[LU] Lufax Holding Ltd.
Q2 2023 Earnings Conference Call
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Gregory Gibb, Director and Co-Chief Executive Officer
David Choy, Chief Financial Officer
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Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Lufax Holding Limited Second Quarter 2023 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, ma'am.

Xinyan Liu: Thank you very much. Hello, everyone, and welcome to our second quarter 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 our latest business strategy, the macroeconomic trends and the recent development of our business. Our Co-CEO, Mr. Greg Gibb, will then go through our second quarter results, and provide more details on our business priorities. Afterward, 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 am now pleased to turn over the call to Mr. Y.S. Cho, Chairman and CEO of Lufax.

Yong Suk Cho: Thank you for joining today’s call. During a complicated macro environment that has been particularly challenging for small businesses, we have doubled down on our efforts to optimize costs and adjust our strategy to achieve our U-shaped recovery. While we continue to make progress towards this recovery, we have also been embracing new initiatives to achieve long-term stability. In the second quarter, we were able to improve our bottom line sequentially and advance our efforts to attain higher credit quality for new loans we enabled. We also drew closer to our goal of transitioning into a 100% guarantee model, and continued our strategies to mitigate risk and diversify business.

Let me provide some updates for the second quarter.

First, China's macro economy is still charting its path to recovery and the landscape remains complex. In the second quarter, China's GDP demonstrated a year-over-year growth of 6.3%, indicating progress towards the country's annual growth target of 5%. However, the performance of the Producer Price Index and Consumer Price Index, as well as some other economic indicators, such as import-export statistics, signal a complicated situation. We will continue to closely monitor market dynamics as we navigate China's evolving macroeconomic environment.

Meanwhile, SBOs remain under pressure and continue to face difficulties in the current environment. The SME business conditions index published by the Cheung Kong Graduate School of Business, which considers factors including sales outlook, profit outlook, and the financing environment, declined from 58.9 in March to 50.2 in June. The Small and Medium Enterprises Development Index and the macroeconomic perception sub-index, which reflects enterprise confidence, published by the China Association of Small and Medium Enterprises, were also below the critical threshold of 100 in the second quarter. This indicates that the operational environment for SBOs remained challenging in the second quarter, and it may take more time for the SBO segment to recover.

On the regulatory front, the overall regulatory environment remained stable. Government authorities have indicated that their priority is to employ policies that will be favorable to economic growth and the private sector. This will hopefully provide a stronger foundation for private enterprises and the platform economy.

Next, let's get into the impact of these factors on our business. Because of the challenging macroeconomic environment for the SBO segment, our U-shaped recovery has been progressing slower than we had anticipated. New loan sales in the second quarter declined sequentially due to weakened high quality loan demand from SBOs, as well as our continued emphasis on operational prudence. As we have discussed over the past several quarters, our goal is to prioritize asset quality over quantity, with the goal to improve our overall asset quality for long-term, healthy, sustainable growth. We continued to see progress on this front. Our C-M3 ratio stabilized in the second quarter, though it remained elevated from historical levels, partially due to the decreased outstanding balance. Moreover, we are pleased to observe that the asset quality of new loans is in line with our expectations. Early risk indicators suggest that the asset quality of new loans enabled after we tightened credit standards is better than that of the vintages enabled during the past three years, although it has not yet fully recovered to the pre-COVID level seen in 2019.

Meanwhile, our consumer finance business continued to witness healthy growth. Consumer finance loans as a percentage of total new loan sales increased during the second quarter, and comprised over a third of new loans enabled during the period. Total outstanding balance of consumer finance loans was up as well. In addition, the NPL of our consumer finance business decreased from 2.4% in the first quarter to 2.2% in the second quarter. In light of the challenging macroeconomic environment encountered by the SBO segment and the relatively long period of time it may take for this segment to recover, we expect our consumer finance business will become an increasingly important part of our portfolio over the next 12 to 18 months.

On the financial side, our revenue decreased in tandem with our outstanding loan balance. In response to this anticipated top-line pressure, we maintained our discipline with regard to expenses. Continuous optimization efforts enabled us to shrink our operating costs at a greater rate than the decrease in income. Together with stabilized asset quality, our bottom line improved over the last quarter.

