[LU] Lufax Holding Ltd.
Q1 2024 Earnings Conference Call
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Executives
Y.S. Cho, Chairman and CEO
Gregory Gibb, Co-CEO and Director
David Choy, CFO
Xinyan Liu, Head of Board Office and Capital Markets

Analysts
Emma Xu, Bank of America
Chiyao Huang, Morgan Stanley
Yada Li, CICC

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Lufax Holding Limited First Quarter 2024 Earnings Call. (Operator Instructions). After the management's prepared remarks, we will have a Q&A session. Please note this event is being recorded.

Now, I'd like to hand the conference over to your speaker-host today, Ms. Liu Xinyan, the company's Head of Board Office and Capital Markets. Please go ahead, madam.

Xinyan Liu: Thank you very much, operator. Hello, everyone, and welcome to our first quarter 2024 earnings conference call. Our quarterly financial and operating results were released by our Newswire services earlier today and are currently available online.

Today, you will hear from our Chairman and CEO, Mr. Y.S. Cho, who will provide an update of the macroeconomic trends and the recent development and strategies of our business. Our Co-CEO, Mr. Greg Gibb, will then go through our first quarter results, and provide more details on our business priorities. Afterwards, our CFO, Mr. David Choy, will offer a closer look into our financials before we open up the call for questions.

Before we continue, I would like to refer you to our safe harbor statement in our earnings press release, which also applies to this call, as we will be making forward-looking statements.

With that, I now pleased to turn over the call to Mr. Y.S. Cho, Chairman and CEO of Lufax. Please.

Y.S. Cho: Thanks for joining today's call. In the first quarter, we witnessed improvement in our early risk indicators. However, high-quality loan demand from small business owners remained

subdued, while our increased risk exposure stemming from our 100% guarantee model means we will be prudent and patient in new business development. Our emphasis continues to be on quality over quantity.

Before diving into business performance, let's take a look at the macro environment. Overall, the environment showed signs of improvement during the first quarter. The Purchasing Managers' Index, or PMI, which measures prevailing trends in the manufacturing and service industries, both trended positively. The index increased from 49.0 in December 2023 to 50.8 in March 2024 for manufacturing, while improving from 49.3 to 52.4 for services.

Despite improvement in the macro environment, the SBO segment recovered at a relatively slower pace. For example, the SME Development Index published by the China Association of Small and Medium Enterprises was 89.3 for the first quarter of 2024, compared to 89.1 for the fourth quarter of 2023 and 89.3 for the first quarter of 2023.

Now, regarding business development. As discussed in our fourth quarter earnings call, in 2023, we completed five major de-risking and diversification actions, including four “mix” changes and one business model adjustment. Thus far, these actions have yielded signs of improvement in asset quality, although we believe operational prudence remains critical to ensure long-term growth and sustainability.

During the first quarter, total new loan sales decreased by 15.6% year-on-year, mainly due to weak-quality loan demand from SBOs and our own emphasis on prudent operations. As we shifted our focus from SBO loans to a more diversified approach, new loan sales of our consumer finance business grew to 20.3 billion in the first quarter, representing an increase of 46% year-over-year. On the other hand, new loan sales of the Puhui business continued to face pressure from a lack of high-quality SBO loan demand and decreased by 35.5% year-over-year.

As mentioned previously, we successfully completed transition into our 100% guarantee business model for the Puhui business by the end of third quarter 2023. Starting from the fourth quarter of 2023, all the new loans were either granted by our consumer finance subsidiary as on-balance sheet loans, or enabled by our guarantee company under the 100% risk bearing business model. As a result, our risk bearing increased from 39.8% of the total outstanding balance as of the end of 2023 to 48.3% as of the end of first quarter 2024.

While the switch to 100% guarantee model will exert a positive impact on our take rate, as it alleviates the effect of elevated CGI premiums, our profitability will take longer time to recover due to higher upfront provisioning.

Now let's turn to asset quality. After successful execution of our de-risking adjustments to the mix of segment and products, region, channel and industry, together with improvements in the macro environment, and removal of short-term negative impact caused by restructuring of our direct sales team and branches, we witnessed improvement in our early risk indicators in the first quarter.

