[PPDF] - FinVolution Group, formerly known as PPDAI Group Inc., also known as Paipaidai
Third Quarter 2019 Earnings Conference Call
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Officers
Jimmy Tan, IR Director
Cliff Zhang, Chairman, Co-CEO
Feng Zhang, Co-CEO
Simon Ho, CFO

Analysts
Steven Kwok, KBW
Yiran Zhong, Credit Suisse
Alex Ye, UBS
John Cai, Morgan Stanley
Jacky Zuo, China Renaissance

Presentation

Operator: Hello ladies and gentlemen. Thank you for participating Third Quarter 2019 earnings conference call for FinVolution Group, formerly known as PPDAI Group Inc., also known as “Paipaidai”. At this time, all participants are in listen-only mode. 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, Investor Relations for the Company. Mr. Jimmy, please go ahead.

Jimmy Tan: Hello everyone and welcome to our Third Quarter 2019 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: ir.ppdai.com.

Mr. Cliff Zhang, our Chairman and Co-Chief Executive Officer, Mr. Feng Zhang, our Co-Chief Executive Officer, and Mr. Simon Ho, 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 Chairman and Co-CEO, Cliff. Please go ahead.

Cliff Zhang: Hello, everyone, and thank you for joining our third quarter 2019 earnings conference call today.

In the third quarter, we continued to deliver healthy and solid results and transition our funding sources towards institutions. Specifically, the proportion of loan originations facilitated by institutional partners increased to 75% for the quarter. More excitingly, our rapid transition in funding base has been achieved at the same time with continuous growth in loan volume. In the third quarter, we achieved year over year and quarter over quarter loan volume growth of 66% and 14% respectively to 24.6 billion RMB. Consequently, for the first 9 months of 2019, our loan origination volume reached 65.3 billion RMB, which has exceeded our loan origination volume in the full year 2018 of 61.5 billion RMB. Our operating revenue increased by 35% year over year to 1.5 billion RMB, and our operating income increased by 32% year over year to 649 million RMB.

Many of you may be aware that , in our most recent Annual General Meeting, our shareholders approved the change of our name to FinVolution Group, and in Chinese to 信也科技. Our ticker symbol will also be changed to FINV on the 29th of November.

Whilst the PPDAI brand will continue to be the main interface for our borrowers, the re-branding of the group will better reflect our diversified businesses, such as in providing technology related services to our financial institution partners and our growing overseas businesses. FinVolution is an integration of finance and evolution, representing better alignment with the range of our businesses, our strategic development and our mission.

As a leader in the technology-driven consumer finance space, we will remain focused on our strategies and maximize shareholder value by expanding our core business, enhancing our brand recognition and continuing to invest in technology.

Now, I would like to pass the call over to our Co-CEO Feng to discuss an update of our business**.**

Feng Zhang: Thank you, Cliff and hello, everyone.

As Cliff mentioned, we have undergone a significant funding transition. In a little more than 12 months, our platform shifted from being mainly funded by individual investors to being predominantly facilitated by institutions. To illustrate more details, in the year-ago period, our institutional funding partners only facilitated around 14% of total loan orignations, while looking at the third quarter of 2019, our institutional partners facilitated more than 75% of loan originations. Notably, since October, all of our loan originations are being facilitated by institutional partners. Today, the number of institutional funding partners active on our platform have increased to around 30.

During this transition period, we have continued to deliver consistent performance:

Overall loan volume grew sequentially in each of the past four quarters, with an average growth rate of 14% for each quarter. Our third quarter loan volume grew 66% year over year.

Our revenues and operating income are both higher by over 30% versus the year-ago period.

And during this period, our delinquency rates have remained broadly stable, despite the ups and downs in the industry and the impact of the macroeconomic slowdown.

Our transition has been rapid and smooth, and arguably one of the most successful in the P2P industry. This successful operational transformation demonstrates our internal extensive experience, strong execution and management capability. This transition would not have been possible without our institutional partners. Their trust and support in us reflect our value proposition to them and further validate our core capabilities, our experience as well as our broad technology capabilities.

Today, we also announced that we are discontinuing the P2P mode of the business and going forward we will focus entirely on servicing and facilitating loans partnering with financial institutions. Since we have stopped new loan originations funded by individual P2P investors, our P2P related loan balance will continue to shrink. As evidenced by the monthly P2P loan balance figures disclosed on the NIFA website, our P2P loan balance has already decreased by more than half from 19 billion RMB at the end of June to 9 billion RMB at the end of October. The loan tenures on our platform are relatively short, on average eight to nine months, so this loan balance will run off fairly quickly without any new originations. Based on the current run rate, our P2P loan balance is expected to be completely run-off in the first half of next year. We believe this run-off process will be smooth.

