[FINV] - FinVolution Group
Q3 2020 Earnings Conference Call
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Officers
Feng Zhang, CEO
Simon Ho, CFO
Jiayuan Alexis Xu, SVP, Finance
Jimmy Tan, Head of IR

Analysts
Daphne Poon, Citi
Hanyang Wang, 86Research
Alex Ye, UBS
Jacky Zuo, China Renaissance
Yiran Zhong, Credit Suisse
Terry Sun, CMBI
Steven Chan, Haitong International
Liang Henry, Gold Dragon

Presentation

Operator: Hello, ladies and gentlemen. Thank you for participating in the Third Quarter 2020 Earnings Conference Call for FinVolution Group. 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, Head of Investor Relations for the Company. Jimmy, please go ahead.

Jimmy Tan: Hello, everyone, and welcome to our third quarter 2020 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.finvgroup.com.

Mr. Feng Zhang, our Chief Executive Officer, Mr. Simon Ho, our Chief Financial Officer, and Mr. Jiayuan Xu, our Senior Vice President for Finance, 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: Thank you, Jimmy. Hello, everyone, and thank you for joining our third quarter 2020 earnings conference call today. We are pleased to report continued progress in our operations with the shift to higher-quality customers. Our operational and financial results were better-than-expected in the third quarter 2020, a further testament to the agility and robustness of our core capabilities.

For the 3-month period between August to October, our average IRR declined to 28%. As China gradually emerges from the aftermath of Covid-19, our loan business recovery has been gathering momentum. Our loan origination volume in Mainland China for the third quarter reached RMB17 billion, representing a 30% increase quarter-over-quarter and exceeding the top end of our guidance range. More encouragingly, our operating income increased by 21% quarter-over-quarter to RMB689 million.

Our focus on prudent credit risk management, coupled with our proprietary risk assessment technology, continued to support improvement across multiple operating metrics in the third quarter in the following ways: First, the vintage delinquency level for loans originated in the second and third quarter of this year is expected to come in below 4%. And going forward, we expect the vintage delinquency rates to further lower to around 3.5% by the end of the year.

Next, the vertical delinquency disclosed continued to show sequential improvement in all time buckets. Notably, the early-stage delinquency rates that are 15 to 89 days past due have fallen to 1.9%, a historically low level for the company.

Finally, all of these continued improvements, despite the Covid-19-induced economic challenges, demonstrate that our diligent efforts in targeting and serving better quality borrowers paid off as bolstered by our enhanced technology capabilities to build greater synergies with our partners.

As expected, we continued to experience strong demand from our partners for quality assets. With our strategic shift towards better quality borrowers, we were able to steadily lower the cost of funding on the platform over the past 1 year. We are glad to report average cost of funds on the platform from institutional funding partners declined to 8.2% in the third quarter. The cost of new funds on the platform is even lower at below 8%.

Given market dynamics in the aftermath of Covid-19 and evolving regulatory environment, our business operations remained healthy and profitable in the third quarter. This performance was powered by our technological capabilities and strong execution of our corporate strategies. With the faster and better-than-expected transition to adjust towards higher quality borrowers, we now expect our loan volume in the domestic market for the fourth quarter to be between RMB18 billion to RMB20 billion, representing an increase of between 6% to 18% over the third quarter.

Now, I'd like to update you on our other strategic initiatives as we continued to leverage our technological capabilities to drive our growth in the long run: First, we are making impressive strides in our international business expansion, in particular in Indonesia which today forms the bulk of our international business. In Indonesia, we operate under a lending license issued by the OJK, and we are now one of the leading fintech platforms in that market with over 3 million registered users.

Our business operations in Indonesia is gaining strong traction. Loan origination experienced a significant rebound of 5 times from the depressed levels in the second quarter 2020 during which many nationwide lockdown measures in response to Covid-19 were implemented. Loan volumes in Indonesia are now well above pre-Covid levels and at the highest levels since we began operating there. The strong momentum is continuing, and we expect loan origination volume in Indonesia to increase another 40% or so quarter-over-quarter.

We also have operations elsewhere in Southeast Asia, for example, in the Philippines, where the Fintech ecosystem is emerging in a highly promising and dynamic manner. We will continue to capitalize on our experience, industry know-hows and technological capabilities to explore growth potential in the technology-driven financial services in these countries.

