[LU] Lufax Holding Ltd.
Q3 2024 Earnings Conference Call
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Executives
YongSuk Cho, Chairman and CEO
Peiqing Zhu, CFO
Xinyan Liu, Head of Board Office and Capital Markets

Analysts
Betty Lee, CLSA
Judy Zhang, Citi
Yada Li, CICC

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Lufax Holdings Third 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, ma'am.

Xinyan Liu: Thank you very much. Hello, everyone, and welcome to our third quarter 2024 earnings conference call. Our 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. YS Cho, who will provide an update of the recent developments and strategies of our business. Our CFO, Mr. Peiqing Zhu, will then provide more details on our financial performance and business operations.

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. YS Cho, Chairman and CEO of Lufax. Please.

YongSuk Cho: Thanks for joining us today for our third quarter 2024 earnings call. During the third quarter, while Puhui loan demand remained weak as small business owners continued to face a complex macro environment, we saw ongoing growth in our consumer finance business. We are hopeful that policy stimulus measures introduced by the Chinese government in late September will help improve the macro environment and have a positive impact on our business performance in the long run. Meanwhile, we plan to stay vigilant and prudent in the execution of our business strategies in light of the increased risk exposure under our 100% guarantee business model.

Before we discuss the business details, let me share some updates on the macro environment. In the third quarter, the macro environment remained challenging for small business owners. The SME Development Index declined by 0.3 points quarter-over-quarter to 88.7 in September. The Business Conditions Index, published by the Cheung Kong Graduate School of Business, also declined from 49.3 in June to 46 in September, suggesting the persistent challenges faced by the small business sector. On the other hand, we were encouraged by signs of a mild recovery in the consumption sector during the third quarter, as the CPI showed improvement from 0.2% in June to 0.4% in September.

In late September, we were glad to see that the Chinese government announced a number of new stimulus policies, including measures to help the recovery of the real estate sector and increase liquidity, such as a cut to reserve requirement ratio and the lowering of existing mortgage rates. Local governments also launched a series of stimulus initiatives relating to real estate and consumption to boost consumer confidence and strengthen the economy.

We believe all of these efforts will have a positive impact on SBOs in China. Meanwhile, we recognize it will take time for SBOs to benefit from these measures and improve performance, so we will remain prudent as we execute our business strategies in the short term. Furthermore, we will also put more emphasis on our non-SBO customers and continue to grow our consumer finance business. This will help us take full advantage of the gradual effects of the consumption recovery and will build solid position for our future growth.

Now, let's turn to our operating results.

First, let's take a look at our loan volume. Total new loan sales in the third quarter were 50.5 billion, flattish year-over-year and improving by 11.7% from last quarter. The quarter-on-quarter growth despite the macro challenges was mainly attributable to the continued growth of our consumer finance business, which offset the ongoing weakness in Puhui loan demand from high-quality SBOs. New consumer finance loans increased by 27.8% year-over-year and accounted for 52% of our total new loan sales in the third quarter, as a result of our continued efforts to roll out smaller tickets and revolving product structures. Balance-wise, our total loan balance stood at 213.1 billion as of the end of third quarter, of which consumer finance loans took up 22%.

Turning to asset quality, our tightened risk control policies and enhanced risk assessment system have helped maintain stable asset quality. The C-M3 flow rate of our Puhui loans remained at 0.9% during the third quarter despite a decrease of total balance as compared to the second quarter. The asset quality of our consumer finance loans also stayed strong, with the NPL ratio further decreasing to 1.2% from 1.4% in the second quarter.

As loans enabled under the 100% guarantee model kept increasing as a percentage of total loans, our balance take rate rose by 1.9 percentage points year-over-year to 9.7% during the third quarter of 2024. Cost of funds continued to decrease, driven by both the monetary policy stimulus and our diversified license strategy. As mentioned during our last earnings call, we acquired a nationwide small lending license in July. We started to provide new loans under this newly acquired nationwide small lending license in August. As of the end of the third quarter, we have provided more than 1 billion in new loans under this new license. We believe our small lending license has the potential to further reduce our funding costs, diversify our product portfolio, and improve our capital management efficiency.

