

[FINV] - FinVolution Group
Q3 2022 Earnings Conference Call
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Officers

Feng Zhang, CEO
Jiayuan Xu, CFO
Jimmy Tan, Head, IR

Analysts

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

Presentation

Operator: Hello, ladies and gentlemen. Thank you for participating in the Third Quarter 2022 Earnings Conference Call for FinVolution Group. (Operator Instructions). After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded.

I'll now turn the call over to your host, Jimmy Tan, Head of Investor Relations for the company. Jimmy, please go ahead.

Jimmy Tan: Thank you, Anthony. Hello, everyone, and welcome to our third 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 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. With China's macro environment rebounding gradually from the low points of the second quarter, our domestic operation is also demonstrating progressive improvements. Powered by our proven strong track record and strategic execution, our industry-leading technological capabilities and our diversified borrowers across China, our business remained resilient. We continued to deliver solid financial and operational performance despite rolling lockdowns affecting multiple cities in China.

Although we are experiencing pockets of improvements in terms of both pandemic restrictions and the macro environment, our operations in the third quarter remain challenging. We continue to adeptly navigate these challenges by leveraging our advanced technological capabilities, as well as our experienced management team of seasoned leaders who have successfully traversed multiple credit cycles during our 16 years of operations.

Our total transaction volume in the third quarter reached RMB45.5 billion, representing sequential growth of 10% and year-over-year growth of 19%. Concurrently, our total outstanding loan balance reached RMB60 billion, representing an increase of 7% sequentially and 34% year-over-year.

With the completion of our business transition, our proportion of category A&B borrowers in the domestic market, who meet our highest credit standards, further expanded to 75% of our total borrowers in the third quarter compared to 58% in the same period last year.

We are also pleased to share that we have completed our pricing transition, and the current average borrowing rate for our loans is around 23%, reflecting our commitment to promoting financial inclusion, as well as our increased compliance level and alignment with the regulatory directives.

Technological innovation remains the cornerstone of our operations, empowering us to achieve consistent performance during challenging periods. Ongoing adjustments have been made to our credit risk assessment models adapting to the Covid lockdown

environment, which enabled steady and progressive growth, while our risk performance has barely fluctuated, even during the Shanghai lockdown.

These solid operational results are mainly due to our sophisticated cutting-edge technologies such as Magic Cube, our all-in-one fund management platform, which supports a wide variety of protocols and effectively matches institutional funds with borrowers in real-time. It can operate up to 55 fund management projects simultaneously, with a daily processing capacity of over 50,000 cases.

Bolstered by a prudent and effective risk management framework, coupled with reliable credit risk assessment models and fraud detection systems, we have improved our risk metrics on multiple fronts. Our day 1 delinquency metric was 5.5% in early November, while delinquency rates below 90 days as of September showed further improvement to 1.34% from 1.44% in the previous quarter. As the impact of rolling lockdowns becomes more manageable, we expect our vintage delinquency rate for the third quarter to remain stable at around 2.3%. Encouragingly, our loan collection recovery rate also remained stable and strong at above 90%.

Separately, we continued to take a prudent approach towards supporting small business owners. In the third quarter, we served a total of 504,000 small business owners and facilitated RMB11.3 billion of loans for this segment, representing 25% of total transaction volume, an increase of 43% from the same period last year. Our small business owners are spread across various Chinese cities in different industries such as retail, wholesale and light manufacturing, among others, which further reduces our related risk through geographic and sector diversification.

We would also like to highlight that around 60% of our small business owners have been in operation for more than 3 years, illustrating their overall stability. We will continue to monitor the economic recovery, and gradually adjust our strategy to keep up with the pace of small business recovery.

Moving on to our international expansion, we are very excited to report that with improvements across multiple operational fronts, revenue contribution from this segment reached 12% of total revenue in the third quarter, marking the first time our overseas revenue contribution exceeded double-digits. We also refined our international branding strategy, producing stellar results across numerous operational metrics such as number of downloads, number of new registration and conversion rates. These achievements earned our Adakami application a spot on Apple Search Ads' Success Stories page, a notable commendation of our strategy's effectiveness in reaching new audiences.

With stronger branding in the local market, our transition to better-quality borrowers in Indonesia has outpaced our expectations, with the proportion of better-quality borrowers in the third quarter expanding to 68% from 62% in the previous quarter. Coupled with Indonesia's improving macro environment and an easing Covid-19 policy, this brought transaction volume in international markets to RMB1.1 billion, representing a sequential increase of 22% and a year-over-year increase of 6%.

