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OneConnect Financial Technology Co. Ltd.

First Quarter 2022 Earnings Call

May 25, 2022

CORPORATE PARTICIPANTS

Ye Wangchun, *Chairman of the Board*

Shen Chongfeng, *Chief Executive Officer*

Luo Yongtao, *Chief Financial Officer*

Michael Fei, *Board Secretary*

Li Jie, *Chief Technology Officer*

Danielle Gao, *Head of Investor Relations*

CONFERENCE CALL PARTICIPANTS

Timothy Zhao, *Goldman Sachs*

Zhou Tianen, *Orient Securities*

Liu Yang, *Morgan Stanley*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to OneConnect's First Quarter 2022 Earnings Call.

At this time, all participants are in a listen-only mode. After the Management's prepared remarks, we will have a question-and-answer session. Please note, this event is being recorded.

Now, I'd like to hand the conference over to your speaker host today, Ms. Danielle Gao, the Company's Head of Investor Relations. Please go ahead, Ms. Gao.

Danielle Gao

Thank you very much. Hello, everyone, and welcome to our first quarter 2022 earnings conference call.

Our financial and operating results were released earlier today. The results and today's presentation is currently available on our IR website. In this conference we have our Chairman, Mr. Ye Wangchun, joining. You will hear from our CEO, Mr. Shen Chongfeng, who will give opening remarks and Q1 business highlights. Afterwards, our CFO, Mr. Luo Yongtao, will offer a closer look into our financials. Then, a Q&A session, our Board Secretary, Mr. Michael Fei, and our Chief Technology Officer, Mr. Li Jie, will be available too.

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Before we start, I would like to refer you to our Safe Harbor statement in our earnings press release as we will be making forward-looking statements, which involve a number of risks and uncertainties that could cause actual results to differ materially. Please note that we may present both IFRS and non-IFRS financial measures as well as adjusted profit margins. A discussion of the limitation of non-IFRS measures and the reconciliation to IFRS measures is included in the earnings press release.

With that, I'm now pleased to pass the call to our CEO, Mr. Shen Chongfeng, Shen Zong please.

Shen Chongfeng

Good morning, everyone. I'm Shen Chongfeng. Thank you for taking your time to join OneConnect's 2022 first quarter earnings release.

In the first quarter, the global economy experienced greater uncertainties due to instability and COVID outbreaks. Nevertheless, OneConnect overcame these difficulties and kicked off 2022 with solid performance.

Total revenue reached RMB 1.02 billion in the first quarter, representing a year-over-year growth of 24.3%. A Third-party revenue was up by 10.5% year-on-year to RMB 340 million. Adjusted net loss ratio was near double-digit improvement, narrowed to 27.6%. Our strong results in Q1 came from effective execution and implementation of second stage strategy and the concerted efforts of everyone at OneConnect.

In addition, on the share repurchasing plan we announced on February 24 this year, OneConnect has purchased 4.2 million ADRs, which amounts to US$5.85 million as of the end of April. We plan to use these shares for employee incentive plan. On our Hong Kong listing, we have maintained close communications with Hong Kong Stock Exchange after submitting our A1 filings on February 28. Our listing plan was executed smoothly per our schedule. These efforts involving OneConnect and the Management's commitment to sustained and healthy development in the capital market, as well as our confidence in OneConnect's future.

Of course, we do recognize that there are increasing economic uncertainties in China due to recent COVID outbreaks. But we believe the negative impact is on the way and our continuous focus on diversified product development and shift to a more stable revenue model which charges on stock volume will also benefit. Over the long-term, the potential of the financial technology industry remains immense. The total TAM of banking IT solutions in China will reach RMB 127 billion by 2024, a CAGR of 25% according to an IDC estimate. We therefore remain extremely positive about the development of the industry.

Looking forward, OneConnect will continue to embrace our vision of technology to create value through expertise and focus on transformation breakthrough and high-quality development, which is our theme for operations in 2022. We will further improve third-party revenue, sustainable revenue, and profitability through persistent efforts in productization and ultimately generate value for our customers and returns for our investors.

Next, I will give you an update of OneConnect's development in the first quarter.