The events of the past several quarters have highlighted the importance of mitigating risk in regards to the long-term health of our business. As such, risk minimization and business diversification will be key components of our medium-term strategic initiatives. Recognizing this, we have devised a multi-layered approach which we expect will help us achieve long-term stability. This approach involves maximizing the utility of our guarantee and consumer finance licenses, continuing our operational shift towards high-performing regions, maintaining strength in direct sales channels, and further enhancing our risk control mechanisms.

We intend to make full use of our guarantee license to focus on growth in better-performing, economically resilient regions. We continue to transition towards the business model under which our guarantee subsidiary will provide 100% of credit enhancement. This approach will allow us to more completely utilize the benefits of our guarantee license and leverage our strong capital position, and result in better profitability in medium term. Currently, our insurance company credit enhancement partners are charging elevated insurance premiums, which puts pressure on our take rates. Switching to the 100% guarantee model will resolve this, and will improve our take rate and profitability. In addition, a 100% guarantee model without CGI partner is simpler. This means easier compliance with regulation, and a better process for borrowers.

We have discussed our transition towards this 100% guarantee model before, and I am pleased to report that we continued to make good progress. At present, we have already secured a sufficient credit line from our funding partners to be able to support this model for 2023 and beyond. During the second half of this year, we plan to continue to increase the proportion of new loans enabled under this model. As a result, we expect our risk-bearing percentage will further increase in the coming quarters. Our ability to do this is based in part on the strength of our capital position. At the end of the second quarter, the leverage ratio of our guarantee subsidiary was 1.6x, as compared to a maximum regulatory limit of 10x.

In addition to transitioning towards the 100% guarantee model, we also plan to further expand our consumer finance business. This decision is motivated by a number of factors. First, under the current macroeconomic environment, consumer finance loans with smaller ticket sizes and shorter durations complement our SBO loan enablement business, which is more heavily impacted by the macro conditions. By providing consumption loans, we can provide a more comprehensive product line to our customers to satisfy their consumption needs. Expanding our consumer finance business also opens up opportunities for synergy with our Puhui loan platform by leveraging our risk control capabilities and existing customer base. Furthermore, our consumer finance license allows us to operate the consumer finance business in full compliance with regulations. With this money lending license, we are able to provide consumer loans directly to our customers under a simple and straightforward business model, which improves customer experience.

As we undertake these efforts, we intend to continue our strategy of focusing on strong regions, enhancing direct sales channel productivity, and bolstering risk control mechanisms in our operations. We have focused, and will continue to focus, on establishing scaled operations in more economically resilient regions. We have previously seen better credit performance from customers in these regions. In the second quarter of 2023, 74% of our direct sales were deployed in top-third and middle-third regions, up from 71% during the same period a year ago. Meanwhile, we will also concentrate on boosting the productivity of our direct sales channel. Average productivity for the direct sales team increased by 10% sequentially in the second quarter.

Risk control will also take the form of a more stringent vetting process. We will continue to prioritize quality over quantity and only accept borrowers that meet our tightened credit standards. This will keep us on track to improve overall loan quality in the long-term. At the same time, we will continue to improve our risk control model. We have developed a new AI + expert model, which integrates our AI capabilities to meet the extensive data requirements of our dual KYC-and-KYB approach. By leveraging AI tools, we can conduct borrower interviews, collect data, and identify potential risks within a shorter timeframe. Our risk assessment experts then leverage the information provided by AI, combined with their own personal experience, to make well-informed decisions. This model strikes a balance between efficiency and accuracy in risk assessment. In addition to these enhancements, we have also upgraded our Credit Loss Forecast Model, which now considers a wider range of macro factors.

As a result of our focus, we expect that our near-term loan growth will remain prudent and somewhat limited. And as we transition to the 100% guarantee model, the increase in risk-bearing will lead to a higher take rate and higher upfront provision. This will suppress our bottom-line performance for the near term. However, we are taking a long-term perspective with these decisions. We are confident that our approach will build a foundation from which we can achieve healthy and sustainable future profitability.