The ongoing transition to better-quality borrowers also helped us deepen our relationship with local funding partners, evidenced by an expansion in the proportion of loans they facilitated to 48% in the third quarter, compared to 39% in the previous quarter, and in sharp contrast to zero local funding in the same period last year. Looking ahead, we are confident in our ability to further increase the proportion of loans funded by local financial institutions as we secure more local funding partners with a larger number of better-quality borrowers.

Even more excitingly, our international outstanding loan balance reached RMB640 million, representing a sequential increase of 33% and a year-over-year increase of 88%. Our outstanding performance in the Indonesian market clearly demonstrates that we can leverage our technologies and business models in the overseas markets. Going forward, we are confident that the revenue contribution from international markets will continue to increase, and that we can replicate these achievements in the Philippines and other suitable countries.

Last but not least, I'd like to provide an update on our ESG performance. We continued to make strides in advancing our ESG initiatives and doing our part for the environment this quarter. Notably, we obtained the ISO 14064 verification from SGS, a well-known international standard certification organization. ISO 14064 provides industry and government with a set of tools to develop programs aimed at reducing greenhouse gas emissions. This verification is a powerful global acknowledgment of our environmentally-sustainable efforts in pursuing carbon footprint reduction, and will ensure that our reporting is respected internationally.

In summary, our stellar results in the third quarter of 2022 speak to our resilient business model, state-of-the-art technologies and extensive operating experience and resources. Looking ahead, we will continue to focus on acquiring better-quality customers, refining our credit risk profile and management framework, while pursuing premium quality growth opportunities in China and abroad. Taken together, we believe that these efforts will position us to smoothly navigate the rapidly-evolving market while delivering sustainable growth and creating greater value for our customers, shareholders and all stakeholders.

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 third 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, despite multiple operational challenges in the third quarter, we are encouraged that our quarterly results were in line with our expectations, including quarterly transaction volume, improvement in risk metrics, and strengthen gains in our international business, among others.

With a larger number of higher-quality borrowers, coupled with our successful pricing transition and advanced technologies, our funding partners are more willing to offer us attractive interest rates, evidenced by our funding cost improvement to 7.1% in the third quarter from 7.5% in the previous quarter.

In addition, the cumulative number of our institutional partners expanded to over 70 with a robust pipeline of potential partners in place. Going forward, we plan to diversify our funding channels through ABS and secure a wider range of financial institutions to further optimize our funding cost.

Driven by our relentless efforts to optimize our operations, effective execution of our overall strategy and skillful deployment of our technological capabilities across businesses, our net revenues for the third quarter grew to around RMB3 billion, up 18% year-over-year. We also delivered a healthy non-GAAP operating profit of RMB683 million.

Our capital-light model proportion also remained stable at around 18%, and we expect to maintain this proportion near the current level going forward. Furthermore, our leverage ratio, which is defined as risk-bearing loan balance divided by shareholder's equity, remained stable at 4.2x.

Thanks to the continuous improvement in funding cost, our stable risk performance and consistent investment in research and development, we have managed to maintain positive results in our business operations. Going forward, we will continue to closely monitor the trends in funding cost and risk metrics.

Between January 2022 and October 2022, we deployed around USD40 million to buy back our shares in the public market. Since we initiated our share repurchase program in 2018, we have cumulatively deployed around USD171 million to buy back our shares on the public market, a testament to the Company's commitment to returning value to shareholders on a long-term basis.

Before I conclude my remarks, let me provide some additional color on our business outlook for the fourth quarter of 2022. Despite the challenging macro environment in China, we will continue to forge ahead by strengthening our international initiatives, optimizing operational efficiencies, reinforcing our successful transition to higher-quality borrowers and propelling technological innovation.

We would like to reiterate that our total transaction volume guidance for full year 2022 remains unchanged in the range of RMB175 billion to RMB180 billion, representing year-over-year growth of 27% to 31%.

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). Yada Li with CICC.

Yada Li: (Speaking foreign language). Okay. Then I will do the translation part. So the first one is compared with our peers, and we will achieve higher growth rates on lower-origination value aiming the slowing growth of the whole consumer finance market. So could you please elaborate more about the reasons? And looking forward, is it possible that we can keep growing at a higher growth rate compared with the market and our peers? So this is the first one.

And the second one is regarding the international business. So how much it will contribute to our new loan sales and the total revenue by the end of this year and next year?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Hi, Yada, this is Jimmy. Let me do the translation for Alexis.

(Translated). During the third quarter, the situation still remain complicated. For example, in the Q2, we experienced a Shanghai lockdown and consumer confidence is still relatively weak. And of course, the resurgence of the Covid has affected the macro environment with rolling lockdowns. And despite the macro environment remain largely unchanged, we still managed to achieve positive results.