LY Fortune, our wealth management tech initiative remains on track in expanding its product and service offerings with continuous growth in cumulative investments facilitated of around RMB1.6 billion, representing an increase of 33% quarter-over-quarter.

In addition, speaking of the development of our technology-as-a-service, we have been making steady progress in empowering banks and other financial institutions to implement digital transformation in their consumer finance operations. We currently have a healthy pipeline of institutions in discussion, and will continue to spearhead our strategy of exporting our technologies to more financial institutions.

In summary, our proven track record in technology innovation, responsible risk management and effective measures taken to navigate across credit and economic cycles, have allowed us to successfully manage through the various regulatory changes in recent years.

We have repositioned our core business. All funding on the platform have transitioned from P2P to financial institutions and the customer base has significantly shifted towards the higher quality segment, resulting in lower lending rates for our borrowers and much stronger credit risk profiles. We continue to invest in new strategic initiatives, leveraging our technology and know-how. And some of these initiatives, such as Indonesia, are gaining momentum and starting to pay off.

We are financially solid, and well positioned to generate sustainable growth and unlock the vast potential in the consumer finance in China and abroad.

Lastly, I would like to take this opportunity to thank Simon for his remarkable contributions to the Company during his tenure. Simon will join our Board, and we look forward to his continued contributions as a Director of the Board. At the same time, I would like to extend a warm welcome to Mr. Jiayuan Xu as our new CFO. We look forward to his contributions in his new role.

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

Simon Ho: Thank you, Feng, and hello, everyone. In the third quarter, amid a recovering Covid-19 environment in Mainland China, we delivered non-GAAP operating profit of RMB698 million, representing a sequential increase of 21%, further demonstrating the sustained profitability of our core business model.

Our balance sheet and liquidity remain strong with RMB3.4 billion in unrestricted cash and short-term liquidity. Leveraging on our strong technology, we look to capture new opportunities and expand our relationships with business partners.

Now, turning to 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.

Net revenue for the third quarter of 2020 increased by 13% to approximately RMB1.8 billion from RMB1.6 billion in the same period of 2019, primarily due to the adoption of ASC 326 at the beginning of the year.

Loan facilitation service fees decreased by 46% to RMB486 million for the third quarter of 2020 from RMB894 million in the same period of 2019, primarily due to the decline in loan origination volume and a decrease in the average rate of transaction fees.

Post-facilitation service fees decreased by 46% to RMB161 million for the third quarter of 2020 from RMB301 million in the same period of 2019, primarily due to a decline in outstanding loans serviced by the company and the rolling impact of deferred transaction fees.

Guarantee income was RMB747 million for the third quarter of 2020 due to the adoption of ASC 326.

Net interest income decreased by 24% to RMB261 million for the third quarter of 2020, from RMB345 million in the same period of 2019, mainly due to the decrease in interest income from the reduction in outstanding loan balances of consolidated trusts.

Other revenue increased by 159% to RMB138 million for the third quarter of 2020, from RMB53 million in the same period of 2019, mainly due to increased customer referral fees to third-party service providers. As we have shifted towards higher quality borrowers on our platform, we have increased the referral of borrowers that do not meet our requirements to third-party platforms.

Non-GAAP adjusted operating profit, which excludes share-based compensation expenses before tax, was RMB698 million for the third quarter of 2020, representing an increase of 6% from RMB658 million in the same period of 2019.

Other income decreased by 49% to RMB26 million for the third quarter of 2020, compared with RMB52 million in the same period of 2019, which primarily consists of gains from investment.

Net profit was RMB597 million for the third quarter of 2020 compared to RMB599 million in the same period of 2019.

Now, before I close, I want to address the regulator's recent consultation paper on micro-lending. In short, this does not materially affect us. We do not rely on our micro-lending company, nor do we have co-lending arrangements with our funding partners. We do have a micro-lending company, but loans disbursed through our micro-lending company is small and accounts for less than 1% of outstanding loans on the platform.

Our core business model is based on a loan facilitation model, whereby institutional funding partners on the platform provide 100% of the funds needed by borrowers. And our role is to provide value-added services to funding partners, as well as providing access to credit to borrowers.

