VCREDIT Holdings Limited (2003.HK)

2021 Interim Result Conference Call

August 26, 2021

Executives:

Stephen Liu – Founder & Chief Executive Officer

Hong Bai – Chief Financial Officer

Ethan Gong – Chief Risk Officer

Echo Fang – Vice Chief Financial Officer

Operator:
Welcome to today's VCREDIT 2021 interim conference call with Chief Executive Officer Mr. Stephen Liu, Chief Financial Officer Miss. Hong Bai, Chief Risk Officer Mr. Ethan Gong, and Vice Chief Financial Officer Miss. Echo Fang.

For the first part of this call, all participants will be in listen-only mode. Mr. Liu will provide an overview of the company recent performance and highlight. Miss Bai will present you with more detailed discussions on financial results. There're Q&A section for the presentations. Now I'd like to take the opportunity to remind you that the company's remark today may include certain forward-looking statements. Number of risk factors beyond its control may cause actual results to differ materially from this forward-looking statement. During this call, the company will present both IFRS and Non-IFRS financial measures. We will also discuss general market condition for the industry, and such information may come from a variety source outside of VCREDIT. Now I'd like to turn it over to Mr. Liu, Mr. Liu please begin.

Stephen Liu:
Thank you. Good morning, everyone. First of all, let me take this opportunity to thank our former Chief Financial Officer Mr. Daniel Zhou for his past important contribution to the company. We regret for his resignation due to personal reasons but wish Mr. Zhou all the best in his future new career. Today, we also welcome our new CFO Miss. Bai Hong who join us 2 years ago. Miss. Bai Hong prior to her 2 years with VCREDIT, has gained the 15 years valuable working experience in international banks and financial institutions, including CITI Group, Royal Bank Scotland, and HSBC. Today our Chief Risk officer Ethan and Vice CFO Echo present, and they will be glad to answer any questions later. Thank you.

Let me start reporting our half year performance. I'm very delighted to report that we have had a record financial performance for the first 6 months ended June 30, 2021. Through our high growth AI driven fintech platform, we have been able to successfully navigate the challenges of the COVID-19 pandemic, as well as regulatory changes and grow our business and provide quality services to our prime and near prime customer. We have achieved a record net profit of RMB777.6 million during the period. Our significant return has been aided by an expanding

Chinese economy and high demand for consumer finance products, and our ability to proactively flex our business strategies and adjust our credit models to target and engage and attract very importantly to retain good customers. Following a period of consolidation, we have successfully adjusted our operations and practices with the loss. In the rest of last few years and the Chinese consumer finance market is now operating and obviously a much clearer and more transparent regulatory framework, which is benefiting both the lenders and the borrowers. Under this environment, VCREDIT has further achieved our mission of offering technology driven financial services to underserve the customers in China. As a reflection of these efforts of our operational and financial performance, including loan origination volume and asset quality all reached best historical record levels during the period. In terms of operational performance, our business performed strongly in the period as confidence and demand for consumer products returned and grow in line with a return of confidence and expansion in the Chinese economy, which rebounded robustly following the initial impact of the COVID-19 pandemic. We quickly realized and initiated important changes to our business strategy, customer focus and credit models to enable us to proactively manage the challenges of the COVID-19 pandemic.

