[FINV] - FinVolution Group
Q2 2022 Earnings Conference Call
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Officers
Feng Zhang, CEO
Jiayuan Xu, CFO
Jimmy Tan, Head of IR

Analysts
Frank Zheng, Credit Suisse
Yada Li, CICC
Alex Ye, UBS
Thomas Chong, Jefferies

Presentation

Operator: Hello, ladies and gentlemen. Thank you for participating in the Second Quarter 2022 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 second quarter 2022 earnings conference call. The Company 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 http://ir.finvgroup.com..

Mr. Feng Zhang, our Chief Executive Officer, and Mr. Jiayuan Xu, 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 CEO, Mr. Feng Zhang. Please go ahead, sir.

Feng Zhang: Thanks, Jimmy. Hello, everyone, and thank you for joining our earnings call. The second quarter of 2022 was a challenging quarter, with Shanghai under Covid lockdown until June 1, 2022, and many other major cities also experiencing varying degrees of lockdown or restricted mobility during the quarter. All these unprecedented challenges significantly affected China's economic growth and exerted additional pressure on certain aspects of our operations.

However, we were able to navigate all these challenges and achieve better-than-expected results thanks to the experience and insight we have accumulated during our 15 years of operations. Consistent investments throughout our chain of technologies enabled most of our employees to conduct their work from home during the lockdown, minimizing disruptions to our operations.

Also, our stable and capable senior management team with pragmatic goals, coupled with an in-depth understanding of the industry, seamlessly executed our decisive strategy despite macro-obstacles.

Together with the Company's ongoing transition towards better-quality borrowers in both domestic and international markets coupled with our long-term goal of financial inclusion, these advantages further contributed to our growth momentum in this challenging quarter. Encouragingly, our total transaction volume steadily increased for the 9th consecutive quarter to reach RMB41.5 billion, up 24% year-over-year and 4.5% on a sequential basis.

Driven by our stable, better-quality borrower base, we achieved a solid set of operational metrics despite weak macroeconomic conditions. The total number of unique borrowers in the quarter remained stable at around 3.1 million.

Additionally, our total outstanding loan balance further expanded to RMB56.4 billion as of June 30, 2022, representing year-over-year growth of 44% and sequential growth of 5%.

With respect to our strategic transition toward better-quality borrowers, our proportion of category A&B borrowers in the domestic market, who meet our highest credit standards, further expanded to 74% of our total borrowers in the second quarter, compared to 68% in the previous quarter and from 54% in the prior year period. Accordingly, our average borrowing interest rate further declined to around 24.2% in the second quarter.

Passion for technological innovation is embedded in our DNA, driving us to pursue high-quality innovation outcomes with the ultimate goal of serving the real economy and accelerating the digital transformation process. We leverage a host of cutting-edge proprietary technologies to maintain our growth momentum while stabilizing our credit risk performance. For instance, our Feng Chao Platform automatically monitors the credit assessment process and risk control rules, accurately tracks data fields, and swiftly evaluates the performance of these data source, leading to a 120% increase in operational efficiency.

Working hand-in-hand with Feng Chao Platform, our Ming Mirror fraud detection system provides visual network and fraud detection images, which can uncover up to 65% of intermediary fraud during the loan application process. Based on knowledge graphs, Ming Mirror utilizes complex network computing, machine learning and carefully-selected rules as well as over 2,000 models embedded with billons of relational data to effectively identify fraudulent activities. We have also implemented these technologies in our overseas markets, validating our technology's flexibility and transferability while strengthening our foothold in those countries.

Supported by a prudent risk management framework with proven credit risk assessment and fraud detection technologies, we have maintained a stable risk level and overcome expected Covid-related issues while propelling growth. Our Day-1 delinquency rate remained stable at 5.5% in the second quarter of 2022 with a continued stable trend into July. Our delinquency rate below 90 days showed signs of recovery, falling to 1.44% from 1.56% in the previous quarter. In addition, as the impact of the Covid-19 resurgence became more manageable, our second quarter vintage delinquency rate is expected to be around 2.4%.

Finally, thanks to our loan collection team's impressive efforts, as well as the easing of lockdowns across China, we have also seen an improvement in our loan collection recovery rate to 91% from 90% in the previous quarter. While maintaining our solid growth momentum, we continued to diversify our funding sources and improved funding efficiency in the second quarter. More encouragingly, our overall funding costs have been on a gradual downward trend. In line with our expectations, we significantly lowered our funding cost by 31bps to around 7.5% during the quarter.