We have a well-capitalized balance sheet, and our leverage is conservative. If you divide the total outstanding loans on our platform of RMB22 billion by our shareholders' equity, the leverage ratio across the business was only 2.8x. And our liquidity position remains strong with approximately RMB3.4 billion of unrestricted cash and short-term investments as at the end of September 2020. Our strong balance sheet means we are well positioned in the current environment, and gives us significant flexibility.

On buybacks, we have continued to buy back our shares. Since our last earnings call, we have deployed USD11 million to buy back our shares. Since we began repurchasing our shares in 2018, we have cumulatively deployed USD122 million on buybacks.

Finally, I wanted to thank you all, and to Feng and our team, for all the support and partnership over the past several years. I will continue to service the Company in my new role on the Board. And I am excited to hand over to [Alexis] Xu Jiayuan, who is well prepared to lead FinVolution, which has strong technology and management capabilities, and is very well positioned to adapt to the evolving environment and deliver long-term value to shareholders.

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

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). For the benefit of all participants on today's call, if you wish to ask your question to management in Chinese, we ask that you please kindly repeat your question in English.

Today's first question comes from Daphne Poon with Citi.

Daphne Poon: So I have three questions here. So first is just regarding your -- on the financial side. So we noticed that there seems to be a meaningful decline in the credit cost intra-quarter on new loans. So if I take your credit loss for quality assurance divided by the off-balance sheet loan volume, it's only like 2.3%. So just wondering what's the reason behind, whether there is any write-back in the quarter?

And second is regarding your unit economic outlook, so after you adjust your loan pricing now to all below 27%. Also what is the long-term sustainable economic outlook? And if possible, can you break it down into the average APR funding cost and credit cost, etc.?

And lastly, I just want to check, I guess, on the regulatory side. I guess apart from this new online micro-lending rule, we do see quite a number of statements from government officials. It seems the tone is more towards the tightening side on this overall fintech sector or the online consumer lending sector. So if management can share your thoughts on the future regulatory direction, or maybe like what you have been hearing from your funding partners or from the regulators on that front?

Simon Ho: All right, Daphne, thank you very much for your questions. I'll take them one-by-one. The first question is about the credit cost and provisioning levels and why they were so low. Yes, there were write-backs in the third quarter because of the better-than-expected credit risk experience, as we have been highlighting throughout the commentary earlier. So there were write-back during the quarter. Particularly for the guarantee credit loss, the figure of RMB 327 million, included in that was a write-back of roughly RMB

690 million, okay? And this write-back is for loans outstanding prior to the second quarter.

Okay. With regards to your second question about the profitability and sort of the unit economics, as we have said, our transition to lower lending rates has been ahead of expectations. Delinquency rates are improving faster than expected. Funding cost continues to decline and we are growing our loan volume.

Because of these favorable trends, we expect our take rate in the fourth quarter to decline only slightly compared to the third quarter. Our take rate was 3.9% in the third quarter, and Q4, we think the take rate will mostly come in in the range of perhaps between 3.5% to 3.9%. Now going forward, we expect the take rate to stabilize, or even improve from this level, as we continue to optimize our credit quality and drive down credit cost. Okay.

Now, as a side note, as we have shifted to better quality borrowers, there has also been an increase in fees from customer referrals. These borrowers don't meet our new standards -- to our new standards, and these have been referred to other platforms. Such referral fees in the third quarter amounted to about RMB 90 million, and these are completely free of credit risks.

So we will continue to -- continuously work to improve profitability, and there is room for efficiency gains as long as volume expands and we work to optimize costs. And we are confident of delivering healthy and sustainable profitability. So I hope that helps address your question on the profitability outlook.

And your final question on sort of government, the regulatory outlook, I think -- look, I think we can make a few comments. I think clearly, I think government regulations, regulators, recognize the value that fintech companies bring to the table, such as in online customer acquisition and servicing, data, technology and in risk management. And I think this has been consistent in all the comments that have come out. And the fintech industry complements and benefits the traditional banks, expands access to credit, increases efficiency. I think this is all very positive.

Personally, I think the recent rules in micro-lending, co-lending seems to be primarily aimed at some of the larger companies. And this does not impact us, as we do not rely on this co-lending model. And as you know, the loan facilitation model that we primarily rely on has been recognized in the CBIRC's online lending rules for commercial banks, which was officially released only recently in July.