In order to limit its impact to our asset quality, delinquency rate, as well as other credit risk metrics during the period, we successfully complete the transition in our credit policies and reiteration of our credit risk model, which has seen our business migrating to and focusing on higher and more reliable prime and near prime customers. Obviously, from those customers, we are able to generate more repeat business. We revise and improve our credit risk model at least twice a year to add the new trends and the different customer behavior driven by the ever-changing market and regulatory environment. Additionally, we reached out and connect with more of our target customers through an expanded network of customer acquisition channels, industry platforms, and reinforced feedback exchanges. All of these initiatives have greatly assisted us in achieving record high loan origination volume of RMB22.5 billion for the period and achieved the best ever asset quality and delinquency metrics with our M1 to M3 ratio and M3+ ratio fall into 2.06% and 1.40% respectively. Our first payment delinquency ratio stabilized at 0.43% for the period. Furthermore, we have significantly improved our brand recognition and increased the customer loyalty for our consumer finance products by proactively reaching out to existing credit-worthy customers with favorable pre-approved credit lines. Total loan origination volume was RMB22.5 billion for the period, representing a substantial increase of 69.2% compared to RMB13.3 billion for the 6 months of last year, which is ended June 30, 2020. The average loan ticket size for the period was RMB13,091, representing a 17.0% increase compared to RMB11,192 for the Corresponding period.

Working with license financial and institutional funding partners is an essential part of our business model for meeting the financing needs of our customers. Our stable funding structure currently supported by 64 external license funding partners, affords us flexibility in the application of our capital structure and to facilitate loan through an off-balance sheet model. Total loan origination volume consummated loan facilitation structure amounted RMB14.4 billion for the period, representing a significant rise of 75.8% compared to RMB8.1 billion for the Corresponding period. Moreover, we're exploring more business opportunities with our existing institutional partner such as offering fintech turnkey solutions. In the long term, deeper level collaboration will strengthen our relationship and trust, benefiting us to a lower funding cost and the higher customer satisfaction.

We have had a satisfactory result in the first half of 2021. We are delighted to announce that our board has recommended the distribution of interim dividend of Hong Kong dollar ten cents, and a special dividend of Hong Kong dollar ten cents. Regarding the outlook and official strategy, we have achieved the robust results, both operational and financial terms during the period. Going forward, we will continue to adhere to our core business of being a technology driven consumer finance online platform targeting underserved individuals. Given changing macro-economic and market conditions, we strive to constantly optimize our models and strategies in order to be able to offer our customers better loan facilitation and personal management services. Meanwhile, we have started exploring new business opportunities, domestic and overseas, to leverage our proprietary top-notch technology, risk management experience and in house talents to drive synergies across different business lines and regions.

With a series of new regulations promulgated in China in the past few years, the government has shaped online lending industry into a well-balanced sector with clearer boundaries during the period. In January 2021, the People's Bank of China announced the draft interim version of Measures for the Administration of Credit Business（《徵信業務管理辦法(徵求意見稿)》）which is to regulate the collection and utilization of credit data. That's further ongoing regulation guidance on loan facilitator, taking more balance risk, as well as on data sharing with financial institutions. Our interpretation that the guidance is mainly to regulate practice of pure loan facilitation process, during which facilitator does not bear asset risk, while typically transfers variety of customer attributes to funding institutions.

In contrast, vast majority of our business is currently through credit-enhanced loan facilitating process, which we actually bearing the risk. We don't really need to transfer data other than any minimum customer identity information. Therefore, our business model is in line with regulation directions. In February 2021, the China banking and Insurance Regulatory Commission, promulgated the Notice on Further Regulation of Internet by Commercial Banks (《關於進一步規範商業銀行互聯網貸款業務的通知》) to establish the framework on joint lending. In March 2021, the Cyberspace Administration of China issued the Regulation of Necessary Personal Information Scope by Common Mobile Internet Application（《常見類型移動互聯網應用程序必要個人信息範圍規定》）which is expected to tighten up collection and personal Information. We believe these ongoing regulations will ultimately result in a more clarity and discipline within the online lending industry. And the further rationalize the sector by taking out non-compliant players. VCREDIT has moved to high ground of compliance ahead of many of our peers and the robust results in this period are a reflection and endorsement of our efforts. With that, I would like to pass to our CFO Bai Hong who is going to share with you further on our financial performance.

Hong, Bai:
Thanks, Stephen. Good morning, everyone. Welcome to our interim results conference for Year 2021. As Stephen mentioned, with the successful implementation of our business strategy in migrating to higher-quality customers and enhanced risk management, our financial performance in the first half of year 2021 represented a significant turnaround compared with net loss in the corresponding period in year 2020.