Meanwhile, our capital-light proportion remained stable at 17% in the second quarter compared to 13% a year ago. These results are a powerful testament to our effective business strategy and skillful execution.

We also remained committed to supporting small business owners during this challenging period. During the second quarter, we served over 500,000 small business owners across a variety of industries, such as wholesale, retail and manufacturing, among others, representing an increase of 23% from the same period of 2021. Transaction volume for this segment further increased to 68% year-over-year to a new record high of RMB10.4 billion, contributing 25% of total transaction volume in the second quarter.

Moving on to our international expansion. Our strategic transition towards better-quality borrowers with enhanced technologies continued to deliver promising results. Transaction volume for the quarter increased to RMB0.91 billion, representing a sequential increase of 6%. Notably, the proportion of better-quality borrowers for the second quarter have exhibited continuous improvement to 62% from 54% in the previous quarter.

With a larger number of better-quality borrowers in our Indonesian business, our proportion of loans funded by local institutional partners also increased to 39% from 14% in the previous quarter and from no institutional funding in the same period last year.

More excitingly, outstanding loan balances for our international markets increased to RMB0.48 billion, representing a year-over-year increase of 60% and a 33% increase sequentially, validating the tremendous opportunities in the international markets.

Last but not least, I'd like to provide an update on our ESG performance. At FinVolution, upholding our long-term commitments and responsibilities to our industry, the environment and society is at the heart of our core values across our operations. We continued to make strides in improving our ESG management practices and advancing our ESG initiatives during the quarter. Our recently distributed fourth annual ESG report, highlights our ESG policies and accomplishments in 2021. And our membership into the United Nations Global Compact reflects our ongoing endeavors.

Furthermore, as part of our ongoing efforts in enhancing our data privacy and information security framework, we have obtained the ISO 27001 dual certification of information security management system issued by DNV, a well-known international standard certification organization. We will continue to reinforce our ESG engagement on multiple levels while leveraging FinVolution's innovative technology and differentiators in ways that improve and sustain communities for generations to come.

In summary, our robust performance in the second quarter of 2022 is another powerful testament to our dynamic business model, technological know-how, and the dedicated efforts of our incredible team. Entering into the second half of 2022, we remain focused on refining our risk assessment and management framework, advancing our cutting-edge technologies, engaging better-quality borrowers and optimizing our product mix.

Looking ahead, we remain confident in our resilience and our ability to skillfully navigate evolving market dynamics in a rapidly changing operating environment, while capturing new opportunities in a more sustainable manner.

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

Jiayuan Xu: Thank you, Feng, and hello, everyone. Welcome to our second quarter 2022 earnings call. In the interest of time, I will not go through all of the financial line items on this call. Please refer to our earnings release for further details.

As Feng mentioned, we are encouraged that despite multiple challenges in the second quarter, we still achieved transaction volume growth for the 9th consecutive quarter while maintaining our risk metrics at a relatively stable level.

With our transition towards better-quality borrowers, coupled with strengthened relationships with funding partners and consistent technological enhancement, the loan approval rates from our funding partners rose to around 80% in June compared with 65% in the same period last year. We have cumulatively cooperated with around 70 licensed financial institutions, and will continue to foster a strong and robust pipeline of potential partners. As the percentage of our better-quality borrowers continues to increase, we expect our funding cost to reflect ongoing improvement during the next several quarters.

Driven by our consistent efforts in research and development, we have continuously enhanced our chain of technologies throughout our operations, including customer acquisition, fraud detection, credit risk assessment, and customer services, among others. Consistent improvements in numerous operational metrics across multiple market cycles clearly illustrate the effectiveness of our tech refinements.

Bolstered by these strengths, our net revenues for the second quarter rose to RMB2.7 billion, an increase of 12% year-over-year. Even more encouragingly, we also delivered a strong non-GAAP operating profit of RMB682 million and maintained a substantial balance sheet with RMB11.4 billion in total shareholders' equity as of June 30, 2022.

During the second quarter, our average borrowing cost was 24.2%, compared with 26.2% in the same period last year. Of particular note, all loans originated for our new borrowers were under IRR 24%, reflecting our ongoing commitment to financial inclusion and our growing ability to align with regulatory directives.