You can go to the Page 3 of our slides. As previously mentioned, there are increasing uncertainties in economies across the world. Finance, as an important leverage for macro adjustments, will have a bigger role to play. FinTech, a driver for development in the financial industry, have naturally become an important focus for the Chinese government. The government has introduced a number of policies supporting the FinTech industry this year, FinTech Development Plan issued by PBOC, for example, maps out top-level design for a new stage of FinTech development and sets the targets and direction for development in the coming 4 years.

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A new document from CBIRC this January, The Guidance on Digital Transformation of Banking and Insurance Sectors, has placed strategic importance on digital transformation. The next three years is expected to be the crucial window where financial institutions become competitive digitally.

Today, we see high level growth in the industry. Data shows that between 2016 and 2020, ROE in the banking industry has been declining and by an increasing margin. To break this pattern, banks want to empower their business through technology. We can see from the numbers that those with growing technology input do maintain a relatively high ROE. Technology investment in the banking industry is expected to grow at a CAGR of 24%, and that sets a great opportunity for OneConnect's development.

Now, please go to Page 4. OneConnect is currently at Stage 2 of development, which focuses on customer upgrade. As the financial technology industry in China has established the basic framework and is now on its way to transform financial services, OneConnect has also wrapped up the customer acquisition stage and embarked on our second stage development of customer upgrade and product integration.

Next on Page 5. On our Open Day last year when we announced our second stage strategy, we talked about customer upgrades and product integration. In first quarter, we are delighted to report that we have made some breakthroughs in both banking solutions and the relatively new Gamma Platform. In the banking division, we continue to deepen engagement with the customers and won more high value customers. We also see new products from Gamma Platforms including core banking, AI customer service, gain more market share.

Next on Page 6. I want to talk about our product integration and upgrade efforts, especially how our mature products are expanding to high value customers. Digital Financial Inclusion platform is the business plus technology integrated product designed by OneConnect for small and medium sized banks. It includes a data layer and the credit lending core covering the whole lending process, from customer acquisition to loan application, and incorporates comprehensive solutions of marketing risk management and scenarios.

This platform has been used by over 2 million SMEs. In Q1, the product has helped us successfully upgraded 2 trillion AUM joint-stock banks to premium plus customers with contract value reaching as much as RMB 10 million. One of our customers doubled its SME loan volume within six months of using our platform.

Next, please go to Page 7. On this page, you'll see another example of one of our mature products, retail banking. With product integration in retail banking, we have now formed smart marketing, smart management, and smart wealth management.

Smart marketing is an end-to-end online management tool for bank managers with 100% coverage of their daily work. This tool can boost efficiency of retail customer acquisition.

Smart management is the mid-office platform covering eight functions including customers, products, and marketing built on micro services and with everything componentized and configurable. The technology system also enjoys higher flexibility.

Smart wealth management serves both investors and advisors in wealth planning, portfolio recommendation, advisory, and so on and so forth. The product empowers wealth management to become more digitalized and smarter.

In Q1, this solution has successfully procured 2 trillion AUM banks that's one-joint stock and one major rural commercial with contract value approaching RMB 10 million. Our solution has achieved 100% coverage of their relationships managers, empowering up to 10,000 managers. We are also happy to know that it is thanks to constant cross-sell and up-sell that we were able to make progress with large financial institutions. Customers started with single modules and gradually adopted more and more modules. Now, they use our

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integrated solutions and multiple products, which means higher ARPU and customer stickiness for OneConnect.

Next, we go to Page 8. I'll give you an update on some of our new products. Core banking system. As the power engine of banking systems, core banking system upgrade is an inevitable step in transport, in information, its infrastructure upgrade, and digitalization of banks. OneConnect have developed a cloud native core system that supports the three core businesses of banks, namely lending core, deposit core, and the payment platform. With only one single platform, customers can access multiple scenarios with merchant on-boarding efficiency improved by 60%.

In terms of system structure, the system is decoupled to support the configuration at individual customer level and can be deployed within one week, which is very rare in the industry. Since its launch last year, we have already sold the product to 10 bank customers. Core banking system also generate higher value from customers. In Q1 alone, three have become our high value customers with the use of core banking system.