And I think more stringent requirements and moves to prevent monopolization, should be positive for proven companies with a strong track record like us. On the one hand, it raises the entry barriers for smaller players, and on the other hand, it should limit competition from the larger major internet companies. So in the long run, I think this will encourage healthy and sustainable development for the industry.

And I hope this helps to answer your questions, Daphne.

Daphne Poon: Yes, yes, sure, thanks, Simon. Maybe just one quick follow-up regarding the loan pricing. May I know what will be the average APR after you have made all the adjustments?

Simon Ho: And I think, as Feng said, we, in the 3-month period between August to October, our average IRR was running at about 28%. And I think in recent months or so, it's been around 27%. So we're around the levels that we want to be; this is where we want to be going forward roughly speaking.

Feng Zhang: And this is -- I'll add. This is dynamic. I think we will continue to observe and watch very closely what the regulators do, and how our funding partners, what their view is, what is their demand, as well as the market, right, our competitors, how are they doing their pricing? So I would just want to call out currently, our IRR is around 27%, 28%, but it is pretty fungible. And we will watch closely all these factors, and adjust if necessary accordingly.

Daphne Poon: Okay. Understood. Thank you.

Operator: Hanyang Wang with 86Research.

Hanyang Wang: Congratulations on an impressive quarter. My first question is on the funding side. So given the recent regulatory environment, is there any change in attitude of your funding partners? And what is the proportion of the breakdown for your institutional funding partners, mainly a few of your top fund partners?

And my second question is about the business model involvement. So what is the progress on your profit sharing model for which you do not bear credit risk?

Simon Ho: Thank you, thank you very much. The first question, we'll have Alexis Xu to answer.

Jiayuan Alexis Xu: Yes, hello, this is Alexis. I will take this question. And for the first question, I want to say our funding partners remain supportive, as you can tell from the gradual decline in funding costs to our platform. And in this quarter, banks and the consumer finance companies facilitate around 85% of our loan volume, while trust companies facilitate around the remaining 15%.

And for your second question about our business model, we have already begun working capital-light models, such as profit sharing models with some of our institutional funding partners. And we will continue to update the market when there is further progress. Hopefully, it can help you.

Hanyang Wang: Thank you. I have a follow-up question on the regulation environment. So basically, I saw some local courts were turning to allow some financial institutions from the four times LPR lending interest rate cap. But it seems that the regulatory authorities, such as PBOC, CBIRC, are still staying silent. So any new color on your side will be very helpful.

Feng Zhang: Hi, this is Feng. Yes, I'll share my thoughts. Yes, with regard to the Supreme Court rate cap decisions, the Supreme Court four times LPR cap only applies to private lending and not to licensed financial institutions. This was clearly stated in the Supreme Court decision, and I don't know if you noticed, it was also evidenced by a recent court ruling involving Ping An Bank in Zhejiang Province. And all lenders on our platform are licensed financial institutions.

Now despite all this, in the spirit of reducing borrowing cost of our customers, providing better services to them; also in line with our strategy of targeting better quality customers, we have voluntarily significantly lowered the borrowing rates for new loan originations since August. As I mentioned, the average borrowing rate on our platform in the last 3 months, August to October, was about 28% on an IRR basis compared to 33% in August prior to the Supreme Court decision. And our current average IRR is about 27%. And as I also mentioned, that we will watch the market and watch the regulators move closely and it is all flexible.

Now we believe we are fully compliant with current regulations, and are able to achieve significantly better credit quality and deliver healthy and sustainable profit under current pricing. And we are continuing to monitor the development in the country, in the industry, and when necessary, make appropriate adjustments that are in line with regulatory requirements and the industry norms.

Hanyang Wang: Thank you. It's very helpful.

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

Alex Ye: I have a few follow-up. First one is on your credit loss for quality assurance commitment. So previously, it was mentioned that there was a write-back of RMB690 million, if I take it right. So if we add it back into the RMB300 or so million of credit loss for the quarter, then essentially, the company is making RMB1 billion of credit loss provision. Then that would be equivalent for around 7% of your off-balance sheet loan volume. So that compared to your expected vintage loss of only like 4% to 4.5%.