We maintained our take rate for the quarter at a stable pace of 3.8%. Together with our partners' support and our constant efforts in optimizing funding cost, we are confident that we can continue to deliver solid results going forward.

With the proportion of our capital-light model stabilizing at around 17%, our leverage ratio, which is defined as risk-bearing loan balance divided by shareholders' equity, remained stable at 4.1x.

Our unrestricted cash and short-term liquidity position further increased to RMB5.2 billion from RMB4.9 billion in the same period last year, representing an increase of 6% year-over-year, further demonstrating the robustness of our balance sheet.

During the second quarter, we continued with our strategy of acquiring better-quality borrowers both in the domestic and international markets with attractive borrowing rates. With the proportion of better-quality borrowers increasing both domestically and internationally, our operational metrics have shown improvement on multiple fronts.

Going forward, we are confident in maintaining our growth momentum while keeping our risk performance at a stable level.

Between January 2022 and July 2022, we deployed around USD27 million to buy back our shares in the public market. Since we initiated our share repurchase program in 2018, we have cumulatively deployed USD158 million to buyback our shares on the public market, reflecting the Company's commitment to returning value to shareholders on a long-term basis. Our board of directors has also approved an addition of USD80 million to our existing shares repurchase program, expanding the program to USD140 million.

We believe that the increase in our share repurchase program is an efficient use of our existing capital, and demonstrates our strong commitment to providing greater support for our shareholders amid such a challenging macro environment.

Before I conclude my remarks, let me provide some additional color on our business outlook for the second half of 2022. With uncertainties in the evolvement of the Covid-19 situation, we remain cautiously optimistic that our business operations will continue to gain momentum both domestically and internationally due to our in-depth experience in the consumer finance industry, our sophisticated technology expertise and our strong relationships with our partners.

We are also well prepared to capture both existing and new opportunities in the markets in which we operate. As a result, we now expect our total transaction volume in the third quarter to be in the range of RMB44 billion to RMB45 billion, representing an increase of between 16% to 18% year-over-year.

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). Frank Zheng of Credit Suisse.

Frank Zheng: (Speaking foreign language). This is Frank Zheng from Credit Suisse. Congratulations on a good set of results despite the headwinds. So I have two questions, the first one is on loan volume. How does the company view volume growth in the second half? Based on the current guidance for the first 3 quarters, volume is expected to reach around RMB125 billion to RMB126 billion. So is the progress to deliver the full year guidance of RMB175 billion to RMB180 billion still on track?

And the second question is more specifically on international markets. How does the company view the contribution from international markets to volume and take rate? And what is the company's outlook for international markets?

Feng Zhang: (Speaking foreign language).

Jimmy Tan: Okay. Hi, Frank. Let me do the translation for Alexis. First of all, we still maintain our full year guidance of 175 billion to 180 billion. However, there are still uncertainties because the Covid outbreak is still happening in many different cities, and therefore, we will still adopt the prudent approach. We have accumulated experience and technologies and refinements during this period, and therefore, we are still able to maintain a healthy and progressive growth in spite of the very challenging macro environment.

Our international business began transition to superior quality since the second half of 2021. You can already see that we have already stated we have completed the transition, for example, in the second quarter, although our transaction volume growth is only 6%. But our outstanding loan balance has increased by 33% quarter-on-quarter, and our proportion of installment loans has also further increased to 85% from 55% in the previous quarter and from only 20% in the same period last year. And with a larger number of superior-quality borrowers in Indonesia, the proportion of loans funded by local institutional partners increased to 39% compared to 14% in the previous quarter.

Our international business transaction progress has been better-than-expected. And in the third quarter, we expect transaction volume to be around 1.1 billion, up 20% quarter-over-quarter and outstanding loan balance to increase around 40%. As our international business has completed its transition to better-quality borrowers, we believe we will enter into a growth stage.

Frank Zheng: (Speaking foreign language). Many thanks.

Operator: Yada Li of CICC.

Yada Li: (Speaking foreign language). The first one is by the end of 2Q 2022, what are the average prices of our loan products in both our existing assets and the new originations, respectively? And what is the proportion of high interest-rate assets in the total outstanding balance of our loans? And looking forward, when can we expect to see the end point of the pricing adjustment and to see a relatively stable take rate? This is the first one.

