REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Q2 2023 Qifu Technology Inc Earnings Call

EVENT DATE/TIME: AUGUST 22, 2023 / 12:00AM GMT

CORPORATE PARTICIPANTS

Haisheng Wu *Qifu Technology, Inc. - CEO & Director*
Karen Ji *Qifu Technology, Inc. - Senior Director of Capital Markets*
Yan Zheng *Qifu Technology, Inc. - Chief Risk Officer*
Zuoli Xu *Qifu Technology, Inc. - CFO & Director*

CONFERENCE CALL PARTICIPANTS

Emma Xu *BofA Securities, Research Division - VP & Research Analyst*
Frank Zheng *Crédit Suisse AG, Research Division - Research Analyst*
Xiaoxiong Ye *UBS Investment Bank, Research Division - China Financials Research Associate*
Yada Li *China International Capital Corporation Limited, Research Division - Associate*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Qifu Technology Second Quarter 2023 Earnings Conference Call. (Operator Instructions)

At this time, I'd like to turn the conference call over to Ms. Kren Ji Ji, Senior Director of Capital Markets. Please go ahead, Kren Ji.

Karen Ji ***Qifu Technology, Inc. - Senior Director of Capital Markets***

Thank you, operator. Hello, everyone, and welcome to Qifu Technology's second quarter 2023 earnings conference call. Our earnings release was distributed earlier today and is available on our IR website. Joining me today are Mr. Wu Haisheng, our CEO; Mr. Alex Xu, our CFO; and Mr. Zheng Yan, our CRO.

Before we start, I would like to refer you to our Safe Harbor statement in the earnings press release, which applies to this call as we will make certain forward-looking statements. Also, this call includes discussions of certain non-GAAP financial measures. Please refer to our earnings release, which contains a reconciliation of the non-GAAP measures to GAAP measures. Also, please note that, unless otherwise stated, all figures mentioned in this call are in RMB terms.

Now, I will turn the call over to our CEO, Mr. Wu Haisheng. Please go ahead.

Haisheng Wu ***Qifu Technology, Inc. - CEO & Director***

[Interpreted]

Hello, everyone. Thanks for joining our second quarter earnings conference call.

During the quarter, given the softening macroeconomic recovery and more cautious sentiment among consumer credit users, we remained committed to our prudent operating strategy and pursue meaningful growth, while maintaining stable risk performance. In Q2, total loan facilitation and origination volume on our platform reached RMB 124.2 billion, up 26.4% year-over-year and 13.5% quarter-over-quarter, reflecting an accelerated growth trajectory compared to Q1. By the end of Q2, our platform had empowered a total of 153 financial institutions and cumulatively served more than 47 million users with approved credit lines.

Throughout the year, we have made steady progress in advancing our strategic upgrades to further improve profitability, while seeking high-quality growth. This will allow us to increase the margin of safety and strengthen the resilience of our business model against the complex macro environment.

In terms of business growth, we have continued to expand and diversify our customer acquisition channels. By partnering with multiple leading credit platforms under the embedded finance model, we have effectively expanded our coverage to the targeted users. We have also developed products tailored to different consumer and SME profiles, addressing varied users' needs and providing additional growth engines for our business.

In terms of profitability, we have taken further steps to boost operational efficiency, reduce funding costs and improve risk assessment capabilities to optimize asset allocation and improve the overall profitability of our loan portfolio.

Now, let me share some of our highlights in the second quarter.

First, we continued to expand and diversify our customer acquisition channels, while leveraging innovative approaches to improve marketing efficiency. In July, we entered into partnerships with top-tier traffic platforms, including short-form video platforms and payment providers to tap into their massive active user bases. Through joint modeling, process innovation and tailored user identification strategies, we boosted user conversion and enhanced our ability to reach targeted users.

With marketing spend largely flat from Q1, the number of new users making drawdowns increased 16% sequentially. Furthermore, we offered some experimental "compelling rates" to boost engagements, in a more innovative and effective way, with high-quality users with stable credit needs, stronger intention to borrow and an appetite for larger credit lines, which also serves as an effective supplement to our existing user base. Moving forward, we will continue to explore effective ways to acquire and manage users from various segments, and address their diverse needs through product innovation.