The C-M3 flow rate for Puhui business decreased from 1.2% in the fourth quarter of last year to 1.0% in the first quarter this year. The NPL ratio of our consumer finance loans also remained

stable. While we are pleased with such improvements in asset quality, we are taking a patient and prudent approach to ensure this success is sustainable.

In terms of broader strategy, we are pleased to announce that we completed acquisition of Ping An OneConnect Bank in early April, as part of our strategic initiative to leverage on strong licenses. These licenses have the potential to underpin a more expanded set of service offerings, allowing us to provide more dynamic services and to further diversify our business.

I would also like to provide an update on the special dividend arrangement that we announced earlier. On March 21, we announced a special dividend plan of US$2.42 per ADS, or US$1.21 per ordinary share. This special divided remains subject to shareholder approval at the annual general meeting, or AGM, which will be held on May 30, 2024. The record date for the annual general meeting is April 9, 2024.

To sum up, in the first quarter, we encountered preliminary improvements in asset quality which demonstrate that our de-risking and diversification initiatives are starting to bear fruit. Despite this, we maintain a prudent approach in our operations as we see continued weakness in high-quality SBO loan demand.

Last but not least, our CFO David will resign for personal reasons with an effective date of April 30. David has been with the company for nearly 6 years, and we thank him for his tremendous contributions to the company. We have appointed Zhu Peiqing as our new CFO, who will assume the CFO role effective from April 30. Peiqing has extensive experience in finance industry, especially in audit and financial management. We look forward to his onboarding and future contributions.

I will now turn the call over to Greg to share more details on our operating results.

Gregory Gibb: Thank you, Y.S. I will now provide more details on our first quarter 2024 results and our operational focus for this year. Please note all figures are in Renminbi unless otherwise stated. Let's begin with an overview of our first quarter performance. During the quarter, ongoing weakness in demand for high-quality loans from SBOs, small business owners, combined with our continued emphasis on operational prudence weighed on new loan sales.

New loan sales in the first quarter were 48.1 billion, representing a 15.6% year-on-year decline. Among total new loan sales, 42% were contributed by our consumer finance business. This is up from approximately 24% in the same period last year.

Revenue in the first quarter was 7 billion, a decrease of 30.9% year-over-year. The decline was mainly due to the decreases in our new loan sales and outstanding loan balance, and was partially offset by our increased take rate, as more of our book comes from the 100% guarantee model.

Our net loss for the first quarter was 830 million, mainly due to increased tax associated with the special dividend. On a pretax basis, Lufax was marginally profitable in the first quarter. Earnings before tax were 447 million in the first quarter of 2024, which compares to 1.1 billion in the same period for last year.

For this quarter, pretax profitability remains relatively under pressure as a result of declining loan balances and new business being loss-making in the first 12 months, due to upfront provisioning under the 100% guarantee model. Partially offsetting these pressures were continued improvements in cost structure, reduction in credit costs, and continued strength in our later stage recoveries.

As Y.S. mentioned earlier, we witnessed the impact of our de-risking and diversification initiatives on our asset quality during the first quarter of 2024. I will now walk through our operating metrics, and how they've evolved in light of these strategic changes.

First, in terms of product mix, we saw our consumer finance segment continued to grow. In the first quarter, consumer finance sales accounted for 42% of new loan sales, up from 24% in the same period last year. Concurrently, the proportion of unsecured loans and secured loans decreased to 37% and 21%, respectively, from 48% and 28% last year. In light of these changes, we have seen a gradual, ongoing shift in our balance mix.

Consumer finance balances, as a percentage of our total balance, reached 14% as of March 2024, compared to 6% at the end of March 2023. Meanwhile, the proportion of unsecured loans decreased to 64% from 72% at the end of March 2023, while the proportion of secured loans has largely remained flat.

In terms of our business model, we continued to build up a roster of new loans under the 100% guarantee model. As we previously mentioned, this has reshaped our portfolio mix and increased our risk-bearing. As of the end of the first quarter, 26% of Puhui's loan balance was enabled under our new 100% guarantee model, and our risk bearing by balance has grown to 48.3% as of the end of first quarter, up from 39.8% as of the end of fourth quarter 2023.

