[PPDF] - PPDAI Group Inc.
Second 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
John Cai; Morgan Stanley
Daphne Poon; Citi
Alex Ye; UBS
Sanjay Sakhrani; KBW
Tian Hou; T.H. Capital

Presentation

Operator: Hello, ladies and gentlemen. Thank you for participating in the Second Quarter 2019 Earnings Conference Call for PPDAI Group, also known as Paipaidai. (Operator Instructions) After management's prepared remarks, there will be a question-and-answer session.

Today's conference is being recorded.

I would now like to turn the conference over to your host, Mr. Jimmy Tan, Investor Relations Director for the company. Jimmy, please go ahead.

Jimmy Tan: Hello, everyone, and welcome to Paipaidai's Second 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 distribution list 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 call will contain forward-looking statements 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 results may be materially different from the views expressed today. Further information regarding these and other risks and uncertainties is included in the company 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 post 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: Thank you, Jimmy. Hello, everyone, and thank you for joining our Second Quarter 2019 Earnings Conference Call today.

During the second quarter, we continued our focus on driving healthy results and maintaining robust and above-standard regulatory compliance. Our solid growth momentum amidst a dynamic and volatile market environment reflects the constant demand for technology-driven consumer finance services in China.

We are particularly pleased with the following metrics for the quarter. Firstly, our institutional funding base showed a continuous progression translating into a 29% year-over-year and 13% quarter-over-quarter increase, in our total loan origination volume which reached RMB 21.6 billion.

Secondly, our operating revenue achieved a 47% year-over-year and 7% quarter-over-quarter increase.

And thirdly, our dedicated efforts to grow both our user and borrower bases continue to show encouraging results as the number of registered users exceeded 99 million, and the number of cumulative borrowers exceeded 16.5 million at the end of June.

Investment in technology and artificial intelligence is at the heart of PPDAI. By leveraging our technologies as a service offerings, we are enabling our institutional partners in consumer finance and creating deeper relationships with our partners. The rapid uptake and acceptance by external third-party financial service providers reaffirms PPDAI's presence as a leading consumer finance marketplace with strong technological capabilities.

We are also extending our technologies and our capabilities to overseas markets, and have started to operate in Indonesia and the Philippines this year, with plans to explore other Southeast Asian markets.

Looking ahead, we will remain committed to exhibiting our core strengths while placing a sharp focus on our business strategies. We expect PPDAI to continue to capture the enormous potential in the consumer finance market both domestically and abroad.

Now, I'd 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. We are thrilled by our second quarter performance that not only illustrates the sustained market demand but also our high resiliency as supported by a vibrant user base, diverse funding structure, and a strong technological capability. As Cliff mentioned, we remain confident in our ability to deepen the diversification in funding sources and expand our institutional funding partners, driving healthy growth in the long term.

As all of you are aware, the diversification of our funding has been a major strategic initiative for us over the past year. This funding transformation has been rapid. In the second quarter, 45% of our loan origination volume was funded by institutional partners, up significantly from 10% in the same period a year ago, and a further increase from 31% in the previous quarter. The proportion of institutional funding further increased to 53% in July.

We now have more than 20 institutional funding partners active on our platform. This has enabled us to deliver steady growth in loan volume quarter-by-quarter. And our loan volume in the second quarter is nearly 30% higher than a year ago.

The profitability of our loans funded by institutional partners is healthy. In the second quarter, 40% of our operating revenue came from loans funded by institutional partners, a significant increase from 24% in the first quarter.

Now turning to credit. Delinquency rates were generally stable in the second quarter and continue to perform within our expectations. If you look carefully at our vertical delinquency rates at the end of June, you will see that there have in fact been small improvements versus the previous quarter, and the delinquency rates are mostly back to the lowest levels since September 2017, thanks to our strong and effective risk management. We expect delinquencies to remain stable in the near term.

Turning to regulations. There continues to be uncertainty in regulations, specifically on P2P registration process. It is uncertain whether there will be a registration process, and, if so, when it will happen.

As most of you are aware, we have been adhering to the government's triple decline policy since the beginning of the year. This refers to the monthly reduction in the outstanding loan balance, the number of investors and the number of borrowers for the part of our business that is funded by individual P2P investors.

In the coming months, we plan to step up our implementation of the government's triple decline policy, and we expect the loan origination volume funded by individual P2P investors to decline more significantly than in the first half of the year. We will continue to accelerate our strategy to expand our funding from institutional sources.