Second, we improved our user engagement capabilities and achieved a significant boost in user activity. Starting from user needs, we optimized our product, risks and operational strategies throughout the user lifecycle. We also enhanced our ability to identify users by leveraging PBOC credit data as well as data related to the broadly defined SME segment. This enabled us to offer more competitive rates and credit lines, and more flexible repayment methods catering to various users' needs, while ensuring the stability of our risk performance. As a result, we saw a notable improvement in drawdown intention among new and existing users.

In addition, through our diverse user outreach and engagement approaches, the first month drawdown ratio of new borrowers increased by approximately 13% from Q1 and the reborrowing rate of existing borrowers, meaning the average percentage of existing borrowers with an outstanding loan balance that draw down again the following month, increased by approximately 8% from Q1. On top of this, we also introduced user loyalty programs and offered a broader range of products and benefits to boost user engagement.

Third, we kept our pricing and risk performance at stable levels, leveraging funding strengths to further optimize our economic model. During the quarter, our deepened cooperation with financial institutions, contributed to a further reduction in our funding costs that far outpaced the market rate cuts. In addition, through innovative product designs, we secured ABS investments from multiple state-owned banks and major joint stock banks. We issued roughly RMB 5.3 billion of ABS in the quarter, up 132% quarter-over-quarter and leading to a further reduction in our overall funding costs. As our credit assessment capabilities steadily improve, we are collaborating with a broader spectrum of financial institutions, which will enhance our ability to optimize asset allocation and boost profitability.

Fourth, our technology solution business advanced steadily and has begun to take shape. We further optimized our product matrix and solutions to address the diverse needs of our banking partners. In terms of organizational development, we assembled a sizable team capable of providing professional services to financial institutions. Small and medium-sized banks are particularly keen to push forward their digital transformation with the support of our end-to-end tech solutions. A number of projects are currently in the implementation phase.

Looking back at the first half of 2023, despite the softening macroeconomic environment, we balanced growth and risk through our prudent operational practices and delivered solid results. In the second half, we will further expand our channel presence and product offerings to enhance user stickiness, forge closer partnerships with financial institutions and optimize our asset allocation to improve our topline and bottom-line performance.

Our ongoing efforts to refine and upgrade our business model will enhance the resilience of our company in today's macro landscape. We are confident that our industry position and unique resources and capabilities will enable us to sustain our leadership position in the credit-tech market and deliver even more robust growth in the long-term.

On June the 20th, we announced a share repurchase program, under which we may repurchase up to USD 150 million worth of shares over the next 12 months. Since the announcement, we have been actively executing the program. We have strong confidence in the company's long-term profitability and cash flow performance and remain committed to rewarding and creating value for our shareholders through the shareholder return initiatives.

With that, I will now turn the call over to our CFO, Alex Xu, who will walk you through our financial results for the quarter.

Zuoli Xu ***Qifu Technology, Inc. - CFO & Director***

Okay. Thank you, Haisheng. Good morning and good evening, everyone. Welcome to our second quarter earnings call. Despite the slower-than-expected market recovery, we continued to see modest improvement in many aspects of our operations throughout the first half of the year.

Users' activity levels measured by drawdown ratios continued to improve in recent months, which led to the accelerated loan volume growth in Q2. Although the pace of macro recovery is still uncertain, we are proactively taking some actions to optimize our product and service offerings, strengthen relationship with key partners and ultimately to drive long-term sustainable quality growth.

In Q2, the quality of our user base remained solid. Key leading risk indicators were relatively stable, near the best level of recent quarters. Day 1 delinquency was 4.2% in Q2 versus record-setting 4.1% in Q1. The slight uptick in day 1 delinquency somewhat reflected borrowers' sentiment towards the ongoing macro uncertainties.

30-day collection rate was 87.2% in Q2 versus 86.2% in Q1. This sharp rebound mainly reflected seasonal factors, as well as some improved collection efficiency. As economic recovery remains uncertain, we may continue to see some fluctuation of these metrics in the near future, although overall risk level should be relatively stable in our continued effort to proactively mitigate risks.

Total net revenue for Q2 was RMB 3.9 billion versus RMB 3.6 billion in Q1 and RMB 4.2 billion a year ago. Revenue from credit driven service capital-heavy was RMB 2.8 billion in Q2 compared to RMB 2.6 billion in Q1 and RMB 2.9 billion a year ago. The year-on-year decline was mainly due to overall decline in expected average tenor of new loans, as well as lower average interest rates. The sequential increase reflected growth in loan volume under capital-heavy and relatively stable effective tenors. Early repayment levels were relatively stable in Q2 versus Q1.