As a result of these measures we have taken, our exposure to P2P lending is getting smaller. Today, P2P contributes to zero of our new loan originations. As of October, P2P loans accounted for less than 30% of the total outstanding loans on our platform and this proportion will continue to fall. Industry and regulatory developments in P2P lending therefore largely have no influence on us anymore.

Fundamentally, the consumer finance market in China is vast and remains under-penetrated, and we are confident that with our experience and capabilities, FinVolution Group is well positioned to connect and facilitate individuals' financing needs with banks and other financial institutions.

With that, I will now turn the call over to our CFO, Simon Ho, who will discuss our financial results for the quarter.

Simon Ho: Thank you, Feng, and hello everyone.

We are delighted with our performance, achieving solid operational and financial results in the third quarter as loan origination volume progressively increased, underscoring the strength of our markets and the growth trajectory of our business. Our non-GAAP adjusted operating income increased year-over-year by a solid 45% and our non-GAAP operating margin was at a healthy level of 43%.

Our operating margin however declined quarter-over-quarter. This is in line with our expectation and was mainly due to the rapid shift in the funding mix on our platform towards institutions. As we have discussed on our previous earnings calls, loans facilitated by institutional investors have somewhat lower margin than loans facilitated by individual investors. Despite the significant transition we have been through, on an absolute basis, our profitability remains very healthy with an operating margin of 43% and annualized return on equity of 33% in the third quarter.

Our balance sheet also remained solid with approximately 2.2 billion RMB of cash and short-term liquidity. Notably, our quality assurance fund remains sufficient with a total balance of 6.0 billion RMB, equivalent to 21% of the total outstanding loan principal and interest with quality assurance. Our results demonstrate the resilience of our business model and our ability to adapt to the changing regulatory and market dynamics.

Now, let me briefly go over the financial results for the third 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.

Operating revenues for the third quarter of 2019 increased by 35% to approximately 1.5 billion RMB from 1.1 billion RMB in the same period of 2018, primarily due to the increase in loan facilitation service fees, post facilitation service fees and interest income from loans invested mainly through trusts.

Loan facilitation service fees increased by 26% to 894 million RMB for the third quarter of 2019 from 708 million RMB in the same period of 2018, primarily due to the increase in loan origination volume.

Post-facilitation service fees increased by 25% to 301 million RMB for the third quarter of 2019 from 240 million RMB in the same period of 2018, primarily due to the increase in loan origination volume and the rolling impact of deferred transaction fees.

Net interest income and loan provision losses were an income of 265 million RMB, compared to an income of 16.1 million RMB in the same period of 2018, mainly due to the increased interest income from the expansion in the outstanding loan balances of consolidated trusts.

Non-GAAP adjusted operating income, which excludes share-based compensation expenses before tax, was 658 million RMB for the third quarter of 2019, representing an increase of 45% from 454 million RMB in the same period of 2018.

Other income was 80 million RMB for the third quarter of 2019, compared with 251 million RMB in the same period of 2018 primarily due to a lower gain from the quality assurance fund in the quarter.

Net profit decreased by 7.9% to 599 million RMB for the third quarter of 2019 from 650 million RMB in the same period of 2018.

Now turning to guidance ….

In the last quarter, we guided that we expected, loan originations facilitated by institutional partners in the second half of 2019 to be in the range of 32 to 38 billion RMB. Having achieved 18.5 billion RMB in loan originations facilitated by institutional partners in the third quarter, we now expect to be hitting the upper half of this guidance range; and for the fourth quarter, we therefore expect total loan origination volume to be in the range of 16 to 19 billion RMB.

This represents a sequential decline in loan volume in the fourth quarter, but we expect this to be temporary mainly due to the drag from our deliberate decision to sharply run-down loan originations facilitated by individual P2P investors, which was still a quarter of our loan originations in the third quarter. In addition, a smaller secondary factor is seasonality, that the fourth quarter traditionally is a tight liquidity period for our institutional partners, such as commercial banks that have to meet certain liquidity ratios at the year-end. We are fully confident that this is only a temporary slowdown and that volumes will recover in the new year. Our institutional partner pipeline remains solid and we are presently in active discussions with over 10 potential new partners.