The momentum and outlook are strong. Credit commitments from our institutional partners totaling over RMB 45 billion. In the first half of 2019, RMB 15.6 billion of loan originations were funded by institutions, and in the second half of 2019, we expect loan originations funded by those partners to be in the range of RMB 32 billion to RMB 38 billion, implying at least double that in the second half of the year versus the first half.

Despite the expected decline in P2P-funded loan originations, we still expect our total loan volume in the third quarter to be in the range of RMB 22 billion to RMB 24 billion, representing moderate quarter-over-quarter growth. And we expect roughly 70% of such loan originations to be funded by institutional partners.

We believe there continue to be a certain degree of fluidity and uncertainty in the regulatory environment, so it is hard to say how much more decline there will be with any great certainty. I want to emphasize that P2P funding from individuals is becoming less and less important as we continue to accelerate our strategy to diversify our funding sources. We are confident in our ability to achieve this target given our proven technologies and end-to-end capabilities to support financial institutions from customer acquisition, risk assessment, to loan servicing and collections, our scale and experience with 99 million registered users, over 16 million cumulative borrowers, and the 12 years that we have been in this business, and our strong management team and ability to execute.

Looking forward, consumer finance in China remains a large and under-penetrated market. The market demand is huge, and we are confident in capturing the potential of this vast market.

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 to have achieved solid operational and financial results in the second quarter as lending volume steadily increased, underscoring the strength of our markets and the growth trajectory of our business.

In particular, our operating efficiency and profitability continues strong momentum highlighted by a 60% year-over-year increase in non-GAAP adjusted operating income and a healthy non-GAAP operating margin of 50%, thanks to our effective cost control.

Our balance sheet remains solid with approximately RMB 2.4 billion of cash and short-term liquidity. Notably, our quality assurance fund remains sufficient with a total balance of RMB 5.8 billion, equivalent to 22.5% of the total outstanding loan principal and interest with quality assurance.

Our results demonstrate the strength and resilience of our business model and our ability to navigate changing market dynamics.

Now let me briefly go over the financial results for the second 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 second quarter of 2019, increased by 47% to approximately RMB 1.6 billion from RMB 1.1 billion 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 25% to RMB 940 million for the second quarter of 2019, from RMB 753 million in the same period of 2018, primarily due to the increase in loan origination volume. Loan facilitation service fees from loans funded by institutional funding partners were RMB 378 million in the second quarter of 2019.

Post-facilitation service fees increased by 53% to RMB 316 million for the second quarter of 2019, from RMB 206 million in the same period of 2018, primarily due to the increase in loan origination volume and the rolling impact of deferred transaction fees. Post-facilitation service fees from loans funded by institutional funding partners were RMB 55 million in the second quarter of 2019.

Net interest income and loan provision losses were an income of RMB 195 million, compared to an income of RMB 18 million 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 RMB 779 million for the second quarter of 2019, representing an increase of 60% from RMB 487 million in the same period of 2018.

Other income was RMB 46 million for the second quarter of 2019, compared with RMB 297 million in the same period of 2018, primarily due to the decrease in the gain in quality assurance and returns from short-term investments.

Income tax expenses were RMB 153 million for the second quarter of 2019, compared with RMB 158 million in the same period of 2018.

Net profit increased by 8.7% to RMB 661 million for the second quarter of 2019, from RMB 608 million in the same period of 2018.

Before I hand the call over to Q&A, I'd like to conclude by emphasizing a few points regarding our funding transition. We expect institutional loan volumes to at least double in the second half of the year versus the first half, and the revenue margin of loans funded by institutional partners is only slightly lower, as shown by the fact that revenue contribution from institutional funding is 40% of total revenues, a slightly lower proportion versus the loan volume contribution from institutional funding of 45% in the second quarter. Finally, over the past year, despite the changes and challenges to the industry, we have continued to deliver consistent performance.

So in conclusion, we are confident in our ability to navigate this transition and changes in the industry. And the long-term opportunity in China's consumer finance market is huge. Our core capabilities position us well to enjoy the benefits of this vast opportunity.

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) And the first question today comes from John Cai with Morgan Stanley. Please go ahead.