On Page 9, you see another case of our new products, AI customer service. Thanks to expertise in financial services, our AI customer service solution has evolved from customer service to diverse applications covering smart collection and smart marketing, which translates to reduced cost and increased revenue for customers. So far over 30 third-party customers have used this solution. In the first quarter, three major customers, including trillion-AUM joint-stock banks and the regulator customers have started to use this solution, applying it to scenarios including customer service and marketing. Our solution has boosted productivity of customer service representatives by 20% and achieved an extensive AI model coverage rate of 94%.

Lastly, I would like to share with you some of our thoughts on COVID outbreak relapses. In the first quarter, a small part of our business has been affected by COVID outbreaks, and we expect our business to be influenced in two ways this year. Firstly, on the implementation type business. Due to travel restrictions, contract signing and implementation will be delayed. Secondly, transaction volume-based business is likely to be affected as a result of limited business activities on our customers' side. For instance, banks couldn't carry out offline lending, auto insurance claims, and current ecosystem volume in EV China limited, because of citywide lockdown.

We have proactively taken measures to counter these influences. For example, we focus more on operation and conversion of volume from our existing customers and have launched electric vehicle jump-start services on our car ecosystem platform. We will also activate contract signing and delivery of implementation projects after restrictions are eased. Part of volume-based business is expected to experience a surge as business delayed by COVID outbreaks resumed and will taper off to average level.

Despite impact from COVID outbreak on parts of our business, we're not too concerned as we have a diverse portfolio with risk management services, operation support, and crowd and so forth, which has been added into financial institutions everyday businesses charge on volume of stock business and therefore are more resilient.

With that, I'll hand it over to CFO, Luo Yongtao to brief on our financial performance in the first quarter.

Luo Yongtao

Okay, thank you, Shen Zong. Good morning, everyone.

Now I will introduce the financials of the first quarter. I would do my part in English. Despite of the COVID impact, we recorded satisfied Q1 results. Just as Mr. Shen said, we have achieved 24.3% year-over-year top-line revenue growth to RMB 1.22 billion from RMB 820 million in the same period of last year. Revenue generated from third-party customers reached 10.5% growth to RMB 341 million from RMB 309 million in Q1 2021. The net loss to shareholders for the first quarter was RMB 318 million. Our adjusted net profit

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margin, excluding a one-off Hong Kong listing expense in this quarter, achieved an improvement of 9.6 percentage points year-over-year to negative 27.6%.

On Page 13, looking into the revenue breakdown by customer type, you can see that we have maintained a relatively stable customer mix in the first quarter. Our third-party revenue contributed 33.5% total revenue in Q1, which was 10.5% year-over-year. Third-party revenue growth was largely driven by increased demands for risk management and operational support services, which are key focuses of our second stage of strategy. However, the COVID lockdown did have an impact on our third-party customer revenue, which was reflected in a decreased implementation revenue in the first quarter. Looking forward, we believe such impact is limited and the business will recover soon after the lockdown to be lifted in major cities.

In the first quarter, Lufax contributed 12.7% of our total revenue. This revenue rose 71.9% year-over-year to RMB 129 million from RMB 75 million. The growth was largely driven by cloud services, risk management, and the new project implementations. Ping An Group contributed 54% of our total revenue. Revenue from Ping An Group rose 25.9% year-over-year to RMB 549 million from RMB 436 million in Q1 last year. The growth was mainly driven by the increasing demand for operational support and cloud services. Looking forward, OneConnect will continue to play a critical role in Ping An Group's financial technology ecosystem. As always, OneConnect regards Ping An Group as our most important flagship client. The services provided to Ping An Group are core technology solutions, which have been deeply embedded into Ping An Group's daily operations.

Our services to Ping An Group also have a proven record of success. For example, in the area of AI technology services, Ping An Group has enabled AI agents through our AI technology to optimize and transform business processes to improve operational efficiency and the customer experience. On operations of the Ping An Group are robust and highly sustainable, evidenced by that in Q1. The majority of the revenue are generated from operation support, risk management, and cloud services, which largely charged on stock business volume. Therefore, we expect our revenue from Ping An Group to maintain steady momentum.