We also kept our focus on prioritizing sales in more economically resilient regions. In terms of our channel, we maintained our emphasis on excellence within the direct sales team, which continues to be our major sales channel and contributed to majority of our new loan sales.

Next, our asset quality. Our overall C-M3 improved to 1.0% from 1.2% in the fourth quarter of 2023. This was mainly due to improvement in the macro environment, removal of temporary negative impact from our geographic and direct sales restructuring in the third quarter, and the vintage run-off as we build up a new book. While we observed improvement in the C-M3 ratio during the first quarter, we remain cautious about the future sustainability of this trend. Given this, and considering our heightened risk exposure, we will continue our prudent strategy of prioritizing quality over quantity during 2024.

Now, let's take a more detailed look at our unit economics at the Puhui business. During the quarter, funding costs remained stable. In addition, our overall APR decreased slightly to 19.7%, as we maintained our focus on higher-quality customers. Our take rate based on loan balance has risen to 9.0% from 7.3% for the first quarter, as loans under the 100% guarantee model comprises a higher percentage of the total loan balance. While we anticipate that loans under the 100% guarantee model will be lifetime profitable, it is important to note that these loans may incur accounting losses in their first calendar year due to a standard but higher upfront set of provisions.

Under our projected business scale, we believe we have a strong balance sheet to support the business, its operations, capital, and liquidity requirements. At the end of the first quarter of 2024, our guarantee subsidiary's leverage ratio was 2.4x, mainly driven by the increase of our guarantee balance associated with our increased risk exposure and the decrease of net assets due to the distribution of the special dividend.

Our consumer finance capital adequacy ratio stood at approximately 15.1%, well above the required 10.5%. As for our balance sheet, we hold net assets of 92.8 billion, with our cash at bank balance amounting to 39.4 billion at the end of the quarter.

I will now turn over the call to David, our CFO, for more details on our financial performance.

David Choy: Thank you, Greg. I will now provide a closer look into our first quarter results. Please note that all numbers are in Renminbi terms, and all comparisons are on a year-over-year basis unless otherwise stated.

As Y.S. and Greg have mentioned, our performance was still impacted by broader economic conditions that have been exerting pressure on the small business sector throughout this period. By strategically shifting to a 100% guarantee model with higher take-rate, higher-quality customer segments, and more favorable geographical regions, we opted to forego some of our business scale with the aim of enhancing the quality of our future loan portfolio, which we believe is important for the long run for the company. Our strategic transition unavoidably led to continued declines in our average loan balance and total income.

Meanwhile, the expected credit loss provision, which must be accounted for upfront on the first day, amplified the accounting loss in the early stages of the product lifecycle under the new business model.

In the first quarter of 2024, our total income was 7 billion, representing a decrease of 30.9%.

During the quarter, our technology platform-based income was 2.6 billion, representing a decrease of 49%. Our net interest income was 2.8 billion, a decrease of 15%, and our guarantee income was 0.92 billion, a decrease of 34.7%. All are basically in line with the decrease of outstanding loan balance, in which guarantee income decreased by a lesser magnitude due to the offsetting effect of an increase in risk borne by the company.

Turning to our expenses. We remain committed to cost optimizations. I want to highlight that our total expenses, excluding credit losses, finance costs, and other losses, decreased by 37% year-over-year to 3.6 billion this quarter, as we continued to enhance operational efficiency. This 37% magnitude of decrease in expense is greater than that of the 30.9% decline in the total income.

Let's highlight just a few of the key expense items. Our total sales and marketing expenses, which mainly include expenses for borrower acquisition costs, as well as general sales and marketing expenses, decreased by 50% to 1.5 billion in the first quarter. The decrease was mainly due to decrease in loan-related expenses as a result of the decrease in new loan sales and decreased retention expenses, as well as referral expenses from platform services attributable to the decreased transaction volume.

Our credit impairment losses decreased by 8.6% to 2.9 billion in the first quarter, primarily due to the decrease in provision of loans and receivables as a result of the decrease of loan balance and the improved asset quality.