John Cai: Good evening management. Thank you for taking my questions. I have three questions. So the first one is about the mix of institution and retail funding, so can you disclose it by balance? How many balance, outstanding balance funded by institution versus retail? And in terms of balance, what kind of the expected loan balance funded by P2P towards the end of the year? And related to that, it's on the economics of institution and the retail funding, it seems the take rate is similar because of the portion from institutional funding in terms of loan volume and the revenue contribution seems similar. So my understanding is that the products are quite different. So maybe can you provide more colors on the economics?

And the second question is about customer acquisition. I notice that origination servicing expense and sales and marketing pickup on a sequential basis. Can management share more about the customer acquisition efforts and the cause?

And the final question is about some trends. So I notice that customer acquisition picked up, but the repeat ratio, the repeat borrowing ratio has also picked up and the average ticket size decline sequentially. And also the tenor also decline. So just wonder, my understanding is that if we lend more to the new borrowers potentially, that the ticket size and tenor might decline. But it seems the repeat ratio is just telling the other story. I just wonder if there's any underlying reasons behind that. Thank you very much.

Simon Ho: Sure. John, let me try to attack some of those, address some of those questions.

In terms of the loan balance, our institutional loan balance at the end of the June quarter was roughly around RMB 12 billion. This is up about maybe 70% on a quarter-on-quarter basis. And our P2P balance in June, was close to about just under RMB 20 billion, okay. That just gives you an idea.

We haven't quite extrapolated all that until the end of the year. But I think you're pretty good at your math, so you might be able to do some very well-educated guesses given the volume guidance we've just provided.

Now, in terms of your questions about obviously, I'm going to jump around to customer acquisition costs. The customer acquisition cost in the second quarter, you're right, did increase somewhat. On average, it was about RMB 190 per new borrower in the second quarter. This increased versus the first quarter was due mainly to the shift in the borrower mix towards the higher credit quality segment, which we've flagged before, and this is in line with the strategy and our focus. And this segment has somewhat higher acquisition costs. But overall, at about RMB 190, this is still a relatively low level compared to our peers. Going forward, we do expect customer acquisition cost to somewhat increase as our borrower base continues to shift towards this higher credit quality segment.

You did mention about our ticket size and our loan tenor. Our ticket size declined a little bit in the quarter on average, mainly because the proportion of repeat loans went up in the quarter, as you highlighted. And the ticket sizes for repeat loan tend to be a bit smaller than first-time loans. Some of these, as you know, maybe just top-up loans utilizing unused credit limits. So there is a bit of an influence there.

The loan tenor shortened very slightly during the quarter. And from what I can see, where I can see it, it's mainly because some institutional partners that we were servicing preferred a bit shorter tenor. So, but there's really no change in our strategy in either of these areas.

Now with regards to your second question, John, you mentioned about take rates, economics, institutional retail being not too different. What specifically did you want to know more about?

John Cai: Yes. So probably just can you give us some the waterfall for the units economics quarter, the gross customers pay in deduct by a funding cost and probably some estimated credit cost, so sort of the --

Simon Ho: For?

John Cai: The product difference, yes.

Simon Ho: I think let me put it this way, John. I mean we could obviously go through a lot more details afterwards. I think if you compare the profitability of our institutional funding business versus sort of the P2P side, there are a few differences to take in mind first. One is, there is a bit of a borrower profile difference. The borrowers that are funded by institutional funds tend to be at the better credit quality end of our range of borrowers that we service. So the expansion in our institutional fund means we are extending into borrowers of better credit quality. And generally speaking, we do offer lower borrowing rates to the segment, but they also have lower delinquency rates.

In terms of profitability, as we've mentioned before, there is obviously some small difference, but not hugely different from our overall profitability. And you can see this, obviously, by comparing those ratios I've given on contribution of loan volume versus revenues. And I think overall, if you look at our institutional funded business, I would say that we would think that the overall profitability of the segment will be quite similar to other online lending platforms that are currently funded mainly by institutions. And I think the ROAs that we generate from this part will be pretty similar, I think, with other players in this space as well. So probably in the sort of 5% to 7%, mid- to higher single-digit level ROAs, which I think is very respectable and attractive level for a consumer finance business.

John Cai: Thank you. That's very helpful. So if I may follow up on institutional funding. Just want to know what would be any balance sheet impact? I understand the trust part, as in we need to consolidate that. What about other institutional funding? The trust is roughly at around RMB 5 billion. So I just wonder the rest, RMB 7 billion, whether we have any guaranteed liabilities that would need to take on the balance sheet of the institutional funding. Thank you.