On-balance sheet loans continued to grow nicely and accounted for nearly 19% of the total loan volume. We issued a record RMB 5.3 billion ABS, up 143% and 132% year-on-year and sequentially, respectively, which helped us further lower our overall funding costs and drive for better utilization of our microlending license.

Revenue from platform service capital-light was RMB 1.13 billion in Q2 compared to RMB 969 million in Q1 and RMB 1.24 billion a year ago. The year-on-year decline was mainly due to overall decline in expected average tenor of the loans and also the modest decline in average pricing.

For Q2, capital-light loan facilitation, ICE and other technology solutions combined accounted for roughly 58% of the total loan volume, compared to roughly 56% in the prior quarter. We expect this ratio to be gradually trending down for the remainder of the year to a normalized level. Also, we are evaluating different components of our operations and seeking a better mix between risk bearing and non-risk bearing solutions based on macro environment and operational conditions.

During the quarter, average IRR of the loans we originated and/or facilitated, remained stable Q-on-Q, well within the regulatory rate cap requirement. Looking forward, we expect pricing to continue to be relatively stable for the coming quarters.

Sales and marketing expense increased slightly Q-on-Q as we remained prudent and continued to diversify user acquisition channels. We added approximately 1.5 million new credit line users in Q2, roughly flat versus first quarter. Unit cost to acquire a new credit user also increased marginally Q-on-Q at approximately RMB 296. Where we will continue to drive for efficiency in our operations, we may adjust the pace of our new user acquisition, based on macro conditions throughout 2023. Meanwhile, we'll continue to focus on re-energizing existing user base, as repeat borrowers historically contributed vast majority of our growth.

Although we will continue to take a prudent approach in booking provisions against the potential credit losses, we should expect further write-backs of the provisions from previous periods, as overall risk profile of our loan portfolios has been stabilizing to improving.

Total new provisions for risk bearing loans in Q2 were approximately RMB 1.9 billion and the write-backs of previous provisions were approximately RMB 525 million. Provision coverage ratio, which is defined as total outstanding provision divided by total outstanding delinquent loan balance between 90 and 180 days, were 511% in Q2 compared to 432% in Q1.

With solid operating results and stable contribution from capital-light model, our leverage ratio, which is defined as risk bearing loan balance divided by shareholders' equity, was again at historical low of 3.3x in Q2 compared to 4x a year ago. We expect to see leverage ratio fluctuate around this best level in the near future.

We generated approximately RMB 1.8 billion cash from operations in Q2, roughly flat Q-on-Q. Total cash and cash equivalent was RMB 8.5 billion in Q2 compared to RMB 9 billion in Q1. Non-restricted cash was approximately RMB 5.3 billion in Q2 compared to RMB 5.1 billion in Q1. The sequential decline in cash position, was mainly due to increase of the cash usage in our balance sheet lending. As we discussed earlier, we will continue to look for opportunities to deploy resources to launch new initiatives, develop new technology and expand service offerings.

Non-GAAP net profit was RMB 1.147 billion in Q2 compared to RMB 976 million in Q1. As we continue to generate healthy cash flow from operations, we believe our current cash position is sufficient to support our business development and to return to our shareholders. In Q1's earnings call, we announced to increase our dividend payout ratio to 20% to 30%, and switch to a semi-annual dividend distribution schedule. Today, we're glad to declare a semi-annual dividend of $0.25 per ordinary share or $0.50 per ADS, in U.S. dollar both, which represent approximately 30% of the payout ratio.

Also, on June 20, 2023, we announced a share buyback plan to repurchase up to $150 million over a 12-month period. As of August 18, 2023, we have already bought approximately USD 28 million worth of our ADS in open market at an average price of $18.03. We will continue to execute the buyback program in accordance with the relative rules and regulations. With a fully execution of the repurchase program and the dividend plan, we may return more than half of our net profit to our shareholders. Going forward, we will continue to optimize our capital allocation plan, and make timely adjustments to generate higher returns to our shareholders.

Finally, regarding our outlook, while we see accelerated year-on-year growth in loan volume in Q2, which is in part driven by easy comp, we do notice continued uncertainty in macro economy. At this junction, we still see a slow recovery in consumer credit, with the growth rate somewhat depending on macro conditions for the rest of the year. As such, we would like to adjust our full year total loan volume target for 2023 to between RMB 470 billion and RMB 485 billion, representing a year-on-year growth of 14% to 18%. As always, this forecast reflects the company's current and preliminary view, which is subject to material changes.