Page 14, moving to revenue mix by business types. Cloud services remained as a biggest driver of our revenue growth, accounting for 29% of total revenue. It achieved a 63.9% year-over-year growth to RMB 296 million in the first quarter this year, compared to RMB 181 million in the same period last year. Benefiting from Ping An Group's ongoing digital transformation, more and more subsidiaries, and affiliates are adopting our cloud services, including Lufax.

Such services charge on deigning IP operation volume, we expect to see steady revenue growth from cloud services in the future. As one of the key strategic focuses, risk management services contributed 10% of the total revenue and achieved a 7.7% year-over-year growth to RMB 107 million in the first quarter of 2022, from RMB 99 million in the fourth quarter last year. Both solutions in our digital banking and the digital insurance contributed to the growth. Revenue generated from Lufax and the third-party customers were both showing growing demands.

Moving to operation support business; largely benefiting from AI customer service solutions and auto insurance services, operation support contributed 25% of our total revenue and achieved a 20.2% year-over-year growth to RMB 255 million from RMB 212 million in the same period of last year. Implementation revenue contributed 17% of total and achieved 1.8% year-over-year growth to RMB 172 million from RMB 169 million in Q1 2021. The lockdowns in major cities resulted a temporary drop in our third-party customer.

Meanwhile, the implementation revenue from Ping An Group retained to growth in the fourth quarter, which averagely led to a slight increase in this sector. Benefited from our second stage strategy, other services were developing well, especially in overseas business and auto insurance ecosystem. It contributed 6% of our total revenue and achieved 130% year-over-year growth to RMB 63 million in the first quarter of 2022 from RMB 27 million in the same period of last year.

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As you can see our business are diverse and well balanced, and we're establishing more solutions in technology infrastructure. Although the COVID outbreak this year has indeed brought uncertainties to the macro-economy, we remain committed to diversifying our products and continuing to adopt stock-based charging model, which is highly stable and sustainable to more businesses.

Next page, I would like to discuss the revenue mix by business segments. We maintained a stable revenue mix by segments. Gamma Platform was the biggest contributor. On top of the cloud services newly developed products, such as core banking system, also posted in the fourth quarter, contributing to Gamma Platform growth. For other segments, Digital Banking accounted for 31% of our total revenue. Digital Insurance accounted for 18%, and the Virtual Banking business accounted for 2%.

Page 16 is our Premium Plus Customer. In our second stage strategy, we focus on higher volume Premium Plus Customers. In the first quarter, our Premium Plus Customers reached to 74 with a 16% growth on a year-over-year basis. Most of them are from our existing customers, which demonstrate the effect of our intensive farming strategy. The newly acquired Premium Plus Customers are mainly from Digital Banking and Gamma Platform.

Next page, let us look at the gross margin. In the first quarter, on the IFRS basis, gross margin slightly increased by 0.3 percentage points year-over-year to 34.3%. Well, our non-adverse gross margin dropped by 4.7 percentage points to 38.8%. We saw that our mature products are actually making progress improving gross margin, for example, SME Banking as a new digital banking and insurance products. However, the newly launched products usually have lower gross margin. Also, in Q1, some of the implementation revenue was delayed due to the COVID outbreak, while relevant to cost capture occurring resulting in a lower margin in implementation sector. Those factors checked down the total gross margin level.

As a young technology company, we are still heavily investing in research and development and utilizing capitalization. It is more suitable to look at non-IFRS margin when compared to other competitors who have already been established for longer time period.

Next page we will take a look at expenses. In the first quarter, we kept spending our research and development to strengthen our technological capabilities, product upgrades, and enhancements. Their research and development expense rose to RMB 363 million in the first quarter 2022 from RMB 281 million in the same period of last year. It accounted for 75.6% of our revenue this quarter, which was 1.3% percentage points higher than Q1 2021.