Finally, I want to provide an update on Ping An Group's mandatory general offer. On September 27, Ping An Group dispatched offer documents and commenced the offer period. If there are no additional requirements from regulators, the offer period will end on October 28. As stated in the offer document, Ping An Group is making the offer solely to comply with applicable rules and has no intention to privatize Lufax. The intention is that Lufax will continue to remain an independent entity listed on the New York Stock Exchange and Hong Kong Exchange. Looking ahead, we will seek to continue to deepen our synergies with Ping An Group, leveraging its brand, reputation, technological resources, and extensive network to strengthen our market position.

I will now turn the call over to Peiqing, who will provide more details on our financial performance and business operations.

Peiqing Zhu: Thank you, YS. I will now provide a closer look into our third 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 third quarter of 2024, our total income decreased by 31.1% to 5.5 billion from 8.1 billion in the third quarter of 2023, mainly due to a decrease of outstanding loan balance by 41.8%, partially offset by our increased take rate as loans enabled under the 100% guarantee model constitute a higher proportion of our total loan book. Meanwhile, our total expenses decreased by 19.2% from 7.7 billion to 6.3 billion, among which the total operating expenses declined by 35.9% from 4.7 billion to 3.0 billion, and credit impairment losses increased by 9% from 3.0 billion to 3.3 billion. Our operating efficiencies improved, with our operating expenses-to-income ratio decreasing to 53.8% from 57.8% in the third quarter of 2023. The increase of credit impairment losses was mainly due to increased provision related to our loan book and certain investment assets. As a result, we recorded a net loss of 725 million for the third quarter.

Turning to the unit economics for our loan business, our APR by balance decreased from 20.1% in the third quarter of 2023 to 19.5% in the third quarter of 2024. Despite the decrease in APR, our take rate by balance increased to 9.7% from 7.8% in the third quarter of 2023, primarily due to the removal of negative impact from high CGI premiums after our transition to the 100% guarantee model and, to a lesser extent, the decrease in funding costs. We expect that the take rate will further increase as the percentage of loans enabled under the 100% guarantee model continues to increase, and that funding costs will continue to decrease as we continue to optimize our funding structure by leveraging our consumer finance and small lending licenses.

On the expenses side of unit economics, while sales and marketing expenses remained stable, credit costs and other operating expenses were a drag on our net margin. Credit costs increased primarily due to the increased risk exposure and provision for our loan book. As discussed before, while we anticipate 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 higher upfront provisions. This accounting treatment affects our short-term profitability but is expected to lead to improved long-term financial performance as the loan portfolio matures. The increase of other operating expenses was primarily due to the contraction in our loan balance and reduced economies of scale.

Now, let me highlight a few of the key P&L items.

During the quarter, our technology platform-based income was 1.6 billion, representing a decrease of 49.9%, mainly due to the decrease in retail credit service fees as a result of the 41.8% decrease in outstanding loan balance. In addition, it was also negatively affected by the cessation of the Lujintong business in April 2024.

Our net interest income was 2.7 billion, a decrease of 18.8% from the same period last year. The relatively lower decrease in net interest income was the result of an increase in consumer finance revenue. Meanwhile, our guarantee income was 818 million, a decrease of 13.1%. In terms of revenue mix, technology platform-based income accounted for 29.5% of our total revenue, down from 40.5% in the same period last year. Net interest income and guarantee income accounted for 48.5% and 14.7% of total revenue in the third quarter, respectively, as compared to 41.1% and 11.7% in the same period last year.

In terms of expenses, our credit impairment losses increased by 9.0% to 3.3 billion, mainly due to increased provision related to loans as we applied a more prudent approach in our ECL model to reflect the complex macro environment in the third quarter, as well as increased provision related to certain investment assets. Our total sales and marketing expenses, which include expenses for borrower acquisition costs as well as general sales and marketing expenses, decreased by 49.9% year over year to 1.1 billion in the third quarter. The decrease was mainly due to reduced loan-related expenses resulting from the decrease in new loan sales and outstanding loan balances, as well as the elimination of the expenses associated with our Lujintong business. Our operation and servicing expenses decreased by 25.8% year over year to 1.1 billion in the third quarter, as a result of our continued efforts to control expenses and the decreased loan balance, partially offset by increased commissions associated with improved collection performance.