And the second one is what is the trend of our risk indicators such as 90-day delinquency and some leading indicators? And regarding the asset quality pressure, have we seen the peak already? And as for the underlying reasons for improving the asset quality, is it because of our active change in the customer acquisition, operation and risk control, or can we just view it as a natural response to the improvement of our macro economy and the recovery from the Covid-19?

Feng Zhang: (Speaking foreign language).

Jimmy Tan: (Speaking foreign language). Hi, Yada, let me do the translation for this question. From the outstanding loan balance and transaction volume perspective, we believe it is similar because of our loan tenure is relatively short at about 8-plus months.

And let me just remind you that in the fourth quarter last year, around 80% of our loans are already under IRR 24%. And in the second quarter of 2022, our average loan pricing is around 24.2% in terms of transaction volume. And also all loans are originated for our new borrowers are already under 24%. And we believe we are ready and have completed the pricing adjustment process. Our business model is healthy, and we still expect growth to continue.

Feng Zhang: (Speaking foreign language).

Jimmy Tan: Sorry, let me just finish the translation. And we believe that there is more room for us to continue with our transaction to better-quality borrowers with further improvement in funding and also in our risk improvement. We estimate the average pricing in the third quarter will be around IRR 23.5% and we maintain a take rate of around 3.7%.

Feng Zhang: Let me quickly add one just to be more specific to the question about when do we expect the price adjustment to be done, and when do we expect the take rate to be stabilized? So in fact that we believe the regulatory environment for pricing regulation, we don't expect major changes in the foreseeable future. And given our pricing is around 24%, we believe the price adjustment work is mostly done.

Now, as we continue to move upscale in our customer quality, we do expect the price to very gradually drop as the customers' quality improve because the better customers enjoy a lower price, but it's going to be very gradual and coupled with the reduced funding and improved risk efficiency. So overall, we believe our take rate going forward will be stabilized at the current level, around 3.7%, as Alexis just mentioned.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Okay. Let me just do the translation. Let us just recap some of the risk metrics. Our Q2 vintage is expected to be around 2.4%, and our loan collection rate from 1 to 30 days further improved to 91% from 90%. And our delinquency rate peaked in April and May, and it has since returned to 2.3%. You can see that there are some fluctuations during the Covid period. However, the fluctuation for us is very small, as it only increased by 0.1%.

And we believe that for us, our company is based in Shanghai and the impact for us is larger than a lot of companies because the vast majority of our core management and employees are headquartered in Shanghai, and we have been locked down for 3.5 months during the Shanghai lockdown period.

Give me a moment, please, and I will do the translation. Okay. The reason can be that our determination in our transition to better-quality borrowers since 2 years ago. And also, our ability has been growing in our change of technologies from customer acquisition to fraud detection to allocation of funding, etc. I would like to highlight two of our notable technologies. For our customer acquisitions, we have the Octopus smart acquisition platform. Under the traditional account management, 1 person can only handle up to 3 accounts. But our Octopus Platform enables 1 person to handle over 30-plus accounts, and this increased our efficiency a lot. And when setting up advertisements under the traditional method, you will need around 3 hours to set up 100 advertisements. However, with the Octopus Platform, we only need about 5 minutes to set up 100 advertisements, and we can save a lot of time.

And another technology that we are using is the fraud detection is the Ming Mirror fraud detection system. This system is able to leverage our knowledge graphs, utilize complex network computing, machine learning and over 2,000 models and better with billions of relational data. We are able to uncover up to 65% of intermediary fraud during the application process. All these technologies enable us to encounter challenges, external challenges and uncertainties during the Covid situation.

Yada Li: (Speaking foreign language).

Operator: Alex Ye of UBS.

Alex Ye: (Speaking foreign language). So to translate for my question, the first one is on the funding cost outlook. Could you share with us how much more room to expect for it to improve for the rest of this year?

And second question is on your asset quality. Could you also give us an update on the latest trend on your day 1 delinquency in, say, July and August? And also, are there any material differences between your SME customers versus your overall portfolio?

And thirdly, on the consumer credit demand, the macro data has been weak. And from your perspective, have you seen the application volume declining materially from same period last year? And how has been the latest recovery trend?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: (Speaking foreign language). Okay. Alex, let me do the translation for the first question. In the second quarter versus the first quarter, our funding costs lowered by 31 bps on a sequential basis. During the Covid period, our partners will be very concerned about the risk metrics fluctuation, but we give them confidence with our stable risk performance. And in the third quarter, we expect further improvement in our funding costs of between 20 to 30 bps improvement in funding costs.