Looking forward, our strategy remains committed to and focused on consumer finance. The market in China is vast and under-penetrated. On the other hand, the demand from financial institutions for our services is also huge and growing. Our core capabilities position us well to facilitate borrowers and financial institutions and enjoy the benefits of this vast opportunity. We are focused on deepening our cooperation with financial institutions, leveraging on our extensive experience and proprietary technologies. We are also committed to our international expansion with an initial focus on South East Asia.

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

Questions and Answers

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

Sanjay Sakhrani of KBW.

Steven Kwok: This is actually Steven Kwok filling in for Sanjay. My first question is just around management's commentary around expansion overseas, and also providing technology to financial institutions. Can you guys elaborate on that? And over time, how should we expect that to ramp up and the impacts on the P&L?

Simon Ho: Sure. On the international front, we started operating in Indonesia since the beginning of this year. And we have recently applied to become a fully licensed P2P lender under Indonesian regulations, and we hope to have a favorable result before the end of the year.

So the business is young, but we will definitely report back with further updates going forward. Philippines is another market we have started operating recently as well. And we are also looking into other Asian markets, such as in India and in Vietnam as well.

With regards to our financial institutions, this is pretty much an extension of the work we're doing on the funding side. We are partnering with many licensed financial institutions for the -- obviously, to help loan facilitations on the platform. At the same time, many of them are deficient, or do not have the full suite of capabilities for consumer finance.

And we are also in there to help them to build their own capabilities in, whether it's risk management, servicing and loans, fraud detection. And we are going in to work with them to implement these capabilities in-house. So this is a big part of our strategy going forward, to work more deeply and closely with financial institutions.

Steven Kwok: Great. Thank you.

Simon Ho: Does that answer your question?

Steven Kwok: Yes, it does. And as a follow-up, just around the revenue yield, you talked about how the decline is attributable to moving more to the institutional side. Should we expect this to be the run rate going forward, or are there any further impacts, given that your funding still had a component of the retail side in the third quarter?

Simon Ho: So obviously, our loan volume grew sequentially by 14%, revenues softened a little, declining by around 3% quarter-on-quarter. This is really a direct reflection of the lower margin, lower take rate, of the loans facilitated by institutions, and also the rapid ramp-up in institutional funds in the third quarter from 45% to 75% of total volume from Q2 to Q3.

I do think most of the take rate decline is behind us, and Q3 I would think is a good reflection of our take rate revenue margins since our platform was already majority funded by institutions in the third quarter.

Steven Kwok: Great. Thanks for taking my questions.

Operator: (Operator Instructions). Yiran Zhong of Credit Suisse.

Yiran Zhong: Congratulations on your latest transformation. I just have a few questions on the latest institutional funding partners. Can you please provide the latest update on the current partners that we're working with? How many currently versus -- 3Q versus 2Q? And any changes in the split between the banks and other types of institutions?

And secondly, what's the customer acquisition cost in 3Q and how is the trend looking so far in Q4? And also, finally, in 3Q, the fair value changes from financial guarantee derivatives RMB43 million. I wonder what's driving that number?

Simon Ho: Sure. Thanks, Yiran. I'll first address the institutional funding breakdown. There has been a continued shift towards working with banks and consumer finance companies. Presently, we are roughly, in terms of loan volume, about 80% of our lending volume, loan origination volume, is being facilitated by banks and consumer finance companies. The trusts are roughly about 15% and other financial institutions would be roughly about 5%.

So we have continued to shift further towards working with banks and consumer finance companies. I would think that we are now at more of a steady state in terms of the proportions, and probably wouldn't expect to see significant shifts from here in the near term.

The banks that we work with -- and this is a common question -- they are primarily midsized banks and city commercial banks. That continues to be the case from previous quarters. The number of financial institutions that we partner with, I believe in the previous quarter, we said it was over 20.

And I think that was the guidance -- that was the comment we made in the last quarter. And this quarter, we said it's about 30 institutional partners that we work with actively. And we have a good pipeline of another 10 that we're actively in discussions with.

With regards to customer acquisition cost, the customer acquisition cost per successful borrower -- per successful new borrower was around RMB220 in the third quarter. In the previous quarter, this was about RMB190 and the increase was expected. And we guided for this in the previous quarter because there has been an ongoing shift in the mix of new borrowers toward the higher credit quality segment, which we're targeting. And this segment has somewhat higher acquisition costs.