Simon Ho: So you're referring to the treatment of the credit risk, right, for the institutional business? So no, the remainder of the non-trust part of our institutional funded loans do not sit on our balance sheet. Where we do give sort of credit, some sort of we call it credit assurance protection, it is accounted for in the same way as what we do for the quality assurance fund. It is under guarantee accounting. It's considered a guarantee liability on our balance sheet. And you'll see that together at the moment with the quality assurance fund payable and quality assurance fund receivable on our balance sheet.

John Cai: Thank you very much.

Simon Ho: OK. Thanks John.

Operator: Next question comes from Daphne Poon with Citi. Please go ahead.

Daphne Poon: Hi, thanks for taking my question. So I have a couple of questions on the institutional funding side. So first is about the mix of funding partners that you have. I would like to have an update like in terms of how many are from trusts versus how many are from maybe banks and the other comes from the finance companies.

And also, we noticed that the take rate for your institutional funded loans was up slightly quarter-over-quarter. So I wonder what will be the drivers behind. And maybe more specifically the institutional funding cost, what's the trend over the past quarter?

And lastly is that you mentioned earlier that you have about RMB 45 billion in terms of credit coming from the financial institutions. So does that mean that you can actually like fully replace your P2P funding with this institutional funding even in the worst case that there's no P2P registration at all? And I'm not sure like whether there will be any hurdle in permitting that. So that's my question. Thank you.

Simon Ho: Okay. Thanks, Daphne. In terms of the breakdown and the mix of institutional funding, currently the majority of our institutional funding comes from commercial banks and consumer finance companies, and we will continue to focus on working with banks and consumer finance companies. As we said, in total, we have over 20 institutional funding partners active with us. I would say roughly around half of those are commercial banks and consumer finance companies, okay.

The institutional funding cost trend, currently it's between around 10% to 11%. The demand that we see from institutions remains strong, and we do see room going forward for the lower funding costs from institutions, okay.

And the take rate for the institutional for the quarter-on-quarter, I don't know how you calculate. But I mean from where we're sitting, obviously, it's largely similar. It hasn't changed much on a quarter-on-quarter basis. So that might just be the way things are accounted for or you might be looking at the trusts as well, which there's a lag effect coming in.

With respect to the RMB 45 billion credit commitment, I think we're pretty confident in achieving what we've set out to achieve. And so far, the performance of institutional, the funding has been beating our expectations every quarter.

Feng Zhang: Yes. This is Feng. I will just add to the third question. The way we are looking at it, we would expect in the third quarter the volumes from institutional funding will be accounting for about 70% of our total loan origination volume. And this percentage will continue to increase fairly quickly toward the end of this year.

So yes, to your question, we're fairly confident even in a possible scenario that the registration of P2P doesn't happen, we think the impact to us is going to be fairly limited and manageable.

Simon Ho: Daphne, does that answer your questions?

Daphne Poon: Yes. Yes, that's very helpful. Thank you.

Operator: And next question comes from Alex Ye with UBS. Please go ahead.

Alex Ye: Hi management, thanks for taking my questions. My first question is about the P2P funding. In opening remark, you just mentioned that in the second half, the company is going to execute the triple decline more rigorously. And so I wonder what are the reasons for that? Is it due to the regulatory requirement? Or is it because we are proactively shrinking our P2P balance? And I wonder what's our future strategy on this?

And my second question is about the institutional funding part. So obviously we are looking at very strong growth in the second half with the doubling of the loan volume funded by institutions. So I wonder what's the underlying driver for that? How are we going to achieve that? So are we expecting more funding to connect with that, funding partners to connect with that? Or are we just need to ramp up our current credit line and that's enough take us there?

And finally, I wonder if you could give us some update on your latest pricing trend integration and any shift in your product strategy. Thanks.

Simon Ho: Sure, Alex. Thanks for your question. With regards to the triple decline, clearly this has been, as you've read and been aware, this has been the government's policy since the beginning of this year. Obviously, we do have an active regular communication with the regulators. And obviously, we believe that at the moment there is still a certain amount of uncertainty and fluidity as we've been emphasizing. But the right way to go is to continue and to more strictly implement this triple decline. But again, if there's anything significant to update, we will come back with that, right? This is what we know at the moment. But as Feng mentioned, P2P funding is becoming a less and less important part of our overall business and it will become pretty much a minor part by the end of this year.