Our finance costs increased by 48.9% to 59 million in the third quarter from 40 million in the same period of 2023, mainly due to the decrease of interest income from bank deposits, partially offset by the decrease of interest expenses after the repayment of our C-Round Convertible Promissory Notes upon their maturity on September 30, 2023.

In terms of capital, as of the end of September 2024, our main operating entities remained well-capitalized. Our guarantee subsidiary's leverage ratio stood at 2.6x, and our consumer finance subsidiary's capital adequacy ratio stood at 14.9%, as compared to the 10.5% regulatory requirement.

As we deal with the complexities of the broader economic environment, we are seeing encouraging signs in terms of asset quality, and in the growth of our consumer finance business. We will remain committed to our prudent strategy as we seek to build a solid foundation for long-term, sustainable future operation, and will uphold our commitment to bringing value to our shareholders.

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

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Betty Lee with CLSA.

Betty Lee: So I have two questions. The first one, could you kindly express what will be the impact of the new policy stimulus on our business? The second is could you share more about the business outlook for this year and beyond?

YongSuk Cho: Thanks, Betty. About stimulus policy, it is surely a positive impact, I think, on all of the economy and in our SBO segment as well. But knowing small business owners in general are in difficulty now, it will take more time for them to benefit from these measures and improve performance. So in the near term, we remain prudent and put asset quality over quantity for SBO lending.

But at the same time, we'll take full advantage of the gradual recovery by putting more emphasis and focus on non-SBO segments and expedite small-and-medium-sized ticket loan growth using our CF license, consumer finance license, and the newly acquired small lending license with their funding cost advantage and customer experience advantage of our guarantee model.

And then about your outlook question, so our volume guidance of RMB 190 billion to RMB 220 billion and loan balance of RMB 200 billion to RMB 230 billion, that remains unchanged. On a single account basis, we know that due to the upfront provision of the 100% guarantee model, so profitability is under pressure in the very first calendar year. But going forward, we know that, and we believe the overall lifetime profitability will surely improve than before.

Operator: Judy Zhang with Citi.

Judy Zhang: I have two questions. The first question is regarding our asset quality. I understand that Lufax has been derisking the loan book for some time, which is bearing fruit in the recent quarters. Could management share a bit more color on our latest asset quality performance? And how has our flow rate and delinquency rate been trending since 3Q?

And second question is, does management have any plan to announce another round of special dividend this year, or any other measures that you are considering to boost the shareholders' return?

YongSuk Cho: Okay. Thanks, Judy. The asset quality indicator remained stable in the third quarter, with C-M3 flow rate of our Puhui loans remaining at 0.9% despite declining balance. So while our consumer finance NPL ratio continued to improve from 1.4% to 1.2%, knowing that our loan balance reduction will come to an end in a few months later, and the portfolio account mix in terms of account vintage, that mix will continue to optimize. So I believe we'll be able to demonstrate more obvious asset quality improvement measured by flow rate. So that, we have confidence.

About shareholder return, we do not have any specific plan yet after our special dividend of this year, but the management team is committed to provide long-term shareholder returns as always. And we will consider alternative ways to return value to shareholders going forward.

Operator: The next question comes from Yada Li with CICC.

Yada Li: My first question is regarding the credit impairment loss. Could you please share a little bit more about why the credit impairment losses increased this quarter, while the risk indicators remained stable? And secondly, I was wondering, what is the trend of the funding costs going forward? That's all.

Peiqing Zhu: Thank you, Yada. I'll try to answer the first question. The increase is mainly due to the provision associated with our loans and certain investment assets. Increase of loan provision was driven mainly by the upfront provision of loans under 100% guarantee model, as we discussed, right, and also the prudent approach in our model to reflect our conservative forecast based on the macro environment in the third quarter. We're still seeing some uncertainties in the macro economy.

And as to the second question, I know you're interested about our funding cost trend, right? And our funding costs further decreased in the third quarter, thanks to the favorable monetary policy and our diversified license strategy. And also we try to spend more time to work with our partners and try to cut down some of the funding cost in terms of the different products. And also, we expect funding costs will further decrease as we continue to optimize our funding structure by leveraging our consumer finance and small lending licenses.

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

Xinyan Liu: Thank you. This conference is now concluded. Thank you for joining today's call. If you have any more questions, please do not hesitate to contact our IR team. Thanks again.

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