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

Gregory Gibb: Thank you, Y.S. I will now provide more details on our second quarter results and our operational focus for this year. Please note all figures are in Renminbi unless otherwise stated.

During the second quarter of 2023, our performance was negatively impacted by the challenging macro environment faced by SBOs. Our total income was 9.3 billion, representing a decrease of 8% compared with the first quarter of 2023. This was mainly due to a decline in loan balance, as well as new loans enabled and pricing pressure from our credit insurance partners. Despite the challenges on our top-line performance, we increased our net profit to 1 billion this quarter, up from 0.7 billion in the first quarter, primarily resulting from our ongoing cost optimization.

Now, let's dive into the details of our performance.

In the second quarter of 2023, our new loans enabled were 53.5 billion, representing a sequential decrease of 6.1%. Our outstanding balance of loans enabled decreased by 13.9% during the same period. These declines were mainly due to a weaker high-quality demand for loans, coupled with our prudent business strategy of employing tightened credit standards on new loans enabled.

Though new loan sales remained under pressure, our direct sales productivity bottomed out in the first quarter and began to show signs of rebound in the second quarter. Average productivity for the direct sales team increased by 10% sequentially in the second quarter. During the second quarter, 61% of new loans enabled came from our direct sales team, compared to 56% in the first quarter.

In addition, we are confident that we are on the right path to prioritize higher quality customer segments concentrated in more economically resilient geographies. As Y.S. mentioned, early risk indicators of new loans enabled after we tightened our credit standards have demonstrated improved asset quality compared with the vintages enabled in the past three years. Our C-M3 ratio, for instance, stood at 1.0% in the second quarter, which improved when compared to historical levels, but remained flat as compared with the first quarter of 2023 despite that the outstanding balance of loans decreased by 14%. If we neutralize for the impact of decreasing balances in the second quarter, an adjusted C-M3 flow rate shows gradual improvement.

As we focus on better-quality borrowers, average ticket size has also naturally increased. Average ticket size of unsecured loans for the first quarter of 2023 increased to RMB285,000, from RMB270,000 for the last quarter.

Our consumer finance business saw healthy growth during the second quarter, despite the challenges faced by our retail credit enablement business. The total outstanding balance of consumer finance loans as of the end of the second quarter was 33 billion, up 31% year over year and 11% sequentially. The NPL ratio improved to 2.2% in the second quarter, as compared to 2.4% in first quarter. We further diversified our product offerings as the contribution from our consumer finance business continued to grow. Consumer loans accounted for 33.5% of new loans enabled during the second quarter, compared to 24.4% in the first quarter of 2023.

Next, let's take a look at take rate. During the second quarter, our overall pricing stood at 20.3%, flat as compared to 20.4% in the first quarter. While funding cost was stable, the take rate remained compressed at 7.0% as our credit insurance partners continued to charge elevated premiums despite improved asset quality for new loans. To address this issue, we continued to advance towards our 100% guarantee model. We have secured sufficient credit line and funding partners to support our 100% guarantee model. As of mid-July, 46 out of our 84 funding partners have agreed to extend loans under the business model where we provide 100% guarantee, with sufficient credit line for 2023 and beyond. Excluding consumer finance, our risk bearing by new loan sales in the second quarter increased to 39.2%, as compared to 22.6% in the first quarter. Our risk-bearing by balance as of the end of the second quarter also increased to 27.5% from 24.5% in the first quarter. At this rate, we expect our risk-bearing by balance will exceed 40% by the end of this year. Our strong capital position has provided a solid foundation for our transition towards this 100% guarantee model. As YS mentioned, the leverage ratio of our guarantee subsidiary stood at 1.6x at the end of the second quarter, which leaves us with sufficient room to grow when appropriate.