Maybe I'll hand over the phone to talk about the institutional growth and the credit commitments and what drives our confidence and outlook.

Feng Zhang: Yes, sure. I think as we disclosed that right now at this point, we have about 20 active partners and the total line approved by these partners totaling RMB 45 billion. So that essentially means that is actually more than what we expect to issue loan, the volume that we need from institutional partners for the second half of the year. But I don't think we stop there. We have a very healthy pipeline for institutions, and we think we are going to continue to expand the base of our institutional partners and we'll continue to expand total credit extended to us by our institutions.

Simon Ho: Yes. And Alex, finally on your question about pricing and the take rate, as we guided on our previous call for the first quarter, we did say our take rate that we used to disclose, that's mainly applied to the P2P funded, retail funded part of the business. That take rate will return to more historical normal levels in the 6% to 7% range, as we focus more on borrowers with better credit quality and strength in our cooperation with institutional funding partners.

What we did in the second quarter, early in the second quarter, was we did lower borrowing costs where we thought they are deserved in order to meet the requirements for our institutional partners and also to obviously achieve our mission of wider financial inclusion. And as a result, this take rate in the second quarter did decline. It fell to 6.4% in the second quarter compared to 7.7% in the first quarter, because of these pricing changes and adjustments we implement into the second quarter.

But from here going forward, we expect this take rate to be relatively stable in the near term. So I hope this answers your question. Does it? Alex, is this okay?

Alex Ye: Yes. Thanks. I have no further questions.

Simon Ho: OK. Thank you.

Operator: And next question comes from Sanjay Sakhrani with KBW. Please go ahead.

Sanjay Sakhrani: Thanks. Just some follow-up questions. I guess on the institutional funding, that commitment that you have for RMB 45 billion, what's the duration of that commitment? And I guess are you guys thinking about sort of longer term funding sources outside of sort of the shorter term stuff that you've done thus far?

Simon Ho: Yes. Sanjay, I think typically if we look at the structure for institutional funding, they tend to be minimum of 12 months. They tend to be longer than 12-month-plus in tenor and duration. And given the ramp-up of our institutional funding, which we really started ramping up big way over the last 12 months, I think a lot of this, a lot of these commitments are pretty new commitments that have come onto the books in recent months. And obviously you've been tracking us for a while. This progression that we've seen in institutional funding I think has been accelerating on a quarterly basis.

In terms of longer term funding, it's clearly something that we love to have and we will continue to explore. Clearly there are certain limitations within the Chinese markets. Happy to sit down and walk through those with you in more detail. But suffice to say that if the options become available, we would definitely consider using them.

Sanjay Sakhrani: And as far as the QAF, sort of like how relevant is it going forward? I mean is that still being used for even the institutions? Or should we expect that to decline over time?

Simon Ho: The QAF, a large part of the QAF mainly services at the moment or relates to the retail P2P funded part of the business. So in fact, retail P2P part of the business declines, then, in relative terms that it'll also decline in the QAF. Amongst the institutional funding that we do, there is some QAF in there. So the buffer is not as large as what we have for retail P2P investors. So there is going to be a mixed effect that will play through, but largely it will continue to be relevant going forward.

Sanjay Sakhrani: Okay. I guess final question. We've heard obviously the economy is mixed around the world and in China. I mean, it's interesting that we're not really seeing that in your credit metrics. I mean is that partly because you're growing up market? Or is it that you're seeing relative strength within your portfolios generally speaking?

Simon Ho: No. I personally think it's partly the nature of the segment we service, our internal risk management ability. And if you look at our numbers, we haven't seen a huge impact coming through from the softening of the economy and all that. And I just want to highlight, if you look at our credit numbers, delinquency numbers, the context of this over the last 12 months, we've been through a lot of volatility in this industry from the pretty severe credit cycle we saw at the end of 2017. Early 2018, we had the closure of a significant number of P2P platforms over the past 12 months. Over 1,000 P2P platforms closed down. And we also had quite a bit of a liquidity squeeze in the last summer and periodically. So we've been through a lot. And I think it's also a testament of obviously our own ability at the same time.

Sanjay Sakhrani: Yes, absolutely. And I'm sorry, one final question. On the regulatory process, when do we know in finality your guess sort of which direction this will go? And has anyone else in the market gotten close or even is operating under any license or any purview on the peer-to-peer side?