Our total income increased by 56% to RMB1.88 billion for the period, compared to RMB1.2 billion in the first half of last year. We have seen a continued rise in total income since the second half last year, the increase is primarily driven by further improvement in asset quality and the growth in loan origination volume, especially under our credit-enhanced loan facilitation structure. Our loan facilitation service fee grew 4 times to RMB 973 million for the period, compared to RMB238 million for the Corresponding period in last year.

Our fair value loss of loans to customer decreased by roughly 93% to RMB129 million for the period, compared to RMB1,800 million in the first half of 2020, and realized a gain from guarantee of RMB294 million for the period compared to loss from guarantee of RMB422 million for the last year same period.

Our operating expenses excluding share-based compensation expense increased by roughly 32% to RMB699 million for the period comparing to corresponding period in the last year, reflecting higher online customer acquisition costs mainly due to a much more proactive customer acquisition strategy.

With above, we recorded a net profit of RMB778 million and adjusted net profit of RMB805 million for the period, compared with a net loss of RMB1,081 million and adjusted net loss of RMB1,042 million for the first half of 2020. Our net profit and adj net profit for the period also represented a 267% increase and 226% increase respectively compared with a net profit of RMB211 million and adjusted net profit of RMB247 million from the second half of last year.

With strong operating results, our leverage ratio which is defined as total loan book divided by equity, kept at a relatively healthy level which currently stands at 6.2 times. The last but not least, in terms of liquidity, we are very mindful for our cash position and the overall liquidity. Our total cash and the cash equivalents also increased to roughly RMB1.7 billion for the period from RMB1.5 billion in the second half of 2020.

With that, I would like to conclude our prepared remarks. Operator, we can now take some questions.

Operator:
Thank you, Miss. Bai. We now begin our question in that section. If you have a question for today's speaker, please press 01 on your telephone keypad, and you will take you after you announce it. If you find that your question has been answered before, press 02 to cancel the questions. Once again, 01 on your telephone keypad now to ask questions.

Our first question is from Eric Wong from Value Convergence Asset Management.

Eric Wong:
Hello good morning. Investors are now concerning about the data security in China, how will it affect your client acquisition cost? Thank you.

Stephen Liu:
I think firstly we believe we actually in full compliance, we keep regular communications with local and even the central regulatory bodies in terms of data privacy as a practice of collecting data. As a matter of fact, I think we are probably one the few players that started very early that we have practices that we rarely collect raw data of customers. We very much rely on the meta data which we work with internet ecosystem companies, but we never collect data directly from them. We actually construct our own scoring model there and we only try to get the meta data. For that part, we fundamentally believe we have high standard in terms of full compliance. About the customer acquisition cost, honestly, I think, firstly, the first half of this year, the customer acquisition cost went up a little bit, you know our average loan ticket size is around 13 thousand, is relatively higher than our competitors. Our customer acquisition cost per customer in the first half of this year of is roughly is 580 RMB, slightly higher than our competitors, and that's the situation for the first half of this year. But we actually, down the road, we think probably the customer acquisition cost will probably go down in the 2nd half this year and even perhaps next year, because we actually rely quite heavily on acquiring customers from big internet eco-systems like Baidu, Tencent and some other folks. Obviously, the competitors are not only we see in our industries, but also from other industries, for example the education sectors. I think a lot of players are actually pulling out of the market. We are seeing less competition in terms of customer acquisition, so we foresee that the customer acquisition cost will come down a little bit.

Eric Wong:
Thank you very much.

Operator:
As a reminder, please press 01 for questions. [3 times]. There is going no more questions, now I pass back the time for management, thank you.

Stephen Liu:
OK, I am sure you know, some of investors may have concerns in terms of recent regulatory conditions, I want pass to our Chief Risk Officer, Ethan, maybe can give you more backgrounds and more context on the current market condition.