Our finance costs decreased by 69.3% to 58 million in the first quarter from 189 million in the same period of 2023, mainly due to the decrease of interest expenses as a result of repayment of C-Round Convertible Promissory Notes and other debts, partially offset by the decrease of interest income from bank deposits.

The key item in this quarter is really the income tax. Whilst we achieved pre-profit tax of RMB 447 million in the first quarter, our income tax expenses increased to 1.3 billion in the first quarter from 0.4 billion in the same period of 2023. This is mainly due to the increase in withholding tax associated with one-off dividends that were paid by our PRC subsidiaries in order to support the potential distribution of the special dividend we announced on March 21, 2024.

As a result, net loss for the first quarter was 830 million, compared with a net profit of 732 million in the same quarter of 2023. Meanwhile, our basic and diluted loss per ADS during the first quarter were both RMB1.52 or US$0.21.

Turning now to our balance sheet. As of March 31, 2024, we had net assets of 92.8 billion, and a cash balance of 39.4 billion.

In terms of capital, as of the end of March 2024, the two main operating entities were well-capitalized. Our guarantee subsidiary's leverage ratio increased to 2.4x, as driven by the increase of our guarantee balance associated with our increased risk exposure and also the decrease of net assets due to the dividend upstream to the parent companies. And our consumer finance company capital adequacy ratio well stood at approximately 15.1%, and well above the required 10.5% regulatory requirement.

All these factors provide significant support for the company to navigate through the evolving macroeconomic landscape and the business transition period, while laying the groundwork for us to continuously reward our investors in the future.

That concludes our prepared remarks for today. Operator, we are now ready to take questions.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Emma Xu with Bank of America Securities.

Emma Xu: I have two questions actually. So my first question is about your special dividend. Could you give us more update on the progress of your special dividend? So with the incurred tax, I guess the money should have been offshore. And what's the progress of this special

dividend distribution? And then in the longer term, do you have any midterm plans for your future shareholder returns after this special dividend?

And my second question is for your asset quality. So I do notice that your flow rate and your 30-day delinquency rate did achieve a notable decline in the first quarter. So do you think this improvement of the asset quality is sustainable into the coming quarters, and then which can also lead to lowered impairment losses in the coming quarters?

Y.S. Cho: Okay. Thank you. This is Y.S. speaking. So your first question about special dividends. We announced a special dividend plan on March 21, and we also announced on March 25, that shareholders of record at the close of June 4, 2024, will be entitled to receive this special dividend. But it is subject to our shareholder approval at the AGM, Annual General Meeting, which will be held on May 30. And then our long-term dividend policy, it remains unchanged, which is about 20% to 40% of the annual net profit.

And then answering your second question about asset quality improvement, yes, we see that C-M3 net flow improved in first quarter down to 1.0% from 1.2% in the last quarter of 2023. We believe our de-risking efforts taken in 2023, those gradually come into effect, such as credit policy tightening, underwriting process, and then sales control measures strengthening, segment mix optimization and channel optimization, and so forth.

And also, as Greg explained, the concentrated impact from geography restructuring in the third quarter last year, that has been gradually fading away. And also, our new portfolio we built from 2023 with better quality, with tightened underwriting. That portion will take gradually a larger part of total loan balance.

However, while we observed this improvement in C-M3 net flow in the first quarter, we still remain very cautious about the future sustainability of this trend. And we'll continue to take prudent action and approach concerning our higher risk exposure under this 100% guarantee model.

Emma Xu: Very clear, thank you. Thank you so much.

Operator: Chiyao Huang.

Chiyao Huang: This is Chiyao from Morgan Stanley. I'm really happy to see some early improvement on the risk indicator and the pretax profitability in the quarter. So I have two questions. One is on the asset quality, you can see there's early improvement. What's the management view on the loan growth into the rest of the year? That's one.

And the second question is on the unit economics. How do management expect it to evolve as we transition to 100% of guarantee model? Could management discuss this a little bit? And could you give more color, more detailed color, on the unit economics?

