarter of 2022, the level of available funds has resumed its normal pattern. Since 2020, we have shifted our product focus to Xiaoying Card Loan, which contributed 100% to the total loan amount facilitated and provided in 2021. With this focused and proven product strategy, we are confident in our ability to sustain steady growth in the loan facilitation business in 2022.

Regarding asset quality, the delinquency rate for all outstanding loans that are past due for 31 to 60 days as of December 31, 2021, was 1.48%, higher than 0.96% as of September 30, 2021 and 0.79% as of December 31, 2020. This fluctuation is mainly attributed to the liquidity tightening in the fourth quarter of 2021. Since February 2022, we have seen our asset quality gradually improving as a result of ample liquidity in financial markets and our stricter risk management measures.

In 2021, we officially commenced operation of our microcredit business in the third quarter after we received regulatory approval for our microcredit license, and during the fourth quarter, we further increased its registered capital to RMB1 billion in compliance with the regulations. We are on track with our microcredit business and look forward to creating more value for our shareholders.

In the fourth quarter of 2021, we invested RMB315 million and become an indirect minority shareholder of Newup Bank of Liaoning, a PRC company and non-state-owned bank. We are exploring opportunities to cooperate with Newup Bank to better serve SMEs, and we are confident that, based on our advantages in technology and risk management capabilities, the cooperation with Newup Bank could bring more possibilities to our business to jointly empower and support the development of the economy in China.

Heading into 2022, we expect regulatory uncertainties to subside with clearer guidelines from authorities. The Chinese government has affirmed the value of Fintech industry to address people's inclusive financial needs and support the development of SMEs. We remain cautiously optimistic about our business outlook while being prepared for any macro uncertainties that may emerge in 2022.

In order to pass on our confidence to the market and increase shareholders value, our board has been timely evaluating, based on current market environment, regulatory policy and condition of business operation, multiple ways of returning profits to our shareholders, including share repurchase as well as cash dividend distribution. Recently, our board approved a US\$15 million share repurchase plan, which reflects our confidence in the Company's fundamentals, strategy and sustainable growth. We are looking forward to an increase of shareholder value in the future.

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

Frank Fuya Zheng: Thank you, Kent, and hello, everyone. We are pleased to deliver solid financial results for both the fourth quarter and the full year of 2021. Total net revenue increased by 15% year-over-year to RMB823 million in the fourth quarter.

We saw a significant improvement in our bottom line with Non-GAAP adjusted net income improved to RMB183 million from a loss of RMB631 million in the same period of 2020. For the full year 2021, total net revenue increased by 65% to RMB3,626 million. Thanks to our relentless efforts on cost management, total operating costs and expenses decreased by 36% to RMB2,315 million. Non-GAAP adjusted net income improved to RMB914 million in 2021 from a loss of RMB1,228 million a year ago.

In conclusion, we are greatly encouraged by the strong results we delivered in 2021, which fully demonstrate the resilience and growth potential of our business. Going forward, we will continue to expand and deepen our cooperation with more institutional funding partners to meet the needs of consumers and SMEs, and execute our proven strategy to drive sustainable long-term growth and returns for our partners and shareholders.

Now I'd like to brief some financial performance for the fourth quarter. Please note that all numbers stated are in RMB. Total net revenue in the fourth quarter increased by 15% to RMB823.4 million from RMB716.3 million in the same period of 2020, primarily due to an increase in the total loan amount facilitated and provided of Xiaoying Card Loan this quarter compared with the same period of 2020.

Origination and servicing expenses in the fourth quarter decreased by 29.9% to RMB385.8 million from RMB550.7 million in the same period of 2020, primarily due to the decline in collection expenses resulting from the asset quality improvement and a decrease in insurance fee paid to insurance company.

Provision for accounts receivable and contract assets in the fourth quarter was RMB19.5 million, compared with reversal of provision for accounts receivable and contract assets of RMB13.2 million in the same period of 2020, primarily due to an increase in accounts receivable from facilitation services as a result of the increase in total loan facilitation amount in the fourth quarter of 2021 compared with the same period of 2020.

Provision for loans receivable in the fourth quarter was RMB40.3 million, compared with RMB33.7 million in the same period of 2020, primarily due to an increase in loans receivable held by the Company as a result of the increase in total loan amount facilitated and provided in the fourth quarter of 2021 compared with the same period of 2020.

Income from operations in the fourth quarter was RMB311.6 million, compared with loss from operations of RMB857.3 million in the same period of 2020.