Ethan Gong:
Good morning everybody. This is Ethan Gong, I believe that many analysts cross industries have already heard about a term'斷直連'in translation it is disconnected between license institutions and data providers. It has some influence on ecosystem of fintech, and I would like to share my thoughts with everybody and see whether there is any question that you probably want to ask and not get chance to ask yet. First and foremost, VCREDIT's business model is based on providing credit-enhanced and loan facilitation. As mentioned by our CEO, Stephen just previously, we bear asset risk, so in the whole business model between Vcredit and our funding partners, there is no data transfer, other than there is minimum of identity of customer information. So '斷直連'or 'disconnect' does not apply to the relationship between Vcredit and our funding institutions. But there is another side of '斷直連' which will impact us. We, through our guarantee company, get data from third party vendors, for example, Baidu, Tencent. Our guarantee company is a fully licensed institution and therefore it is eligible to get data. But there is another side, when we get data from, for example, Tencent, if needed, we will always be able to rolling the data service through the licensed bureau, so we are able to put everything and every single individual step of getting data, processing data in the loop of licensed company and license bureau as well. So

therefore, the process that we are using data, we're processing data, and we're scoring our customers, have already under, we are in line with the regulation direction already. Of course, there is a couple of places that is not very clearly defined yet, we are talking to regulator very frequently as well as we are talking to our competitors or peers in the industry to make sure that we are one step ahead of regulation and make sure that our business model can be stable can be smoothly set into the regulation direction as well. So here is what I take from '斷直連' and the influence on the ecosystem. If there is any question, I am more than happy to answer.

Stephen Liu:
This is Stephen. I also want take this opportunity to share our take on the sort of market information that probably many our investors have some concern. In regard of the pricing ,24%. So firstly, I want to reiterate that according to Chinese law actually 36% is legal. Anything above 36% is illegal. The cap is 36%. However, our current business model is 100% supported by licensed financial institutions. Licensed financial institutions, they are subject to regulations from CBIRC. So according to recent development , some of , actually most of the 消費金融公司, consumer credit companies, they have already received 窗口指導, window instructions, from local regulatory bodies, starting from actually July 1st of 2022, they are no longer allowed to do any consumer credit business for any interest rate above 24%. And we also got instructions from both partnering financial and commercial credit companies. But as to banks, they don't formally receive any window instructions, but some banks in order to make sure political correctness, and they are more disciplined, they also want us to lower the pricing to 24%. Currently our pricing offered to all customers ranges from 18% to 36%, our current average pricing is slightly over 30%. So that's the current situation and I want to share with you, taking this opportunity, that according to our internal simulation, and as a matter of fact, you also can tell from our, you know, credit metrics, our current nonperforming ratio is, at the end of June, is 1.4%, actually that ratio further went down in July. We are very comfortable that we will be able to successfully to migrate ourselves to a player with much lower price. According to our internal assessment, currently more than 80% of customers are actually doable and profitable under the scenario of 24%. And also, the situation of 24% interest rate cap, we estimate our net take rate on the basis of loan balance, we dropped to roughly 3%. That's current situation. We do not intend to immediately switch to 24% across all our customers portfolio but we will pay attention and we will talk to our funding partners and we will, we got to follow their instructions because our funding come from them. So, we forecast there is going to be a transition stating from the second half of this year and likely I think we should be able to complete the transition successfully by the end of the next year. That's the current situation and I also want to share some of our view on this 24% sort of new regulation. Thank you. Any other question?

Operator:
As a reminder, if you have questions, please press 01. As a reminder, please press 01 for questions. There is going no more questions. Management, do you want to do a conclusion?

Stephen Liu:
Ok. Again, we want to thank everyone for coming to our earning conference, and thank you all. And we look forward to talking with you next time, for our full year financial result announcement.

Hong Bai:
Thanks everyone. If you have further questions, please contact with us offline. Thank you.