With that, I would like to conclude our prepared remarks. Operator, we're now open to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question comes from the line of Alex Ye from UBS.

Xiaoxiong Ye ***UBS Investment Bank, Research Division - China Financials Research Associate***

[Interpreted]

So my question is, so there appears to be some dislocation between the strong volume growth and the less strong revenue growth in the past 2 quarters. So is it mainly due to the higher repayments issue or there is some product mix change that led to such changes? So how should we expect the revenue take rate trend going forward?

Zuoli Xu ***Qifu Technology, Inc. - CFO & Director***

Sure. I think, I will take this one, Alex. And you're probably right, basically, the reason that the loan balance grows as well as the revenue grows slower than the loan volume growth is mainly because of the duration of the loans and so far this year are shortening, which in part is because of the issue we encountered in the first quarter of the early repayment.

If you recall, in the first quarter, there was a pretty significant impact on the revenue stream, because of early repayments. Even though, in the second quarter, we saw that the early repayment sort of peaked around the April timeframe and that has started to gradually, although marginally, trending kind of to the right direction for us, but still compared to historical average, we're still seeing a shorter duration of the loan book. Now, that shorter duration would definitely result in kind of a slower accumulation of the loan balance and also kind of a slower growth in revenue, relative to the loan volume.

I guess, from a product mix perspective, they didn't have too much significant directional impact, say, we're taking a bunch of new products that happened to be shorter duration. No, I don't think that's a significant factor and it has more to do with the issue I mentioned earlier.

Then, going forward, ever since the second quarter, we are taking some kind of measures to gradually move the tenor of the loans to a longer period. As I mentioned, from May to July, we see a gradual improvement so far. And for the second half, we will continue to take some actions to manage the duration and, hopefully, in the second half, for the revenue take rate, you will see a little bit improvement or increase compared to what you saw in the first half.

Operator

Next question comes from the line of Frank Zheng from Credit Suisse.

Frank Zheng ***Crédit Suisse AG, Research Division - Research Analyst***

[Interpreted]

This is Frank from Credit Suisse. The first question is based on the latest macro environment and the credit risk performance of the portfolio, do we foresee any extra provision we need to take or is there any more room for extra write-back going forward, especially considering the provision coverage ratio recorded another step up to over 500% this quarter? And the second question is a follow-up of the previous question. Can the management give us more specific measures taken to improve the duration of loans? And I am just curious that in the current macro environment, are we preferring longer duration or shorter duration?

Zuoli Xu ***Qifu Technology, Inc. - CFO & Director***

Okay. I think I will take the first part and then I'll let our CRO, Mr. Zheng, answer the second part. So, in terms of provisions, as you know, we have been adopting a very consistent policy to book our provisions conservatively and make sure that all the provisions are more than enough to cover the potential risks there. And if you look at the historical financial reports of us, basically other than the very special quarter, 1 or 2 quarters, for the majority of the period, we have the write-backs from the previous provisions.

As I mentioned in my prepared remarks, I think, right now, we see a relatively stable, although some fluctuation in the risk profile, so you should continue to see write-backs in the coming quarters, although the size of the write-back we can't determine at this point. It's up to, you know, the third-party evaluation and also all the other factors. But directionally you will continue to see write-backs in the coming quarters.

And in terms of continued booking additional provision, we will take a more prudent approach, based on our observation of the macro environment, and if we feel necessary, we will book more provisions and to counter the potential risks.

The provision coverage ratio you mentioned, the 511% versus last quarter's 430% something, that's not a metric we have a target on. Rather than, it's a calculated number. So we book the provision and then when we do the calculation, it happened to be 511%. So that's not something indicating that we're targeting a higher coverage ratio or something, no. We book provisions basically based on that quarter's loan volume and third parties' evaluation.

I will stop here. And the second part of question, I'll hand over to Mr. Zheng.

Yan Zheng ***Qifu Technology, Inc. - Chief Risk Officer***

[Interpreted]

We believe loan duration is a combined result of contractual tenor and early repayment. So first, I will talk about the early repayment. Early repayment was steadily declining, mainly due to the macro environment changes and the second reason is our operational efforts.

From a macro perspective, the early repayment sentiment was cooling off. We have observed that the early repayment ratio for our historical loan portfolio has been decreasing for 4 consecutive months from April to July. And from operation perspective, we have refined our operation strategy to reduce the early repayment in 3 ways.

