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Transcript

OCFT 2022Q3 Earnings Release

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Danielle Gao Hello, everyone, and welcome to our third quarter 2022 earnings conference call. Our financial and operating results were released early yesterday and are currently available on our IR website. Today you will hear from our Chairman and CEO, Mr Shen Chongfeng, who will give opening remarks and business highlights. Afterwards, our CFO, Mr Luo Yongtao, will offer a closer look into our financials. And then, in the question and answer session, our management team will be available too. We have our Head of Southeast Asia business, Ms Tan Bin Ru, and Chief Executive of Hong Kong Virtual Bank, Mr Michael Fei, and our Head of Strategy and Products, Ms Ellen Jia.

In today's conference, our management team will make statements in Mandarin or in English. For those in Mandarin, a consecutive translation will be provided. If any discrepancy, management statement in the original language will prevail. Unless otherwise stated, growth rate of all the metrics refer to the year-over-year growth versus the same period of last year, and the currency is in RMB.

Before we start, let me quickly cover the safe harbour statement as we will be making forward-looking statements which will 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. With that, I'm now pleased to turn the call to our Chairman and CEO, Mr Shen Chongfeng.

Chongfeng Shen (as translated) Hello, everyone, I'm Shen Chongfeng. Thank you for taking the time to dial in for OneConnect's 2022 Q3 earnings release. Before I begin, I would like to announce a personnel change first. During today's Board meeting, the Board approved Dr Ye Wangchun's resignation as Executive Director and appointed Ms Fu Xin, the Chief Operating Officer and Director of the Strategic Development Centre of Ping An Group as a Non-Executive Director. The Board accepts and appreciates Dr Ye's contribution to the Company during his tenure as Executive Director.

International complexities, implications from COVID and macro uncertainties perpetuated into the third quarter. Despite these challenges, OneConnect team overcame difficulties, went all out and achieved solid performance in Q3. Revenue in the first nine months, up by 13%, reached RMB 3.22 billion.

Macro-economics and the pandemic continued to weigh on the growth of parts of our business, including some implementation projects and usage or volume-based products. In other words, we see declining usage in lending products and auto insurance ecosystem products.

Other than these products, we did note robust developments from other solutions. For example, offerings from Gamma Platform, especially AI customer services, maintained its strong growth momentum in the first half of 2022 in both customer number and revenue. Overseas business, which includes Ping An OneConnect Bank in Hong Kong, registered a growth rate of more than double last year's.

As an important initiative in our Stage II strategy, OneConnect has continued product integration and upgrade by launching new offerings. In Digital Insurance, we released a digital management platform for life insurance agents and kicked off cooperation with a global top 50 insurance company, applying our products to its business in South Africa. As for Digital Banking, we have integrated retail and SME lending systems and built a middle platform based on a

unified technology architecture. On top of that, we proactively adjusted our product portfolio by phasing out products with heavy customisation and low ROI, as well as improving product standardisation. Over the short term this is at the extent of some projects and growth rates. But looking forward, these efforts will further cement OneConnect's competitiveness in our core products and generate valuable returns.

Next I'll brief you on business development in this quarter.

Please go to page 3 of our slides.

This year we are still at the second stage of our development, broadening customer engagement where we focus on Ping An Group and financial institution customers as well as integrate product and build Gamma Platform.

Now we are at page 4. We remain committed to "One Body, Two Wings" Strategy in Stage II, which means we continue to focus on financial institution customers by expanding our ecosystem and overseas business.

In Q3, total revenue reached RMB 1.07 billion. Premium Plus customers increased by 9, year-over-year, to 163. Operation efficiency improved significantly. Margin of net profit attributable to shareholders narrowed markedly by 13 percentage points to -12.4%.

Next on page 5. As "One Body and Two Wings" strategy takes root, OneConnect achieved greater coverage of financial institution customers in the first three quarters.

Digital banking products, including digital lending, AI banker deepened our engagement with Hua Xia Bank, Bank of Ningbo, Bank of Suzhou and many other customers, enabling them in their digital infrastructure and accelerating applications of home-developed technologies.

In Digital Insurance, we initiated relationships with many insurers in the first three quarters, Dajia Property & Casualty Insurance, Liberty Mutual, TK.CN INSURANCE and Jintai Insurance to name just a few. These brand names demonstrate our growing penetration among insurers.

In terms of Gamma Platform, upgraded hit products, including AI customer services, continue to make new market breakthroughs, as you can see from projects with Bank of Guizhou, Bank of Beijing and Bank of Chongqing, etc.

Standardisation of high gross margin products is the key to OneConnect's future as a business-end service provider. As you can see on page 6, AI customer services, leveraging OneConnect's unique advantage of "Business + Technology" and incorporating diverse financial scenarios and leading technologies, now expands to a wide range of functions, including smart customer service, smart loan applications, smart marketing and a robot platform. 5 knowledge bases, 1,600 AI service scenarios, over 200 quality assurance models and over 3 million AI sales scripts underpin the product, boosting AI adoption rate to as high as 94%.

By the end of September, third party revenue growth in AI customer service doubled on a year-over-year basis. Premium plus customers also expanded significantly. Its customers are also quite sticky. Net expansion rate for premium plus customers in the first three quarters exceeded 100%.

Next please go to page 7. Overseas business remains a key initiative in our "One Body Two Wings" Strategy as we continue to strengthen international presence in Hong Kong and the Middle East.