Now looking into the fourth quarter and looking at the trends that we see at the moment, I think this acquisition cost per new borrower should be relatively broadly stable in the fourth quarter. We're not seeing huge pressures at the moment.

And finally, your question on the fair value changes that are in our P&L and income statement, you have to -- I think the way to look at it, there are more numbers around this in the third quarter. So, this is the realized -- there was a realized loss from financial guaranty derivatives of RMB37 million. And there is a fair value loss of RMB43 million in the fair value change of financial guarantee derivatives. You really should be looking at these two line items together and netting it off.

The financial guarantee derivatives, if you go back in time and memory, these relate to a second investor protection reserve fund that we used to run. It's called the investor reserve fund and we discontinued this at the end of 2017. So what you're seeing, these is the gradual maturity of these investment programs that this IRF, this investor reserve fund, was protecting. And during the quarter, there was more maturities happening, and hence, you see slightly larger numbers.

But you really should be looking at a net basis, and on a net basis, you will see that the number has been -- the net result hasn't changed much versus previous quarters. I could walk through this with you in more detail separately, if you're interested.

Yiran Zhong: Sure, thank you.

Simon Ho: Okay.

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

Alex Ye: I have a few simple questions. Firstly, is on the loan tenure. So you have continued to decline a little bit to around -- a bit more than 8 months. So just wondering is that a deliberate strategy we are taking? And how should we expect it to trend going forward?

And second is on the -- so about the borrower acquisition. So we have mentioned that our borrower acquisition cost has increased as expected because we are moving toward the higher-quality customers. And going forward, how should we expect the trend on your customer acquisitions if we are moving further toward the higher-quality borrowers, or are we comfortable with the current segment? That's number two.

And finally, just would like to have an update on your share repurchase scheme. And it will be great to have your thoughts about your capital return plan regarding dividends and share repurchase scheme.

Simon Ho: Okay. Thanks, Alex. Yes, the loan tenure shortened slightly to the lower end of 8 to 9 months, the low end of that range. It's mainly -- it's not a deliberate strategic shift; it's mainly because certain financial institutions that we partner with, their preference is of the shorter tenure. So it's really driven by the preference by some of the institutional partners that we're working with.

With regards to your question on customer acquisition cost, the trends in the segment we are working with, yes, we do have plans obviously, in the coming year to further expand towards the even better credit quality segment. And the customer acquisition costs will obviously shift as well in that regard. In the near term though, we don't see much pressure in what we're doing, but there may be some shifts as we go into 2020.

But bearing in mind, as you work with a different segment, you're dealing with different profiles, different ticket sizes potentially, different credit -- better credit risks. So I think you really have to look at the whole package in totality at the end of the day.

And finally, your question on share buybacks and capital management, we still have an outstanding buyback quota of US$51 million. And we will continue to approach our buybacks opportunistically and will take into account, of course, our operational needs, given that there is a certain degree of capital intensity dealing with the institutionally-facilitated model that we're running at this moment.

In terms of dividends, our stance on this is the same as in previous quarters, that it isn't our intention to pay dividends each year. But of course, this is subject to review at the end of the day by the board. And we will also take into account the capital needs that we have in our business model. So that remains unchanged.

Alex Ye: Yes, that's very helpful. Thank you.

Operator: (Operator Instructions). John Cai of Morgan Stanley.

John Cai: I dropped off accidentally previously, so I'm not sure if this is repetitive questions. But I would like to have a breakdown of the revenue by funding source. So what portion of the revenue is contributed by P2P funding versus trust funding versus other institutional funding? And if possible, can the management provide the loan balance as of end of 3Q and what is the latest number or what is the outlook about the outstanding loan balance?

And also on the risk, I think that our risk performance is stable, so against there is a sector trend that something is outside transition risk, and our own transition essentially going down the risk curve to target lower-risk borrowers. So is there any colors behind our stable risk performance? Is that a net result, or how should we understand that?

And a related question is our current customer base. If we need to compare them with maybe 2 quarters ago when our fund was mostly P2P, do we see a significant change of our borrower base, or maybe the outstanding loan per borrower had changed significantly when we transit to more institutional funding?

Simon Ho: Yes, John, thanks for your questions. Regarding your first question, revenue breakdown, you can see it clearly from our income statement, the contribution from trusts. That is the net interest income and provisions, loan loss provisions, item on the revenue side.