So I'm wondering how we should reconcile these two numbers? Why are you still making such provisions currently for the current quarter?

And my second question is on your take rate outlook. So it was mentioned in an earlier question that the take rate for the next quarter is going to be slightly lower, or even close to this quarter. But given your average IRR is lowering from 36% to 27%, I'm just wondering where were the savings in unit economics coming from? Obviously, your lower credit cost is one of the important factors, but just wondering where are the other parts of the economic savings?

And my last question is on your international business expansion. So we have seen a lot of more details in this quarter. So I'm just wondering if those international continue to gain scale, how would that impact your P&L? So where are they booked at currently?

Simon Ho: Right, Alex, very, very good questions and insightful. I'll take them one-by-one. I think your first question about the guarantee credit loss, I think, yes, you are correct, new provisions were running at around RMB1 billion. Now I think we'll put it this way. I think we continue to use a certain degree of prudence in our loan provision assumptions, given that there's always obviously some degree of uncertainty looking into the future. And of course, if improving delinquency trends continue, our assumptions could be too conservative and we may have obviously some provision releases in the future. So I think you should bear that in mind.

Secondly, in terms of your question about the take rate, yes, and I think that as we mentioned, delinquency rates have been steadily declining, and has been better than expected. And this has contributed to a better take rate. Now our take rate in the second and third quarter was, in hindsight, understated because credit risk was, at that point in time, overestimated. So in other words, if we had perfect foresight on our credit performance, our take rate in the previous quarters would have been higher than what was shown in our income statement.

So due to these two reasons, the decline in take rates being reported, or what we expect to be reported in the fourth quarter, will be relatively small. I hope that makes sense to you.

And then your last question about Indonesia, I think Indonesia right now is a small sort of low-single-digit component of our loan volume at the moment. Obviously, it's growing much faster than the China business, and I think we want to highlight that the contribution to loan volume is likely to be relatively small, on the small side, but it does have higher profitability. In general, Southeast Asia will have higher profitability compared to China.

And so I think that it doesn't -- it is not impacting the bottom line at this point, but we just wanted to flag the success, the traction, the momentum we've been getting there. And obviously, should the international Indonesian businesses do have more of an impact on our numbers and bottom line going into next year, we will make appropriate additional disclosures and update you.

Feng Zhang: Alex, this is Feng. I want to add a bit more color on the question about the P&L and the take rate and the unit economics. So just to add on what Simon has already said, just a very quick like 80-20 math, our IRR is about 27% and our funding cost to FTP is around 8%. And our vintage loss rate -- and this is on original balance basis, we're expecting that to be 3.5%. So that, given our loan tenure, is about 8 months. So if you translate that 3.5% original balance basis to an IRR basis, that will be roughly 8.8% roughly annualized loss rate. So if you take the 27% minus 8% minus 8.8%, you roughly come out around like 10%, so that will be our take rate on an IRR basis.

Now usually, we talk about take rates on a per original loan amount basis. So you translate that back, given our loan tenure is around 8 months, so that gives you about 4%. And now this is a very simplified version because the accounting was slightly different for trust-based origination versus our loan facilitation model, and roughly like 20%. A small percentage of our fee is recognized in a delayed fashion. But like all things given and take, I hope that gives you a color, roughly like a 4% take rate, given our current credit quality and our current pricing is very reasonable. Hope that helps.

Alex Ye: Okay, thanks. So if I may, just one follow-up on the write-back. So I'm wondering, given we are now in the fourth quarter, the middle of the fourth quarter, just wondering, do we have any visibility on any potential more write-back in the fourth quarter, because we have been having consistent write-back in the past 2 quarters? I'm just wondering, do we further expect that in the near term, and yes, any color on that.

Simon Ho: Yes, Alex, I think as Feng has been saying, risk performance has been obviously fairly -- pretty good at the moment. And we are expecting the vintage delinquency rates to be -- and the new originations that we're doing this quarter to be down in the sort of 3.5% range versus the sort of just below 4% range in the last 2 quarters. So I think the credit metrics are heading obviously in a positive direction, and we'll have to see at the end of the quarter where things end up at.

Feng Zhang: Yes. I think if the credit quality, the environment has been benign, and I think if these trends continued, that would be like better than what we had assumed in the provisioning. I think it is possible that we may have some further release moving forward, but that's an if.