Simon Ho: No. I don't think any platform has gotten any license or registration, as you suggested. And in terms of the timing, I think, again, it's not certain from where we sit and its fluid and we just have to keep in touch and we'll keep you updated.

Feng Zhang: I agree with Simon. This is Feng, Sanjay. I agree with Simon. We don't know for sure whether this will happen and, if so, when. But I think I want to reemphasize, as I mentioned, that we would expect that by end of this year, the proportion of the P2P funded loans, loan originations is going to be accounting for a very small percentage of our total loan origination. So by that point, I think whether this happen is not going to be that important to us.

Sanjay Sakhrani: I appreciate it. All right. Thank you.

Operator: (Operator Instructions) And the next question comes from Tian Hou with T.H. Capital. Please go ahead.

Tian Hou: Good evening management. The question's related to recent news. So the regulatory agencies asking P2P vendors to what that term is, you know the connection of various system to certain regulatorysystems , I – mean does your system has to be accessible by the government, something like that. So I wonder if PPDAI has already finished that. And the reason I ask for that, because in this government policy that they quote number like a 22 something, they say, if you are not bring your system to their system, so you may not be able to conduct P2P business. So it looks like really serious policy measurements. So that's where my question comes from, just wonder, what's the progress on that front?

Simon Ho: Okay. Tian, there's various systems that require for P2P platforms to connect into government systems to be compliant. And frankly, we comply with all of them. We are live and feeding data with all systems that are required by us. I can tell you that. And that is not a reason in our case for rejecting any of our applications, in our view. So we are committed to all those systems that you mentioned, yes.

Tian Hou: That's very helpful. Make me feel better. And also, the thing is that you just got a lot of institution money and institution funding. So I wonder what are those institutions? And so we saw some local banks like Baoshang Bank, Bank of Jinzhou, which ran into some problems. So I just wonder what kind of institution you are teaming up with today. And I just hope you guys not exposed to other people's risk. Thank you.

Simon Ho: Yes. Tian, I think that's a great question. Let me just address a few things. Of course for the consumer finance companies, clearly, they all belong to the nationwide consumer finance companies. And in trust space, we work with basically all the leading trust companies that are active in consumer finance assets. For the banks, we do work with a number of city commercial banks and I think the concern is around there. In terms of city commercial banks, we don't partner, work with any of the names that have been in the press lately with their issues.

And we do have criteria for selecting our bank partners. We look for those that have solid operating history, healthy financials, liquidity, capital adequacy. And at the end of the day, we do see still a lot of demand from this space, because there are you know still over, even in the city commercial banks, smaller regional banks there's 4,000, over 4,000 of these city and rural commercial banks in China. And our balance sheet isn't that large relative to these names. So I think there is still quite a lot of room for us to expand and service these players. These banks are also fairly well suited to working with us, because at the moment they don't have the sufficient capability to obviously to do consumer lending and, therefore, they most need our services and support.

Tian Hou: Okay. That's very helpful. Thank you.

Simon Ho: Thank you Tian.

Operator: And next question is a follow up from John Cai with Morgan Stanley. Please go ahead.

John Cai: Hi , thank you for taking my question once again. So this one ratio that I would like to follow up. In particular, it's related to the QAF protected loan balance. I think now we have a QAF fund that's equivalent to 22.5% of the loans. Just wonder how do we see these ratios going forward, because now I think it's a blended or weighted average of institution and retail? My understanding is that potentially there's room for this to decline because institution and overall we are looking for better quality customers.

And another question about customer acquisition or growth actually, because, so first of all, can you talk about the total customer acquisition cost is spent this quarter? I think there's some sales and marketing and origination and servicing.

And the second question is what is the total cost we should expect going forward? Because it seems the acquisition cost is reasonable, and then the risk is controllable and we have sufficient funding obviously. And it seems that we can spend more on customer acquisition to fuel growth going forward.

And I think the final question is about maybe plan B, because I think now we are moving to institutions and the other players I heard they are trying to get some online micro-loan license. Just wonder, other than the loan facilitation or through the heavier institution, are there any other plan we are working in preparation of the potential no registration scenario for P2P? Thank you very much.