But for the loan facilitation, post-facilitation, fees, I would really encourage you to -- I think I would encourage the market investors to look at it in totality because in the last quarter, we were pretty much predominantly driven by institutional funding partners.

And as we said previously, that the sort of the take rate dynamics that we saw in the third quarter is, in our view, a probably a pretty good reflection of what it will look like going forward. So I think we're pretty comfortable with where -- what we see in that front.

The loan outstanding balance as of the end of the third quarter was RMB35 billion. And the outlook of this is, it's clearly -- I think fourth quarter, we may see some softening, as we've guided to loan origination volume, total loan origination volume, in the fourth quarter will be a little bit soft for temporary reasons.

And at the same time, because we are also running off the P2P loan balance obviously, still quite rapidly. So that will be a near-term drag as well. But we are confident, past this stage, this transition period, that's coming to an end, we could deliver healthy growth going forward.

Your next question is around credit risk delinquencies. And you've noted that delinquencies were generally stable in the third quarter and continued to perform within our expected range. In the short term, in the fourth quarter, there could be some small upward pressure, mainly on the back of the tightening of loan collection and data practices across the industry. But overall, we believe this is manageable. And we expect our delinquency rates, as you mentioned, to be structurally improving due to our shift toward a better-quality borrower segment relative to the past.

So I think structurally, the direction is still for improvement, although in the fourth quarter, there is obviously, a bit of pressure from what's happening in the industry.

And finally, with respect to the outstanding loan per borrower, I don't think we've seen significant shifts. This segment, we may be -- first-time borrowers, we are lending slightly larger than before, but I think in broad terms, no significant difference from previously. Does that answer your question, John?

John Cai: Yes. So on the overall borrower base, so now we have predominantly funded by institutions. How does the borrower, let's say, overlap with our historical borrower base, which is mostly funded by P2P? Do we see a significant change of the borrower base composition?

Simon Ho: There is some overlap, there is some overlap. But we're also adding on new borrowers, so it's a combination of both. I don't have specific numbers in front of me, but it's both. As you can see, we are acquiring new customers in the market, and these are obviously the target segment that we're working on.

John Cai: Thank you.

Operator: (Operator Instructions). Jacky Zuo of China Renaissance.

Jacky Zuo: Actually just to follow up on John's questions regarding to the borrowers, as we actually move into better-quality borrowers, just want to get some evidence because previously, we actually provide a breakdown of our borrowers in terms of different risk level according to our risk management system.

Simon Ho: Yes.

Jacky Zuo: I just want to get a roughly breakdown of the change of the lower-risk borrowers in the recent quarters. And I think a related question is in terms of borrower acquisition channels, what has been the change in the process when we're moving to better-quality borrowers? That would be very helpful.

Simon Ho: Sure. Jacky, I think you're right, there has been a significant up-shift in the credit ratings of our borrowers. Previously, as you all know, we have 7 levels of -- or 7 credit ratings for approved borrowers; levels 1 to level 7, where 1 is the highest quality and the 7 is the lowest or the highest -- or the lower quality; it's higher delinquency rates. And that's a better characterization; 1 is low delinquency rate, 7 is the highest.

Previously, I think if you look back 18 months or 18, 24 months ago, we were primarily lending, operating, in sort of the levels maybe 4 and 5 -- 4, 5, 6-ish, that sort of the bell curve, the concentration. Currently, I think we are mainly servicing segments 2, 3, 4 is the vast majority of our loan originations today. So there has been a sizable, significant shift in that mix.

And sorry, Jacky, I missed your final -- the last part of your question. Would you mind repeating it?

Jacky Zuo: Yes, it's about the borrower acquisition channels. So what are these changes because we want to acquire better-quality customers.

Simon Ho: Yes. So the channels have -- obviously, has shifted a little -- have shifted somewhat. And to reach sort of our target segment of borrowers, we have shifted towards using more -- putting on more advertising and social media channels, such as using WeChat more. Our app stores have also been a very key and significant channel for us as well. So we have shifted towards using more social media types of channels as a result.

Jacky Zuo: Got it, very clear. Thank you.

Operator: (Operator Instructions). As there are no further questions now, I'd like to turn the call back over to Jimmy Tan for closing remarks.

Jimmy Tan: Thank you once again for joining us today. If you have further questions, please feel free to contact Paipaidai's investor relations through the contact information provided on our website or in our press release.

Operator: This concludes the conference call. You may now disconnect your line. Thank you.