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

Jacky Zuo: Congrats on the solid results. And congrats, Simon and Alexis for the new role. And yes, and thanks, Simon, for all the help in the past years. So just two questions from my side. Number one is the drivers behind the solid recovery of the loan volume in the third quarter, and I observed that the ticket size also increased. So how much of the loan volume increase would you attribute to the larger ticket size; and how much would you attribute to the new borrowers, especially the high-quality borrowers? And any change to our customer acquisition strategy? Any color will be helpful.

And the second question is on regulation again. So just looking into details of the new online micro-lending license rules, since the capital requirement is quite high, and it's a bit difficult for all the listed players to get the national license. So will that affect your business if at the end, you can't get an online micro-lending license?

Simon Ho: Yes, Jacky, let me just quickly address some of those questions. I think in terms of the ticket size increase, I think it's expected and normal because as we shift to a better quality, higher quality, borrower segment, as you can see from the credit metrics, that we're showing at the moment, delinquency rates down in the sort of 3.5%, 4%. Our borrowers in these segments just don't -- they tend to borrow a bit larger than what we used to give out. So actually, for first-time borrowers, the ticket sizes are now roughly -- the average ticket size in the third quarter for first-time borrowers was about RMB8,500; it is edging upwards. But typically speaking, RMB9,000, RMB10,000 is not uncommon.

So this is sort of the area we are operating in at this moment and that's actually been an ongoing process over the last several quarters, so it isn't just suddenly a big bump. That number is an average for the third quarter so -- and of course, the better-than-expected loan volume in the third quarter is related to sort of the better-than-expected transition we've had to a lower lending rate environment. So we've had the confidence to actually to grow, to expand the book, as we saw the sort of numbers and the performance come in.

So I think that it's hard to separate. It's ticket sizes, but it's an ongoing transition which, as we consistently said, has been -- it's been better-than-expected. It's been faster and more successful than expected.

Now in terms of the customer acquisition channel strategy, it hasn't changed significantly. We mainly rely on a range of social media platforms, information feeds and advertising such as WeChat, Toutiao, Douyin(Tiktok). And the types of channels haven't changed much, but the message, the optimizations, we are continuously improving.

And we work very closely with our key channels to build models and deploy technology that can more accurately target the customers that we seek. And I think we will continue to optimize and expand these channels to effectively reach out to our customer segment. So it is quite detailed and quite technology-driven. But we are seeing that the adjustment overall has been smoother than expected.

And your final question is simple. Yes, the capital requirements of micro-lending licenses are much higher than the previous version of the consultation paper. But I think at this point in time, we will just have to, A, wait for the final rules, and B, assess what we ought to be doing. At the moment, we don't rely on the micro-lending license, as we said, so we use the loan facilitation model, but we'll have to see. We're still obviously waiting and thinking.

Jacky Zuo: Yes, very helpful. Thanks again, Simon.

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

Yiran Zhong: Congratulations on the strong quarter. I just have one follow-up question on the customer side. It seems that you've been quite effective in your transformation to move up the quality curve for your customers. So can you please share your thoughts in terms of how you managed to achieve that so far? It seems that the number of new borrowers, as a percent of unique borrowers in 3Q, was at a low level versus historical levels. So can I read that as you're relying more on the better quality segment of your existing borrower pool? And what's the way forward from here?

Simon Ho: Sure, Yiran. Yes, the number of unique borrowers that you see is lower, but that's also a reflection of loan origination volumes that are still at sort of low levels relative to where we want them to be. And so it's really a reflection of where the business is and of course, the larger ticket sizes which we just mentioned, yes.

So our transition to better quality borrowers, I think, how we've done it, it's been a combination of several factors. One is obviously, as you know, we have discontinued lending to borrowers with relatively high-risk profiles. Number two, we've been adjusting the rates for existing borrowers as well, and increasing the focus of customer acquisition in higher-quality segments. And three, we've also been quite successful in reactivating previously inactive users that have been of good quality, and of course, we are offering them lower lending rates now. So probably they're open and coming back to us because the interest rates are now attractive to them.