Gregory Gibb: Thanks. Greg here responding. So on the asset quality while we've seen the improvement, as Y.S. just outlined, which is clearly good news, in terms of demand by customers, particularly of the quality that we're targeting, that demand is still to be on -- is somewhat subdued, right? So when we look at the first quarter, we haven't seen an uptick, a

meaningful uptick, in the demand among strong borrowers. So that is really going to drive our continued prudence because we really want to see stronger demand before we would expand beyond where we are today in terms of volumes.

Obviously, given that we're now transitioning, we have transitioned all new business to the 100% guarantee model, and more and more of our total book will be that 100% guarantee model. We do want to observe for a few quarters. We think is right as we are taking on more risk. So we stick to -- in terms of the guidance we've given for this year, new loan volume, we expect to be still 190 billion to 220 billion, which at the end of the year, would take us to an ending balance of about 200 billion to 230 billion. So that's the outlook. It remains unchanged, I guess, since the last quarter when we gave guidance on this.

In terms of UE, I think this is really the most important trend also to watch, now that we've shifted fully to the 100% guarantee model. As we've said, if we look at our loan balance, given that more and more is coming from the 100% guarantee model, our take rate has increased now to 9% from 7.3%. And if you look at new business that's now being done under the 100% guarantee model, the gross take rate is approaching 14 percentage points, right? So basically, it's effectively a doubling from where we were a couple of quarters ago, as we shift from the CGI model now to more and more under the guarantee model. So this is a trend that we will expect to continue.

So as we move throughout the course of this year, such that more and more of the book is 100% guarantee model, you should see the overall take rate converge up to about 14%. And then from there, it's a question of our cost management and it's a question of continued improvement, hopefully, on the credit quality, which will then drive the bottom line. And we haven't given guidance on that yet.

But just to highlight that, we note when we do new loans, for example, in 2024, new loans under the 100% guarantee model, we do expect them to be lifetime profitable. But we also do expect that in the first calendar year, due to upfront standard provisions, they will have a negative P&L contribution, but again, lifetime profitable. So that's our outlook on the unit economics side.

Chiyao Huang: Thank you very much.

Operator: Yada Li with CICC.

Yada Li: This is Yada with CICC. And my first question is regarding the risk-bearing percentage. Since last quarter, the company has completed the transition towards a 100% guarantee model. Looking forward, could you please give us more color on how to view the risk-bearing percentage at the end of this year and in future?

Secondly, I was wondering if you could share more about the outlook for the bottom line? In addition, if possible, can you elaborate more about once we have gone through the transition period, what is the expected margin or the profit take rate for the SME loans? That's all.

Y.S. Cho: Thanks, Yada, for your question. Let me take your first question, and then I will pass the second to David. About 100% guarantee model transition, that started from fourth quarter, the fourth quarter last year, that all new loans that we booked were granted either by customer

finance company, as on-balance sheet loans, or was granted by our guarantee company on the 100% risk-bearing base model, right? And then knowing that, as of the end of first quarter this year, including safe business loans, the total loan balance, for which we are bearing risk responsibility is 48.3% out of total loan balance, then which is up from 39.8% from the previous quarter.

And it is 26% of total Puhui loan balance that was enabled under our new 100% guarantee model. And then going forward, surely because this is our new model in place, so it is gradually -- I mean, the portion of our risk-bearing balance will gradually and continues to grow.

David Choy: All right. So Yada, thanks for the question on this quarter net loss. I think as we mentioned before, we did achieve a pretax profit for this quarter. The key item actually affecting this quarter is really on the income tax. Income tax expenses increased to 1.3 billion, as you know, in this quarter, from 0.4 billion in the same period of 2023. This is really mainly due to the 1.05 billion withholding tax, which associated with our cross-border dividend upstream from PRC operating entities to the immediate holding company offshore.

So as I mentioned, this cross-border dividend upstream arrangement is primarily to support the distribution of a special dividend plan that we announced on March 21, and of course, for other general liquidity arrangement purpose offshore. That's my comment I would make.

Operator: Thank you. That concludes our question-and-answer session for today. I will now turn the call back over to our management for closing remarks.

Xinyan Liu: Thank you. This concludes today's call. Thank you for joining the conference call. If you have more questions, please do not hesitate to contact the company's IR team. Thanks again.

Operator: Thank you. This conference has now concluded. You may now disconnect.