Next, let's go into the details of our bottom-line drivers. Our persistent cost optimization efforts have been the primary driver of our bottom-line's continued improvement. As a result of these initiatives, operating costs decreased by 14% sequentially, dropping to 4.9 billion in the second quarter of 2023 from 5.7 billion in the first quarter. Credit impairment losses also decreased slightly from 3.1 billion in the first quarter to 3 billion in the second quarter of 2023, mainly due to a decrease in provisions due to the lower loan balance.

Furthermore, in unsecured lending, when there is a large spike in credit costs driven by macro factors, market participants often witness higher levels of late-stage recoveries as the economic environment improves. This trend has been seen in markets such as the U.S., Taiwan, and Korea in their respective retail credit crisis between 2000 and 2010. Consistent with this general observation, our absolute amount of recoveries in the first half of 2023 increased by 45% as compared to the same period last year.

Finally, as Y.S. mentioned, our strategy is to de-risk and diversify by fully leveraging our licenses to achieve growth in better-performing regions, while simultaneously retaining strong loan channels and creating solid risk control mechanisms. I'd like to discuss the expected impact that our approach will have on our business.

The recovery of new loan sales will depend mainly on the recovery of macro demand. We do not expect a rapid macro recovery in the near-term for SBOs. In combination with our strategy of prioritizing quality over quantity in light of the increased risk exposure when we transition into the 100% guarantee model, we do not anticipate significant growth in new loan sales in the coming months. Going forward, our new loan sales mix will likely shift as consumer finance loans will account for a greater portion of new loans enabled. This increase in consumer finance loans will help to offset some of the decrease in SBO loans.

As a result of the aforementioned factors, we expect our total new loan sales for the full year to be in the range of RMB 190 billion to 210 billion. The drop in new loan sales and outstanding balance will continue to weigh on our revenues in the second half. This will be partially offset by the improvement in our take rate as we remove the impact caused by the elevated CGI premiums in transitioning to the 100% guarantee model, which is expected to result in a take rate of 13% to 14% for all new loans by the fourth quarter.

We will maintain diligence with regards to the bottom-line. At present, impairment costs are expected to remain at an elevated level, roughly 3 billion a quarter, through the remainder of 2023. However, starting in the second half the driver of impairment expenses will shift gradually from past portfolio charge-offs to provisions for new loans under the 100% guarantee model. Under the 100% guarantee model, a significant portion of provisions for all new loans are front-loaded in our accounting, while revenue is recognized throughout the loan's lifetime. As such, our bottom-line will be suppressed in the second half as we accelerate the transition to the 100% guarantee model. However, this shift is expected to result in higher margins, and support our U-shaped recovery, once the majority of the portfolio is supported by the 100% guarantee model. In the meantime, we will continue to emphasize efficiency and expect operating costs will continue to decrease year over year.

I will now turn the call over 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 second quarter results. Please note that all numbers are in Renminbi terms, and all comparisons are on a year-over-year basis unless otherwise stated.

In the second quarter, our total income was 9.3 billion, while total expenses decreased by 27.2% to 8 billion. The decrease in total expenses was primarily due to a decrease in sales and marketing expenses. As a result, our net profit was 1 billion in the second quarter of 2023.

Next, let's have a closer look at our total income. First, as Y.S. and Greg mentioned before, our performance was impacted by the complex macroeconomic situation affecting the SBO segment. This resulted in a 39.4% decrease in our top-line this quarter.

During this quarter, our technology platform-based income was 4.1 billion, representing a decrease of 44.8%. Our net interest income was 3.4 billion, a decrease of 32.8%, and our guarantee income was 1.1 billion, a decrease of 40.7%. As a result, our technology platform-based income service fees as a percentage of total income declined to 44% from 48.3% a year ago. In addition, due to the increase of income from our consumer finance business, our net interest income as a percentage of total income actually increased to 36.3% from 32.8% a year ago.

Furthermore, due to the decline in loan balance and a lower fee rate, guarantee income was 1.1 billion, compared to 1.9 billion a year ago.

Our other income, which mainly includes account management fees, collections, and other value-added service fees charged to our credit enhancement partners as part of the retail credit enablement process, was 310 million in the second quarter of 2023, compared to 532 million in the same period of 2022. The change was mainly due to the change in fee structure that we charged to our primary credit enhancement partner.