So I think we're pretty confident that because of improving credit quality, the credit loss metrics over the past year, we are able to maintain healthy and sustainable profitability, despite this lower pricing. So yes, so I think that's how we've made the transition. I don't know if there's just anything sort of further, whether answers your questions, whether you want to have any follow-up on what I've just said?

Yiran Zhong: That’s helpful. Thank you.

Operator: Terry Sun at CMBI.

Terry Sun: So just wanted to ask about the funding cost trend. You're saying the funding cost yield coming down in 3Q. I just want to understand the logic behind it because we've seen some marginal tightening of liquidity, and the interbank costs actually have been rising a bit. So why the funding costs are still coming down?

Simon Ho: Sure. I think that's a very fascinating question, a great question. I think there's probably a couple of angles to this. I think one is we're not a very large player. So in terms of the overall liquidity in the market, we're pretty small, particularly relative to the banking system. Secondly is that our lending volumes have come off quite a bit over the past 6 to 9 months because of Covid, credit risk concerns and all sorts of obviously changes in environment. And actually, for a period, we have more demand for our assets than we do have for the assets themselves.

And bear in mind also from the bank's perspective, I think this is still a very attractive segment they want to be in. If you look at the returns that they are getting, whether it's low 8% or below 7% to 8%, it's still a very, very good return business for them. So I wouldn't be surprised that they would continue to work with us, continue to source quality borrowers and assets.

And yes, so I think you're all very familiar with the banks, the banking system. This is a very attractive business for the banks at the end of the day, I believe, yes. And we're pretty confident that our funding costs can continue to improve from these current levels.

Terry Sun: Okay. Thank you.

Operator: (Operator Instructions). Steven Chan with Haitong.

Steven Chan: Congrats for your new role for Simon, I hope that is a half-retirement life.

Simon Ho: (Laughter).

Steven Chan: Anyway, a few quick questions, a quick follow-up. First of all, if I use the sales and marketing expenses you estimated so cost -- per customer acquisition cost, it seems that there was a rise in average customer acquisition cost in 3Q compared with first half. So I just wanted to know whether it is correct or not, and what has caused the rise in customer acquisition cost? Is it one-off, and how is it looking forward like? That's the first one.

And the second question, just to clarify, you just mentioned that about 85% of funding partners are consumer finance company and 15% on trust company. So none of that is from bank. And my question is that recently, there are some court case in different areas saying that the consumer finance companies may have to apply for the High Court lending ceiling. So if most of your funding partners are consumer finance companies, are you worrying about that you have to abide to the lending rate cap? So that's the second one.

And finally, I think just to follow-up on Alex's question about your assumptions in the expected credit loss, so you have made RMB 1 billion and some write-back. Do you think that you will relax your assumption a little bit in Q4, and maybe going forward in Q1 next year, because of the improving vintage?

Simon Ho: Yes, Steven, thanks for your questions. I think your second question is very simple. I think you probably misheard our response. The 85% figure is for banks and consumer finance companies combined. In fact, bank is a large, large majority; it's about probably 65% or 2/3 of the book. Consumer finance is probably about roughly 15% to 20%, maybe around 20% or just below that. So we don't think that's a huge problem for us. I think the bulk of the funding and the liquidity in the market, as you know, come from banks. And there are many, many more banks in the system than consumer finance companies at the end of the day.

In terms of the increase in your customer acquisition cost, I think yes, you're right. I think your calculations are fairly -- the trends are accurate and correct. There has been a general increase in customer acquisition cost, as we have been flagging on each of the call we've had in the past few quarters. And this is mainly because of the shift to better quality borrowers that have significant and stronger credit risk profiles and they borrow larger ticket sizes.

And you should also bear in mind that in the second quarter and the first half of the year, there were not normal environments for customer acquisition because of Covid. And everyone was holding back customer acquisition. So Q3 not only saw a bounce back in market activity, but we ourselves also increased customer acquisition as we looked to resume growth. So I think these are the main reasons behind obviously a pickup in customer acquisition costs in the third quarter is the shift in our customer segment, the bounce back in activity, and also our more active push to acquire new customers.