Simon Ho: Yes. Okay, John. Thanks for your questions. I think that in terms of the Quality Assurance Fund, the coverage ratio 22.5%, yes I do think the future trend will be lower and exactly for the reasons as you mentioned, because of the mix effects, the fact that we're shifting towards a somewhat different segment of borrowers. But also to bear in mind that the buffer, the Quality Assurance Fund buffer that we've had, that we do have between individual P2P funding versus institutional funding is a bit different. The P2P funding historically has been very, very strongly over reserved, as you understand, right? And that's how we ended up achieving over 20% coverage ratio, which is pretty big. Now, so they'll come down. But I think we continue to maintain fairly prudent and conservative view on our quality assurance buffer and funds.

And then with regards to our customer acquisition cost, yes, you're right. The majority of our sales and marketing expenses, I think like maybe 80%, 90% of that is customer acquisition-related. And there's also some that are sitting in origination and servicing. And I recall from memory that maybe about 20% or so of the origination and servicing relates to, again, customer acquisition. So I think that'll help you just get a sense of the total amount that we're spending. I think the total amount we're spending would be similar in aggregate number to maybe the sales and marketing expenses we reported.

And that as we build this business out, obviously, we will need to spend more. But still I think the long term and lifetime value of the customers that we are getting and acquiring is still very, very profitable. As we mentioned earlier on the call about the profitability expectations for the institutional funded business.

And finally, in terms of the micro-lending licenses and other licenses, I think we already have an Internet micro-lending company ourself. But obviously, if we are offered the opportunity for another one, we would definitely certainly consider. So this is definitely one option down the road that we think will present itself, yes. But generally we will keep an open mind and we will consider.

John Cai: Yes. Thank you. So the total customer acquisition cost, how do we see that in the second half of this year? Any chance that it might go up significantly because we want to grow faster? Thank you.

Simon Ho: I think it depends on obviously the overall growth. I think we are slowing down on the P2P side. We've guided toward positive loan origination growth in the third quarter. But it's still obviously within moderate bounds. And likely similar situation possibly in the fourth quarter as well. So we're not, at the moment, growing by 100% at that rate. So I don't think you need to overly worry about that. And we'll try to keep good control over our overall costs.

John Cai: Yes. I mean I'm actually thinking that if the environment and the acquisition efficiency is okay, it's probably okay to spend more. But yes, it's up to the company. So thank you again for taking my six or seven questions in total. Thank you very much.

Simon Ho: Thank you, John, for your interest.

Operator: And next question is follow up from Alex Ye with UBS. Please go ahead.

Alex Ye: Hi Simon. I just had two quick questions. So first is, so we have 20 funding partners active for now and half of them are banks or consumer finance company, and we have RMB 45 billion of credit line. So I just wonder if we can have a comparative number in the last quarter, so for us to just have a sense of how much progress we have made in just the past quarter?

And my second question is on the loan volume of about RMB 21 billion in Q2. So could you give us a breakdown of that in terms of the accounting treatment by on and off balance sheet? Thanks.

Simon Ho: So I think for the last quarter we were probably looking at about, I think it was like 10 to 15-ish institutional funding partners. I might have to confirm that last quarter 10 to 15, I think it was around there. We're now over 20. We're not at 20. We're over 20, by the way. I don't recall what the credit line is for last quarter. Again, you're stretching me out. But I think I think the growth is pretty fast. It has been pretty fast during the quarter, right?

If you look at the loan balance, the outstanding balance of institutional funding basically on a quarterly basis, we're growing at like close to 100% a quarter. So if you think about that type of rate, then it'll be quite different, three months ago, three months after.

And Alex, what is your, sorry, your last final part of the question? It slipped my mind. Sorry. Can you repeat that? Alex?

Alex Ye: Yes. So of the RMB 21.6 billion of loan volume in the second quarter, right, so we have 45% of that from institutions. So I just wonder if you could give us a breakdown of that further into how much of that go to the on balance sheet and how much go to the off balance sheet? Thanks.

Simon Ho: The only part of the institutional funding that goes on balance sheet is the trust component. And in the second quarter, that component was, roughly speaking, about maybe 30-odd percent, 30 percent-ish, around there. The rest is off balance sheet. It's not on our balance sheet, yes.

Alex Ye: So just to confirm, is it 30% on balance sheet, right?

Simon Ho: Yes. Yes. Yes.

Alex Ye: Okay. Thanks.

Operator: And this will conclude our question-and-answer session. I'd like to turn the conference 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 Paipaidai Investor Relations through the contact information provided on our website or in our press release.

Operator: This concludes today's conference. You may now disconnect your lines at this time, and have a great day.