Turning to our expenses. We have maintained our commitment to cost optimization. Our total expenses, excluding credit and asset impairment losses, finance costs, and other losses, decreased by 21.6% year over year to 5.0 billion this quarter, as we continued to enhance our operational efficiency. In the second quarter, our total expenses decreased by 27.2% to 8.0 billion from 10.9 billion a year ago. This decrease was primarily due to the decrease in sales and marketing expenses.

Our total sales and marketing expenses, which mainly include expenses for borrowers and investor acquisition costs, as well as general sales and marketing expenses, decreased by 27.3% to 2.5 billion in the second quarter. This decrease was attributable to three factors. First, the decreased new loan sales and corresponding reductions in commissions. Second, the decreased investor acquisition, retention expenses and referral expenses from platform service as a result of decreased transaction volume. And third, decreased general sales and marketing expenses led by the optimization among our sales team.

Our general and administrative expenses decreased by 35.3% to 493 million in the second quarter, mainly due to our expense control measures and decrease of tax and surcharge.

Our operation and servicing expenses decreased by 0.3% to 1.6 billion in the second quarter, mainly due to our efforts in expense control and decrease of loan balance.

Our credit impairment losses decreased by 14.7% to 3.0 billion in the second quarter, primarily due to the decrease in provision of loans and receivables, a result of the decreased loan balance.

Our finance costs decreased by 38.7% to 136 million in the second quarter from 221 million in the same period of 2022, mainly due to the increase of interest income from bank deposit and decreased interest resulting from our early repayment of Ping An Convertible Promissory Notes, partially offset by the increase of interest expenses driven by increased interest rates.

As a result, net profit for the second quarter was 1 billion, compared to net profit of 2.9 billion in the same quarter of 2022. Meanwhile, our basic and diluted earnings per ADS during the second quarter were both RMB0.42 or USD0.06.

Turning now to our balance sheet. Our balance sheet remains strong and solid as our cash at bank balance has increased since the end of our last fiscal year. As of June 30, 2023, we had a cash balance of 46.9 billion in cash at bank, as compared with 43.9 billion as December 31, 2022. In addition, liquid assets maturing in 90 days or less amounted to 38.2 billion as of the end of June 2023.

As of the end of June 2023, our guarantee subsidiary's leverage ratio is only 1.6 times, as compared to a maximum regulatory limit of 10x.

All of these factors offer substantial backing for the company to navigate the changing macroeconomic landscape, while maintaining our resilience and continuing our dividend payout.

That concludes our prepared remarks for today.

Operator, we are now ready to take questions.

Questions and Answers

Operator: Thank you. (Operator Instructions). Alex Ye of UBS.

Alex Ye: I have two questions on the loan demand side. So in the past few months, have you noticed any change in terms of your SME loan demand, for example, the application volume? And have you seen any sign of a sequential recovery, or is it actually weakening?

Second, I'm wondering if you have done any survey on your existing SME customer base regarding whether they're pulling back their demand, or what could potentially make them more positive? And in particular, I'm wondering if you think the current property downturn has anything to do with the weak demand from high-quality borrowers? For example, maybe they will suffer from the downturn or maybe they think the property prices declining, which makes them like willing to risk their assets?

Yong Suk Cho: Thanks, Alex. This is Y.S. answering your question. If you look at other market data, such as total social financing or the bank loan, you can see that the market demand is not in good shape; it's quite weak. And likewise, our high qualityloan demand was weak indeed. While we believe the recovery of China's economy in the long term, but we believe it takes some time, especially for our SBO segments to recover that underpins our loan demand.

Mostly, our loan demand is driven by borrowers' willingness to borrow, which, in turn, is most affected by how they see the investment opportunity, and then how they see near-term economy for their business, right? So knowing that, we believe it will still take a while to receive a turnaround of loan demand from the high-quality SBO segments.

Operator: Emma Xu of Bank of America.