Net income attributable to X Financial shareholders in the fourth quarter was RMB145.5 million, compared with net loss attributable to X Financial shareholders of RMB655.5 million in the same period of 2020.

Non-GAAP adjusted net income attributable to X Financial shareholders in the fourth quarter was RMB183 million, compared with Non-GAAP adjusted net loss attributable to X Financial shareholders of RMB630.8 million in the same period of 2020.

For further financial information, please refer to the earning release on the Company's IR website.

Now for our business outlook. We expect total loan amount facilitated and provided for the first quarter of 2022 to be between RMB15 billion and RMB15.4 billion, and the range of increment in total loan amount facilitated and provided for 2022 to be from 15% to 25%. This forecast reflects our current and preliminary views, which are subject to changes.

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

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Mason Bourne of AWH Capital.

Mason Bourne: To start, I was hoping you could give more background on your investment in Newup. Why now and your main goals?

Frank Fuya Zheng: Hi, Mason, this is Frank. Thanks for your question. And the Newup Bank is one of 7 banks owned privately; so it is not state-owned bank. And the purpose is only one purpose only, as we try to -- with this equity interest, we try to explore the opportunity, a new way to develop jointly our SME business, which is greatly encouraged by the government at the current times.

Mason Bourne: Great. And then -- go ahead.

Frank Fuya Zheng: So you will now see, in terms of business volume or otherwise, this is more like a long-term strategic investment for us. Thank you.

Mason Bourne: And then on the SME side, how do you think about potential profitability of that segment compared to your current business?

Frank Fuya Zheng: That side is kind of a tough. That market is different from us, but have some overlap with the current business we serve. We are mainly right now served in consumer market for the individual, up to like 80% or whatever. And the overlap is about anywhere between 10% to 30%.

So the bank, especially for the small bank, they are mainly lack of technology ability to develop the SME market. They have their own market. But they have approached the market in very traditional way. It's mainly by person. So by this cooperation, we try to leverage each other's advantage from us. So we are mainly a provider of technical approach to them, they maybe provide some other market assets marketplace for us.

But I'll be cautious, any outcome at this stage is very preliminary, which we would not strongly advise anyone, should not give any forecast or projection regarding the result about it.

Mason Bourne: Okay, great. And then on your guidance, you provided total loan volume expectations. How do you think about profitability in 2022?

Frank Fuya Zheng: So not just us, our competitors all are kind of cautious in general for this year. We gave like 15% to 20% increase in terms of volume for this year. And we cannot give any earning forecast at this time, mainly because even though on the regulatory side, we believe it will be a quite stable situation in 2022. But from the economic side, it is quite uncertain, especially the current right now is zero tolerance on Covid-19.

Right now, the bigger city in China, like Shanghai, is right now in like a total lockdown. And not just Shanghai, many, many cities are in the Covid situation, it quite spreads among 27 provinces. Many, many cities, they are doing the testing, a Covid test every day. So there's a supply situation and some industry is affected a lot, like the restaurant, travel, entertainment, all greatly affected a lot of people in those industries kind of in furlough status. You know what I mean?

But those employees in those industries, I think it is some kind of related to our business in the consumer market, they are the people we serve, basically. You know what I mean? So we kind of are cautious, that's the main reason we did not give earning (guidance) at this time.

But one thing we're pretty sure, and we will be profitable substantially this year, but maybe not as much as last year. But we are kind of reluctant to provide exactly figure at this time. Thank you.

Mason Bourne: I can appreciate that. And then lastly, it's good to see buyback put in place. Could you talk more about how you think about capital allocation going forward?

Frank Fuya Zheng: Just as we stated in the press release, we will do the buyback from time to time, but we are not trying to correct so-called this very severe undervalued share price situation. I think we are not in a position to correct that situation by us alone. It's an industry-wide situation; it's tied to many, many other things.

But we definitely will do when we think it's very much out of line in terms of share price. So we will still mainly use our cash to explore new business opportunity and acquire more customers and grow our business basically. That's our intention.

Mason Bourne: Great, thank you.

Operator: Matthew Larson with National Securities.

Matthew Larson: Do you have an explanation why your company, plus some of your, I'll call them competitors, whether it's 360 or even to a certain extent, YRD and FINV; you're trading at 1x or 2x earnings, and yet your earnings are growing. You face the same headwinds that any lender has, uncertainty about the economy, delinquencies where your underwriting has to be strong and regulatory issues.