Next, the sales and marketing expense reduced to RMB 109 million in the first quarter 2022 from RMB 167 million last year accounting for 10.7% with 9.7 percentage points improvement. The COVID impact is one of the reasons we traveled less and spend less on marketing activities during the lockdowns. For general and administrative, excluding one-off listing expense, we saw a significant improvement in the ratio. The adjusted G&A expense dropped to RMB 175 million first quarter 2022 and accounted for 17.2% of our total revenue, which was 4.9 percentage points improvement on a year-over-year basis.

Moving to operating margin on the right-hand side. In the first quarter, our operating loss slightly rose to RMB 355 million from RMB 346 million in the same period of last year. The operating margin improved to negative 34.8% in the first quarter by 7.4 percentage points from negative 42.2%. If we take out the one-off expenses, the adjusted operating loss ratio dropped to negative 31.2%, which improved by 11 percentage points on a year-over-year basis. In respect of net profit margin, in the first quarter, our net loss to shareholders rose to RMB 318 million from RMB 305 million in the same period of last year.

The net profit margin improved to negative 31.2% in the first quarter from negative 37.2% in the same period of last year, which was a six-percentage points improvement. Again, if we exclude the listing expense, the adjusted net loss ratio dropped to 27.6% improving by 9.6 percentage points on a year-over-year basis. This year, we will focus on three key financial metrics, which are also of benefit to our investors; they're third-party revenue growth, sustainable revenue growth, and path to profitability.

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In previous session, our CEO has elaborated on the first point. For the second point, we remain committed to diversifying our products to retain this sustainable growth and gradually moving to adopt stock-based charging model to more businesses. For example, AI customer service offering support for both banks and issuance and cloud services. Given the nature of the revenue model, they're highly stable and sustainable. On the third point, let's look at the next page. Path to profitability comes from multi-effects. First of all is gross margin, where we improve gross margin by ongoing product standardization. At the same time, our professional sales team will help our customers to design more standardized solutions to minimize customization requirements.

We will continue to invest in research and development resources on technology and the core products as we believe it lays a foundation for future competitiveness. However, we will only allocate resources in our core technology products with a higher investment return. We do regular performance review and phase out of those products which do not fulfill the requirements. We will strengthen our sales team's capabilities and improve their per capita productivities. For general operation expenses, we will keep following the stringent cost control measures, and expect to continuing downward change in a revenue ratio in the future. We summarize the key financial metrics as well as non-IFRS reconciliation details in the following two slides for your reference.

Now, I will hand back over to Danielle. Thank you.

Danielle Gao

Thank you, Mr. Luo. Operator, we are ready for questions. Please open the line.

Operator

The first question is from the line of Timothy Zhao with Goldman Sachs. Please proceed.

Timothy Zhao

Yes, thank you, Management. Two questions from my end. First, I think from the product revenue contribution perspective we see cloud services become the largest revenue contributor in the first quarter, for the first time. Could Management share some color on the gross margin revenue performance of cloud platform services, and how should we look at third-party revenue contribution in terms of the revenue contribution and growth we see in cloud services?

My second question is on the virtual banking business, this is the first time we disclose the revenue contribution. Could Management share color on how we should look at the revenue contribution from the overseas business and what is the detailed plan ahead? Thank you.

Luo Yongtao

This is CFO, Luo Yongtao, I will answer your first question. The business nature of our financial cloud is actually different against other cloud services which mainly provide hardware services, therefore the gross margin is different as well.

The financial cloud mainly serves financial institutions and that means higher requirements on security and data protection. As the financial institutions are going through digital transformation, most of our PaaS and the SaaS applications are based on financial cloud infrastructure.

On third-party revenue contribution in financial cloud, we do see fast growth in the first quarter although the base is relatively low in the same period of last year. The revenue contribution from third-party in financial cloud grew year-on-year by seven times. The absolute amount remains low however. Our license for group cloud business is still being reviewed. That means we can't officially launch cloud financial services yet.

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The fast growth in third-party revenue contribution in financial cloud do demonstrate our strength in this product and we are proactively preparing for future business development.

Danielle Gao

The second question is about overseas business, Michael Fei will take your question.

Michael Fei

On our overseas business, here you only see disclosure titled PAOB but actually oversea business includes our revenue contribution in Southeast Asia from Digital Banking, Digital Insurance and the Gamma Platform. Together these solutions have contributed nearly 10% of our revenue contribution from third-parties and that is quite significant.