Emma Xu: I have two questions. The first one is about your loan growth outlook. So we do notice that the management has already guided down to your full year loan growth to 180 billion to 210 billion compared to around 300 billion previously. So could you tell us more what drove you to lower your full year loan growth plan? And further, could you tell us a little more about the loan mix of your new loan growth plan? As you mentioned earlier, you want to grow more of your consumer loan, considering the weak demand on your SBO segment.

And the second question is about the asset quality trend. So we do notice that your flow rate stayed flat sequentially in second quarter, partly due to the contracting loan balance. But how is the underlying trend of your legacy loan book? So from a vintage perspective, do they continue to improve? And what's your expectation of the asset quality trend in rest of the year?

Yong Suk Cho: Thanks, Emma. Just before, Greg provided our new guidance on new loan sales for this year, right, which is from in the range of 190 billion to 210 billion for this year. The reason of adjustment is the recovery of new loan sales will mainly depend on the recovery of macro demand. And then as I said in answering the previous question, we do not expect a quick turnaround of this demand side, or recovery of macro economy in near term, especially for SBO segments. So that's why we adjust our new loan sales guidance. But at the same time, as also Greg said, we expedite our customer finance business growth, so it takes more and more part of our new loan sales.

Our strategy is mainly to prioritize quality over quantity, knowing that we are bearing increased risk with 100% safe guarantee model. But we believe this will eventually be a good foundation for long term while sustainable profitability.

Regarding asset quality, if you look at ourflow rate, over C-M3 flow rate, it didn't change from the last quarter, and it still remains elevated from historical levels. As we said, it's mostly because our declining new loan sales, thus declining loan balance.

But if you look at -- if you want to have a different look from this balance change, the full new loans generated in 2023 this year, we can see obvious improvements in the asset quality, as compared with all the vintages. Although it's obviously better than last year or 2 years ago, it has not fully recovered back to the pre-COVID level in 2019.

So in conclusion, in short, the asset quality for new loans is obviously improving. But as a whole portfolio, you cannot see the incremental net flow because of declining balance.

Operator: Chiyao Huang of Morgan Stanley.

Chiyao Huang: I have two questions. One is could you give us a little bit more color on the latest progress on the transition to 100% self-guarantee, especially with the arrangement with the funding partners? What type of institutions have been signing up for the new guarantee model? And what's the new credit line given by those funding partners? And how does that compare to previous CGI model?

And the second question is could you elaborate a little bit more on your new product strategy and client strategy, because we're obviously transitioning to a higher quality or lower-risk borrowers, but we're still targeting around 20% loan pricing. So I'm just wondering what's the strategy to achieve that end while maintaining a similar pricing?

Gregory Gibb: Sure. Greg here, I'll answer your questions. On the transition to the 100% guarantee model, we are very much in good shape that if we want, by the fourth quarter of this year, 100% of all new business can be done under this model, and that is what we will probably shoot to achieve. We've got, out of our funding partners, an ongoing process. So with 84 funding partners, 46 have already agreed to extend; and out of this 46, a number have already started to operate and cooperate with us under this model.

This cuts across all types of funding partners, so be it large banks, mid-banks, smaller-sized banks and other trust-related cooperation, that is across the board. So there isn't a trend that says it's just small banks signing up for the new model, it is really all types.

In terms of a credit line that we were able to achieve with our funding partners under having the credit insurance, versus now, the guarantee, it is a transition process. Roughly, if you look at the line, some give them actually more, some give less. But on average, we're probably seeing a reduction of about 40%, 40% to 50%. But in the context of our focus on higher-quality customers and being more selective on regions, in terms of the new business volume that we expect to generate this year and into next year, we have more than enough capacity with what we've got in place.

The new guarantee model, based on our experience, even in the past with CGI, once an institution cooperates with you on a model, they're comfortable with the performance, the chance to increase credit lines going forward is always there. So I think from a funding availability under the new model, really no issues at all.

And in fact, given that all banks right now are being very tight on their own loan extensions, given their own views of the macro environment, being able to work with us where we do have the 100% guarantee, our assets are attractive to them. And so we do see increasing competition amongst our funding partners to try and get more business from us, right? So really, there’s no issue in terms of how it affects funding, and the model will be very much complete, as I said, by the fourth quarter.