Total loan origination volume in the third quarter reached RMB 45.5 billion, validating the resilience of our business. This is due to several reasons. For example, our experience accumulated in navigating multiple credit cycles; our successful business transition to better-quality borrowers, which enables us to achieve positive results during uncertain times; and also our technological capabilities accumulated over the years.

Let me share an example of the Covid situation with you. For example, when we encounter a situation of lockdown, we will make ongoing adjustment to refine our risk models tailored to different categories of risk areas such as low, medium, high. When an area has been identified as a risk area, we will monitor and make the necessary adjustments to the models and rules within 2 days, and specific strategies will also be tailored for different areas. As a result of our proactive strategy, we have made very positive improvement.

For the outlook, the macro environment is complicated and without major changes in the core policies, and with the uncertainty still persist in the economy. Although loan demand remains stable, but there might be some fluctuations in the future. And on the longer term, we are still very confident of the growth in China consumer markets.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Hello, Yada, let me do the translation for Alexis again.

(Translated). Our international business transition to better quality began in the second half of 2021. And we have also reported successful transition in different stages since the last quarter. And during the third quarter, we continued to strengthen our international business and revenue contribution from this segment with double-digits of revenue contribution in the first half this year.

Transaction volume in the third quarter reached RMB1.1 billion, representing a sequential increase of 22%; and concurrently outstanding loan balance also reached RMB640 million, representing a sequential increase of 33%. And going forward, we are confident for our international markets because the policies in Indonesia and Philippines are much more confirmed right now. And in the Indonesia market, our transaction volume is increasing along with the transition to better-quality borrowers. And in the third quarter, our proportion of better-quality borrowers increased to 68% compared to 62% in the previous quarter.

And with a lot of better-quality borrowers, we are actually working with more local financial institutions right now. We are working with Bank Jago and another two local financial banks. And going forward, we are confident to further increase the proportions of loans funded by local partners.

And for the situation in the Philippines, we are confident to replicate our success into Philippines and other suitable countries. And we are also actively exploring new products such as working with hypermarkets to develop consumption scenarios. And besides Indonesia and Philippines, we are also actively evaluating new countries and markets, searching for suitable local partners, looking for licenses. And we believe our technologies and capabilities can be leveraged into more countries and financial institutions. We believe the growth in the international markets will continue at double-digits with continued increase in revenue contribution.

Jiayuan Xu: (Speaking foreign language).

Yada Li: (Speaking foreign language).

Jimmy Tan: Okay. Operator, please continue.

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

Alex Ye: (Speaking foreign language). So I have two questions. First one is in terms of your outlook for the next year. Understand that you're not in a position to discuss your guidance for the next year, but just want to get your color on your direction and strategy. So given now, China has a lot of discussion about the reopening and we have seen more concrete measures being deployed. So I'm wondering how do we balance your growth and risk management for the next year? And if we do see China pushing ahead with the reopening sometime next year, how would that affect our growth, the pace of our growth? In other words, what kind of activities or signs do we need to see, such that we will be more comfortable with our growth?

And the second question is on your sales and marketing expense for this quarter. It's up quite a lot sequentially. So I'm wondering to what extent that is related to domestic or international markets? What are the key drivers for increase and the outlook ahead?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Alex, this is Jimmy. Let me do the translation for Alexis.

(Translated). Let me share the company's strategy with you. We have both domestic and international business. The global situation is still complicated and if you take a look, there are different policies in each different country. What we are trying to do now is to pursue high-quality (inaudible) and this can be reflected in a number of ways.

For example, increasing the overseas market revenue contribution and penetration into more markets and finding the right customers. These customers will have much more loyalty and be much more resilient in a complicated environment. And number three, have an appropriate balance sheet with sufficient cash business and have a separate leverage to navigate challenges in the competitive environment.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Alexis, let me do the translation.

(Translated). Environment in China is much more complicated, although we have experienced or seen positive signs resurfacing in the recent days. But the impact on the economy is still uncertain on the overall level. We will still need to monitor certain signs, such reports such as the China Consumer Confidence Index. And of course, we will make the appropriate adjustments when we see any improvement in these signs.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Alex, let me do the translation for you again.

(Translated). From the P&L perspective, you can see that our sales and marketing cost has been increasing. But if you take a look -- but we are looking at it from an LTV perspective, which is still very healthy. Our funding cost in the third quarter has improved significantly, and this has also given us a larger leeway for an LTV. And our borrowers have an LTV of above 36 months.

In the third quarter, the increase -- we have also increased our customer acquisition efforts compared to the second quarter. This is the reason why you have seen an overall increase in sales and marketing. However, in the fourth quarter, we have begun to meet improvement in our customer acquisitions, and we have seen costs decreasing by around 10%.