The first is, we applied a new telemarketing rule, to incorporate the early repayment ratio into the KPI of the salespersons, so the salespersons tend to control this ratio. Second, we offer some benefits to retain the users when they have the intention for early repayments. Three, we reduced the 7-day interest free coupon to avoid those short-term borrowers. Based on those optimizations, we have seen improvement in our early repayment situation.

As for contractual tenor, we won't say shorter the better or vice versa. We offer the tenor based on the user's profile. For example, for those who have stable income and higher creditworthiness, we tend to offer a longer tenor to lower their repayment pressure. But for those who have less long-term visibility, we tend to reduce the risk exposure and shorten the tenor to control the risk. So, different user profile and the ticket size will have different impact on the short-term and the long-term credit risks. We will further upgrade our self-developed GBST model, the Gradient Survival Tree model, to improve the fitness of loan tenor and balance the profitability and risks.

In conclusion, in the current macro conditions and our proactive management, we expect the early repayment ratio will further decline and our effective loan duration will increase in Q3.

Hope this answered your question.

Operator

We'll move on to the next questions from the line of Emma Xu from Bank of America Securities.

Emma Xu ***BofA Securities, Research Division - VP & Research Analyst***

[Interpreted]

So, I have 2 questions. The first one is about the loan demand in third quarter. We see the short-term consumption, household consumption loan, declined RMB 42 billion in July and it seems the consumption recovery remained lackluster. So what do you see the loan demand at your side? And the second question is about loan pricing. So will the lackluster loan demand impact your loan pricing? And with the LPR being cut for twice since June, do you also need to adjust down your loan pricing?

Haisheng Wu ***Qifu Technology, Inc. - CEO & Director***

(foreign language)

I will answer your question. We also noticed that the citizens' short-term loan has decreased in July. From our perspective, our loan balance continued to increase in July and August, unlike the declining trend of the citizens' short-term loan balance.

From demand perspective, since the beginning of this year, we have seen some structural changes in terms of users' demand. From user quality perspective, the highest quality users tend to repay the loan earlier, while the lower quality users have relatively stable demand. And from the usage perspective, the broadly defined SME users are more active than the consumer credit users, especially for those in the construction, transportation, tourism, hotel and catering industries. Plus our operational efforts, we have gained efficiency improvement in managing the broadly defined SME segment.

Given the softer consumer credit demand, we expect to increase our spending on the broadly defined SME users. We will increase our penetration in the broadly defined customer segments in new user acquisition. And for the existing users, we will improve our service quality to improve the user stickiness.

In terms of the pricing, we expect the pricing will be stable in the future. From our past experience, the LPR rise or cuts had very little impact on our pricing. Our pricing is mainly determined by the supply and demand in this market.

Operator

One moment for the next question. Next question is from the line of Yada Li from CICC.

Yada Li ***China International Capital Corporation Limited, Research Division - Associate***

[Interpreted]

I'll do my translation. This is Yada with CICC and today I just have one quick question. I was wondering could you please elaborate more about the consideration behind the $150 million share repurchase program this time? And should we consider it as a regular way to return value to the shareholders?

Haisheng Wu ***Qifu Technology, Inc. - CEO & Director***

(foreign language)

Zuoli Xu ***Qifu Technology, Inc. - CFO & Director***

Okay. Yada, thanks for the question. Basically, every quarter, we are reviewing our cash position as well as our capital allocation strategy. And when we determine that there is actual free cash sitting there idle without making too much of a return, then we would like to deploy that cash either in the form of the dividends or in the form of the buyback.

So it's, I would say, an ongoing process in future quarters as well. And we consider an optimal balance between the buyback and a dividend, is the best way to return to the shareholders. So like I said, the first thing first, we need to complete this USD 150 million buyback program and, along the way, we will do our periodical review to determine what to do afterwards there. But for the longer term, I would say some kind of a combination between the buyback and the dividend.

Operator

Thank you for the questions. In the interest of time, I will now conclude the Q&A session. I would like to hand the call back to management for closing remarks.

Zuoli Xu ***Qifu Technology, Inc. - CFO & Director***

Okay. Thanks for everyone joining the conference. Since we have our peers right behind us in their earnings call, so to the courtesy, we just conclude our call here. If you have additional questions, please contact us offline. Thank you.

Operator

Thank you. This concludes today's conference call. Thank you for participating. You may now disconnect.

[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]