In terms of the mix, right, obviously, our focus is really on achieving that credit quality, really ensuring that the new business we do is getting back to as close to 2019 levels as possible. So I'd like to highlight that there's really four things at play here, right? There's four areas where we're changing mix and emphasis to get the kind of growth we want and the credit quality we want.

So on the customer side, clearly, what we're doing is we're prioritizing more what we call strong small business owners. And these are small business owners whose companies have a clear legal structure, have a longer operating history, operate more in industries with a stabler capital position and stronger long-term distribution networks of their own business. And these strong SBOs, if you look over the last 18 months, have performed significantly better than the rest of the portfolio. These strong business owners make up about more than half of our ENR today. So that is the number one shift.

Our mix will increasingly be focused on the non-consumer finance portion to these customers. And even for the consumer finance portion, we will also try and serve these customers' individual needs. So there's a change in mix on customer.

The second is really greater emphasis on the more resilient economic regions. Historically, we have covered a large number of cities. Here, we're being more selective in terms of where we view new business growth, based on our view of their ability to recover in a difficult environment, and to be in reasonably good standing over the next couple of years perhaps compared to weaker geographies.

Then layering on top of that shift in region, you have the shift in mix on product, where there's more emphasis on the consumer finance side. And then we have our shift in channel, where if you remember, historically, we had 40% more of the business coming from cooperation with third-party channels. Here, we're placing much greater emphasis on our direct sales, and they make up now a greater proportion of our new business because they have tighter control, understanding the customer, and in creating a more complete service bundle for the customer across now guarantee products and consumer finance products, as well as being able to detect better fraud where it may exist.

So all of these shifts, when you add them up, it does mean that we are operating off of a narrower scope, right, than historically in terms of our focus of customers. But within this prioritized scope, we believe that we can then achieve the new business at the credit quality we want.

With regard to pricing, because we have a mix here of a secured product, unsecured product, consumer finance product, what we're finding is that our ability, once we've got these good customers to provide them with the ticket size that they're looking for, to provide them with the duration they're looking for, there isn't as much price sensitivity, to be honest. So we think that keeping kind of a 20% APR and then keeping within our focus is a way to obviously not grow very quickly, right? We're still going for prudence. But to serve business that will give us the right top line take rates and the right bottom line results as we look out over the next 12 months.

So a lot of that transition, a lot of those changes in mix are really now underway for six to nine months, and we'll continue to push in that direction.

Operator: Yada Li of CICC.

Yada Li: This is Yada with CICC, and I just have one quick question for today. Could you please share more color on the FY23 outlook of the top line and bottom line? And how to understand it in the current macroeconomic environment? And that's all.

David Choy: All right. Thanks, Yada, for your questions. I think we did have a statement on our full year new loans outlook in our earning release. Here, let me comment some more about how the top line and the bottom line may evolve with this kind of changing.

First, on the top line, inevitably, the top line will be affected by the decrease of new loan sales as a result of our more stringent credit acceptance criteria that we mentioned earlier. Of course, the decrease in the new sales will in turn affect the average loan balance, and thus will also have an impact to the revenue. These two impacts will be mitigated by the improvement in take rate when we transition to the 100% guarantee model.

For the bottom line, I think we've mentioned before, when our new business model moved towards the 100% guarantee model, a significant portion of our expected credit loss provisions of new loans will be front-loaded on day one -- from an accounting perspective, of course, they don't have any impact on the cash profit in that sense -- while the revenue is recognized throughout the loan's lifecycle. As such, our bottom line will be suppressed in the second half as we accelerate the transition to the 100% guarantee model.

However, let me re-emphasize one more time, this shift, we expect to have positive results in the longer term and support our U-shaped recovery once the majority of the portfolio is supported by the 100% guarantee model.

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. Thank you.

Xinyan Liu: Okay. Thank you, operator. This concludes today's call. Thank you all 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. That concludes the call today. Thank you, everyone, for attending. You may now disconnect.