We've experienced those for years here with our lending companies, whether they're payday loan companies or peer-to-peer lenders. There's a company called Upstart, which trades at probably 50x multiple. It seems to have a very similar business model.

I think the share buyback is very smart because your volume has dried up, and you really could make a difference by putting a floor in the stock. And it's very, very accretive, of course, also to be buying your stock down here and you could buy it even up quite a bit. Do you have any explanation why your industry groups trade at -- essentially, some of them trade below cash on the balance sheet. Is that just an anomaly because you, as investors, have lost interest, or is there something else out there?

Frank Fuya Zheng: Mr. Larson, thank for your question. I believe this is your first time joining our call. And I think that if we get like a cash value for our share, we will be very happy actually. We are actually much lower than cash, okay.

Kent Li: I think what Frank is trying to say is that in some of the investors' eyes, that this industry has no future, right? I think it's a very difficult to comment on why other people think that this industry should be valued like this. And we, as a management team, we certainly think our stock is undervalued. That is why that we put in this repurchase plan, as we just mentioned. And we think that at this moment, it's just a natural move for us to buy back some of our shares.

I think even it is really the risk, all right, different people associate different industry with different risk levels. And in our particular case, I think that one is this industry is still, I would say, even though we have a lot of governance, it is still not very clear how this industry is going to develop going forward.

And another one, of course, is relationship between China and the U.S. -- I will say it's not great, right? So I think that when investors are thinking about Chinese companies, that they naturally put -- or we put some discount on it. So I think that in the end, really nobody knows what is the correct evaluation is. You probably have a feeling of where it should be, and at this moment, we certainly think that we are lower than where we should be.

Matthew Larson: A comment on that -- sorry, go ahead.

Frank Fuya Zheng: Yes, that's the issue for this. All the Chinese companies listing in the U.S. is part of the trade war between China and U.S. as you all know. So there's a PCAOB issue, I'm sure you all are aware of that. And that is a question whether all Chinese listed companies or

Chinese companies could be continued listing in the U.S., it's in doubt right now. And we hope that will be solved some time.

And for our particular industry, I think another answer is very simple, is that the visibility is almost zero because the older, regular environment and the regulatory uncertainties for our industry, the issue. I also believe you are all aware for our industry and I think that's the answer for your question.

Matthew Larson: Well, as a long-term investor, obviously, I'm interested in growing my investment. And your company has done very well and a couple of runs at considerably higher prices and hopefully, that'll occur again. But I guess I would say that the share buyback is a very good thing to do because it's a large enough buyback, 7% or 8% of your market capital, and I don't know what percentage of the float.

But I just would be very -- for me, just looking at how accretive it is, and you have enough spare cash on the balance sheet to do such a thing. And you could really put a bid in the stock, and we could get this company and others to really see some upward trajectory after being kind of just forgotten. They've been orphaned almost because investors kind of ignore stocks once they get down to the share price that your stock has been, \$2 or maybe \$3 if we're lucky.

And so I just hope you continue to see ways to not only continue to show good operating earnings and do well within your industry, but find a way to elevate your stock because you could easily trade at twice where it is now, which would give still a small earnings multiple and a big discount to book. But you would bring in more investors if the stock would get above, say, \$5, which is a minimum for any investor. So that would be a goal to do it one way or another, besides just the obvious, which is to continue to operate your business in a very profitable manner.

So I look forward to you guys being aggressive with share buybacks, particularly at the price where it is now where it's extremely attractive and accretive. You're trading at less than 2x earnings, trailing earnings, which is you would never find that in the United States. So thank you for listening to me and congratulations for the quarter and I like the guidance going forward.

Frank Fuya Zheng: Thank you, Mr. Larson, and thanks for your question. And for the share buyback, that's exactly what we're trying to do. We basically try to set up a floor for the share price and but as you know, the floor is not that big. So I am afraid we probably -- no ability to buy a lot of shares unless we check the price very big way. That's also not something we want to do because we are in that industry; everybody's trade below the 5x PE, something like that. We are kind of very low, but we can improve a little bit.

But we are definitely not in the like 10x earnings, PE earnings trade at 10x earnings. That's kind of what we're saying. So we basically do something you expect, and thank you for your question again.

Matthew Larson: All right. Thank you.

Operator: This concludes our question-and-answer session. I'd like to turn the conference back over to Tanya Wen for any closing remarks.

Tanya Wen: Thank you 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 the follow-up contact. We look forward to speaking with you again in the near future. Thank you.

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