Let me do the translation for question number two as well. Our day 1 delinquency rate is around 5.5% in the second quarter, and we have seen improvements since then. And in the second quarter, we serve over 500,000 small business owners with over 10 billion in transaction volume. And before the pandemic, the credit performance of our small business owners is around 10% better than our retail borrowers. And during the lockdown period, we have seen the risk metrics of small business owners is slightly higher than the retail borrowers.

And in the second quarter, we have also observed that the risk level for small business owners have returned to similar levels with the retail borrowers. And going forward, we expect the risk metrics for small business owners to fall below retail borrowers.

Alex, let me do the translation for the last question as well. Regarding the customer demand, the data from the overall consumer data is rather complicated. It will be affected by various factors; for example, the macro environment impact affecting consumer confidence, the stimulus policy impact on liquidity and the post-pandemic recovery impact on consumption. If you take into consideration of all these factors, the overall consumer consumption has been rather stable with limited fluctuation within 1% to 2%. Our data can also prove that the loan application demand has been relatively stable in the second and third quarter.

Alex Ye: Thank you.

Operator: Thomas Chong of Jefferies.

Thomas Chong: (Speaking foreign language). My first question is about our competition, given the pricing is trending to 24%. And going forward, how should we think about our competition with our peers and traditional banks?

And my second question is about the international business. How should we think about the areas that we can replicate from domestic to international? And are we seeing any differences in the behavior between the borrowers in these two areas?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: (Speaking foreign language). Thomas, let me do the translation for you. Okay. We can view competition from a few different perspectives. Number one, China market is large and still growing; and number two, compared with the traditional financial institutions, we are still not in the same segment as them, as their pricing is much lower. If you think about this, there are 7,000 traditional financial institutions.

And number three, the players in this market have been reducing a lot. And in finance market, it is very different from the international segment because it is not a winner-take-all situation. And we feel that competition is still relatively okay, and we are still very confident of the future growth.

Feng Zhang: Hi, Thomas, this is Feng, let me take the second question. So with regard to our expansion internationally, I think there are a lot of things we can and we are leveraging from our domestic experience. I think the most important thing is please remember that we have 15 years' operational experience in the China market.

So if we think about the international market and we are mostly in the developing countries, and particularly in Southeast Asian region in terms of fintech developing stage, probably somewhere around 5 to 15 years ago, if you compare to China, around that period, I think there are many aspects. But I would say like Indonesia is probably around kind of like similar to 2014, 2015 period of domestic China. I think the credit infrastructure is still undergoing pretty rapid improvement and the market is growing very fast. And I think for another country we're operating in, in the Philippines, it is probably like in a few years behind Indonesia.

So I think the experience we have accumulated these years are very, very valid and valuable for our expansion for our development in the Southeast Asia market, and additional future in other developing countries. I think it is on systems, on knowhows and on talents, right? So we have a very experienced team. For example, one of the things that I think is particularly relevant, if we are thinking about building a valuable and sustainable business in Southeast Asian region, is our experience in transitioning or transforming our business from a high-pricing population strategy to a very healthy low-pricing and high-quality consumer base strategy.

Current state with infrastructure situation, credit infrastructure situation, in South Asian market, inclusive of finance, the pricing is higher than what the domestic China market has, which is normal, I think match the developing stage of those markets. But as we move forward, we're going to see price drop both from the regulatory requirement perspective and from the economic development and the market competition perspective. And that journey we went through in China, and our team has tons of experience in that.

And that kind of explained why we managed the transition in our Indonesian market for the last 1 year period when we moved upscale, pretty good speed that Alexis has just mentioned. So I think those experiences are very valid and makes us feel very confident, coupled with if we think about, hey, in China like 2014 and 2015, we are very optimistic about the growth prospects in those markets. And we think our experience is going to help us become a leading player in those markets. Thanks.

Thomas Chong: Thank you.

Operator: This concludes our question-and-answer session. I'd like to turn the call back over to the company for closing remarks.

Jimmy Tan: Hello, everyone. Thank you for joining FinVolution second quarter earnings conference call. If you have any further questions, feel free to reach out to our Investor Relations team. Have a nice day.

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