Alexis Yu: (Speaking foreign language).

Alex Ye: (Speaking foreign language). Thank you.

Operator: Frank Zheng with Credit Suisse.

Frank Zheng: (Speaking foreign language). This is Frank from Credit Suisse. I have two questions. The first is a follow-up on the international markets. Can you provide more color on the take rate of the international markets, as we see in terms of revenue contribution, they account for around 12%, but in terms of volume or outstanding balance, it's still quite small? And also, in terms of net profit, what is the proportion that international markets contribute?

The second question is on SME owners' loans. Around 25% of loan volume is for SME owners. As we understand, SME tend to be more cyclical and sensitive to macro environment, what kind of credit quality trend have we observed? Any notable difference compared to consumption loss?

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Hi, Frank, this is Jimmy. Let me do the translation.

(Translated). The Indonesia market, right, is our main focus right now. And it is very different from the China market in terms of pricing, risk and the profile of the borrowers. Our product is 100% compliant with the regulators, and we are also in the process of shifting to better-quality borrowers. The take rate is stable, and if you compare to the China market, it is much more higher at around 10%. And for the net income contribution, it is still small. The main reason is because we are still reinvesting into the Indonesia market, as we are still growing that portion of our business.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Okay. Frank, let me do the translation.

(Translated). And in the third quarter, we have served a total of over 500,000 small business owners and facilitated loans amount of RMB 11.3 billion, contributing to around 25% of total transaction volume. Let me just remind you that our small business owners are a natural extension of our current business end users. And they have an average ticket size of around RMB20,000, which is not very large, and the risk is very manageable if you compare to those SME loans.

And although the impact of the lockdown is more severe for businesses, I would like to note that around 60% of our small businesses have been in operations for more than 3 years. And their overall stability and risk performance is better. And in the past, right, we have observed that the risk performance of our small business and the performance of our consumer loans are on a similar base level. And going forward, we intend to make adjustment and strive to achieve better risk performance for our small business owners in different industries to achieve a better risk performance for them.

Jiayuan Xu: (Speaking foreign language).

Frank Zheng: (Speaking foreign language).

Operator: (Operator Instructions). Thomas Chong with Jefferies.

Thomas Chong: (Speaking foreign language). My first question is about the overseas business. Given that we have been seeing SEA Grab and GoTo investing in the fintech business, and a lot of progress is making so far, so just want to ask about our Indonesia and Philippine strategies, whether we would think about cooperation with them, or the market is big enough for us to go into a standalone basis?

And my second question is about the domestic business. How should we think about the SME contribution in coming quarters?

Feng Zhang: Thomas, this is Feng. Let me try to answer your first question. Yes, I think it's a very good question. Overall, as Alexis has mentioned, we are very bullish about our overseas opportunities, and particularly our current market in Southeast Asia. Well, if you look at around the world, there are not many countries or markets as attractive as Indonesia and the Philippines. So these countries present, in our view, very good like an economic development opportunity and growth prospects, and particularly for the consumer lending segment.

So when we look at them, in a way, like it's very -- in a way like from many aspects, it's similar to like China around like 2014-ish. So there are tons of opportunities, and I think we've been in those markets for several years. So I think we've established like a front-runner position, a very good position in competition.

And one of the things that as you mentioned, I think that makes us like feel really excited about this market is, I think we have -- the market is much more open from both a regulatory front, a regulation perspective, as well as from competition perspective, which is -- from both of these two perspectives are very different from our domestic China market. So this bodes well for our growth potential and the development opportunities.

And it presents more possibilities for us to do things that are, frankly speaking, not very viable in our domestic market. So things like getting to POS financing, things like partnering with upcoming like the giants, like GoTo, or even things like getting into segments like digital banking, right? These are things that are not quite possible like in domestic China, very difficult, but there are tons of opportunity that's wide open. So I think as we continue to grow our business in these markets, we've established a very strong footprint there. I think all these things are possible, and we are very actively looking into these growth opportunities. Yes, thanks.

Jiayuan Xu: (Speaking foreign language).

Jimmy Tan: Hi, Thomas, let me do the translation.

(Translated). Based on the current environment right now, small business owners' loans will not be a main focus for our company. And going forward, we believe the current trend of around 25%, we will maintain our proportions of small business loans at similar levels.

Jiayuan Xu: (Speaking foreign language).

Thomas Chong: Okay. Thank you so much.

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 all for joining our third quarter earnings conference call. If you guys have any further questions, please feel free to reach out to our Investor Relations team offline or online. Thank you so much.

Operator: This concludes this conference call. You may now disconnect your lines, and thank you.