In overseas business, we have very clear value proposition. We are one of the very few players who can provide end-to-end solutions to our customers and we see great potential in overseas.

PAOB is one of our good examples of exporting products in the last year. Different from other seven virtual banks in Hong Kong, our strategic focus is on serving SMEs and we are using OneConnect's SME digital lending solutions to serve small and medium sized enterprises in Hong Kong.

In 2021, 26% of small and medium sized enterprises experienced their first time in securing a loan from a bank and that's provided by PAOB, and the quality of these loans are actually very good. We only saw one non-performing loan last year.

Overall, we remain positive about our development in overseas.

Danielle Gao

Operator, we can have next question.

Operator

Thank you, Mr. Zhao. The next question is from the line of Tianen Zhou with Orient Securities. Please proceed.

Tianen Zhou

Thank you. Congratulations on financial results and thank you for taking my question. I have one question about the Hong Kong listing plan. Could you please update us on the Hong Kong listing plan? Thank you.

Danielle Gao

Yes, thank you, Zhou. Michael Fei will take this question.

Michael Fei

I think the progress is that we're on track where they have two rounds of communication with the Hong Kong Stock Exchange and SFC. Yes, we're hopeful in the short term, we will achieve our targets.

Danielle Gao

Thank you. Operator, we can have the next question.

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Operator

Thank you. The next question is from the line of Liu Yang with Morgan Stanley. Please proceed.

Liu Yang

The first one is about the cloud platform. We see a very strong year-on-year growth by the Q-on-Q wise it has been staying at around RMB 300 million for three quarters. Could management help us to understand more about the seasonality of this business, and which growth, year-on-year, or Q-on-Q should be more indicative for future?

The second question is about the non-IFRS gross margin. We see some decline year-on-year. Is it due to the cloud platform has the low R&D capitalization and amortization expense or something else?

The third question is about the operating cash flow, because we see a stable net loss and a narrowing net loss margin, but the operating cash flow in first quarter is weak. Is it due to some cash collection issue at the end of March because of the Shanghai lockdown or anything else? Thank you.

Danielle Gao

Luo Zong will take your questions.

Luo Yong Tao

On your cloud question. For 1Q22's cloud revenue, we believe that Q on Q number will be a better metric, because in the second half of 2021, we see more new business units from Ping An, for example, Lufax started to use its product and that means the revenue growth would contributed mainly from our stock and existing customers, and therefore if you want to have a better look at the growth potential, Q on Q would be a better metric.

There are two factors contributing to relatively low non-IFRS gross margin. The first is that with the launch of the new products, like core banking, we did experience lower gross margin in early stage. Secondly, due to the lockdown measures and traveling restrictions, the implementation projects have been delayed and that means our revenue growth couldn't match the delivery cost.

On cash flow, overall, the operating cash flow remains normal. But we did see the impact of Covid 19 has caused higher amounts of receivables at the end of Q1.

There is slight mismatch between cash flow and profit and loss. The difference in Q1 is mainly due to the mismatch in receivable collection between 4Q21 and 1Q22. We had a relatively faster account receivable collection pace in 4Q21 but in 1Q22 due to Covid impact the pace has been slowed down, especially in March. We also see expansion of VB business in PAOB and that has led to some cash outflow.

But at the end of Q1 our available cash amounted to RMB 2.2 billion. In longer term, our cash flow performance does match our profit and loss expectation. In the future, we will continue to improve profitability, increase our revenue growth, and be more disciplined with cost reduction so as to achieve a narrowing of net loss. We will also prioritize our target of breaking even. So far, we see that our cash position is in line with our development plan in the future, and is enough to support us until we break even.

Liu Yang

Thank you.

Operator

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Thank you, Mr. Liu. That concludes the question-and-answer session. Now, we'll turn the call over to Danielle Gao for closing remarks.

Danielle Gao

Thank you everyone for joining the call today. If you have any questions just feel free to check us out to our IR team. We appreciate your interest in following us and looking forward to speaking with you again. Thank you.

Operator

That concludes today's call. Thank you for your participation. You may now disconnect your lines.

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