But I do want to highlight a few points that you should bear in mind is firstly, we do estimate -- we internally estimate a typical borrower will breakeven within the first 12 to 18 months. So our newly-acquired customers deliver healthy NPV, net present value, despite the higher cost of acquisition. And secondly, our new borrowers, they only account for about 10% of the loan volume today, and 90% still come from repeat borrowers where we do not pay any acquisition cost at all. So I hope that clarifies and explains sort of the trend that we're seeing.

And your final question about obviously, our assumptions in the fourth quarter and write-backs, and I think we've addressed this quite thoroughly; I think we've commented on this quite thoroughly. I don't think I can, say, pre-empt myself into assumptions going forward. I think that would be obviously dangerous. But obviously, should we see actual credit loss levels being better than expected, then that should really result in some write-backs and releases. And yes, so it will depend on the situation at that point in time.

Steven Chan: Thank you, very clear.

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

Liang Henry: Congrats on the good quarter results. I just have two quick questions to follow up. One, can you guys share your secret sauce on sort of managing down the delinquency ratio or the NPL, while most of the players in the industry is more or less still struggling, or see the delinquency rate is still much higher than the pre-Covid period, while we are just getting it down to sort of record low again and again. Can you share like how you guys manage to do that?

And the second question is you speak of the new customer acquisition, and it seems like the loan volume is gaining more momentum in the fourth quarter onwards. Can you share your plan of the marketing input, and expand forward, and how you would think of acquiring new customers, what channels and what kind of plans [forward]?

Feng Zhang: I'll take the first question about credit risk. This is Feng. I think it's a combination of the environment and our measures, the active measures, and the risk management philosophy and the culture we have and the capability, of course.

In terms of the environment, we have observed coming out of Covid-19, and the cleanup of P2P and fintech platforms with tighter regulations, and generally, an improvement in the credit information like availability of PBOC credit bureaus, all things has led to, in our view, a more benign credit environment than, let's say, of course, the pandemic period, but also being slightly better than the pre-pandemic period last year.

And now more importantly, I think we have taken a lot of proactive measures now. Besides the continuous shift to better quality borrowers, as Simon has mentioned, not only we have a step-up effort in acquiring better quality new customers; we have also done a lot of work to kind of reactivate some dormant users with better offers, better price, better lines. And that generates some positive selection, getting the better quality of dormant customer, inactive customers.

And also we continue to optimize the use of technology in customer acquisition, i.e., more accuracy targeting low-risk customers, continue to optimize our risk models, credit policies as well as our loan collection practices. So all these factors, when we combine them together, that results in the loss rate, the credit quality improvements you have seen, it demonstrates very clearly in the vertical loss rate tables we have in the new release, as well as in the vintage loss rate curves quarter-by-quarter continues to drive lower. Hope that helps.

Simon Ho: Yes, Henry, thanks for your question. I'll address your second question about the customer acquisition front and marketing, how we're thinking. I think no doubt, I think as our loan volume grows, obviously, I think we will have to spend more on marketing and acquiring and targeting new customers. I think that's sort of inevitable.

We do internally focus very hard on trying to assess the profitability of each new user that comes into the platform. So as I mentioned, we do use an NPV model to model out and try to estimate profitability, how much we should be paying. So I think the customer acquisition cost should -- the appropriate cost should be different for every platform depending on the type of obviously borrowers, the ticket sizes and also their ability to manage risk and generate a return from that customer. So I think in some ways it's actually hard to be completely comparable.

And my final comment is, as we mentioned before, it's probably not my expertise at all, but we are happy to obviously follow up with you about details in terms of the operational details. But there is a lot of obviously, optimization that goes on with our key channel partners, how we build models to specifically target -- an effective model to target the type of borrowers that we seek from each of these key channels.

So I think there's been a huge amount of work that's gone into these type of activities, which I think is very under-appreciated, and you don't see it as much in the numbers upfront, but it's a lot of what we do. And I think front-end team spent a lot of effort on this and I think we could -- clearly, we could have -- we could sit down and explain all this in much more details as a follow-up, aside from obviously the call today.

Liang Henry: Yes, thank you from me, Simon. And we appreciate all the awesome contributions, your effort and being very helpful. Congrats again on the strong quarter.

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

Jimmy Tan: Thank you once again for joining us today. If you have further questions, please feel free to contact FinVolution Investor Relations team. Good night.

Operator: This concludes this conference call. You may now disconnect your lines. Thank you.