Ping An OneConnect Bank is the first virtual bank in Hong Kong to focus on SME services. We are also the only one to use alternative data for modelling, which means simpler and more precise loan approvals for SMEs, and won us recognition from HKMA and HKMC. PAOB is committed to digital financial inclusion. Account opening can be done online and within one day. Of the customers we serve, 30% are first-timer loan applicants. Revenue growth in 2021 ranked first among virtual banks in Hong Kong and revenue continued to show strong momentum in the first nine months of 2022, increasing by 2 fold year-over-year. PAOB also enjoys great brand name in the industry, evidenced by awards from renowned financial media including Asia Money, Euromoney and Hong Kong Economic Journal. The Bank ranked 45th in the global top 100 digital-only banks' ranking, top one in Hong Kong.

Our credit reference services agency in Hong Kong, Ping An OneConnect CRA, also went well and we officially received the license for CRA business this week. The Company is expected to launch business in 2023 to provide three types of products and services, namely traditional credit reference services, innovative credit reference services and cross-boundary services (for example issuing cross-boundary credit reports). As always, we aim to deliver differentiated, diverse and accessible credit reference products and service models, contributing to the establishment and improvement of credit reference systems in the Greater Bay area.

At the same time, we have also broadened our presence in the Middle East. In September we announced our collaboration with Abu Dhabi Global Market to empower the development of a SME financing platform. The platform aims to promote financial inclusion in the region, improve transparency and lower operating costs for SMEs. We officially launched our UAE subsidiary in Abu Dhabi Global Market this October to provide digital services with leading technologies such as cloud computing, artificial intelligence, to empower financial institutions in the Middle East and North Africa in their digital transformation.

Also on page 8, additionally we are also happy to announce that our brand new life insurance product made advances in the international market. With the new digital and efficient all-in-one platform for life insurance agents which spans a wide range of insurance services, from digital advisory experience and sales assistance to customer insight. We formed a strategic partnership with a global top 50 insurer to empower the digital transformation of its life insurance agents in South Africa.

On page 9, as we mentioned in the opening remarks, the future of OneConnect lies in product standardisation. During the first nine months, we continued to improve our products by standardising functions and completed over 60 updates. In Digital Banking, we integrated retail and SME lending systems and built a middle platform based on a unified technology architecture. Upgrades in Gamma Platform include data middle platform improvement and AI

capability improvement in AI Customer Services. We are confident that standardised products will boost OneConnect's overall profitability. Another part of our efforts to executive this key initiative in Stage II strategy, i.e. product integration and upgrade, is to proactively adjust our projects. We phased out projects with heavy customisation and low ROI. As a result, we see improved ROI in Q3.

While a COVID outbreak resurges across China, we are only one month away from the end of 2022. For OneConnect the macro environment and the pandemic have put our business growth under pressure. However, this does not undermine our confidence in our future, which stems from recognition by the market and our customers, boosted product competitiveness, and the growth in financials that our team has worked hard to deliver. We believe these external challenges are only temporary. As a young tech company, we will remain agile and remain committed to improving third party revenue and becoming profitable.

Next our CFO, Yongtao, will give you a detailed update on our financials in Q3 and the first nine months.

Yongtao Luo Thank you, Mr Shen. Good evening, everyone. Next I will give you an update on our financial results in Q3. Total revenue in third quarter reached RMB 1.07 billion and the third party revenue remained steady at RMB 0.35 billion. Premium Plus customers or customers with revenue contribution over RMB 1 million was up by 9 customers to 163. Net loss in this quarter was RMB 0.13 billion with a net profit margin at negative 12.4%, which improved significantly, or 13 percentage points, from negative 25.3% in Q3 2021.

Let's start from the top line. Revenue remained stable at RMB 1.07 billion in the third quarter and increased by 13% to RMB 3.22 billion in the first nine months of 2022. In Q3 the revenue increase was driven by operation support, implementation and others. However, this was offset by the revenue drop from business origination and risk management resulting from pandemic curbs and our continuous phase-out of low value projects as a core initiative in our second stage strategy. I will give you more colours on revenue growth drivers later.

Revenue mix by customer type remains roughly the same in this quarter compared to the same time period last year. Revenue from third party customers reached to RMB 351 million, same as Q3 last year, and accounted for 33% of total revenue. Due to COVID impact, revenue from business origination, auto insurance claim products and domestic implementation business shrank. Phase-out of low value products also reduced our revenue. Other than the businesses mentioned above, we still achieved stable improvements.

Contributions from Lufax grew slightly by 5.2% from RMB 113 million to RMB 118 million, representing 11% of total revenue. Operation Support business contributed most of the revenue growth. Revenue from Ping An Group reached RMB 599 million in the third quarter and made up 56% of the total revenue. The overall contribution from Ping An Group remained steady. The usage volumes of some transaction-based products decreased, for example, P&C claims related products and banking lending products. This was offset by customer service support business and newly launched projects to meet the business requirements.

Moving to revenue mix by business type, implementation revenue accounted for 19% of total revenue, reached RMB 202 million from RMB 189 million for the same period last year, which was driven by the ongoing digital transformation

in Ping An Group and our new overseas life insurance business expansion. On the other hand, implementation revenue from domestic third party customers dropped due to the pandemic travel restrictions and our continuous phase-out of low value projects with high customised requirements.

Revenue from business origination was RMB 94 million compared to RMB 115 million for the same period last year, primarily due to the decreased loan volumes as a result of pandemic curbs and the macro economy. Revenue from risk management was RMB 105 million this quarter versus RMB 113 million for the same period last year, primarily due to the decreased usage volumes of P&C insurance claim related products that are more susceptible to COVID control measures.

Revenue from Operation Support rose to RMB 294 million from RMB 280 million for the same period in the prior year, primarily benefitting from the increase of product usage charged by stock-based fees, especially various types of business for customer services. Revenues from Cloud Services platform remained steady this quarter, with revenue contributions of RMB 297 million, slightly dropped from RMB 303 million in the same period last year.

As mentioned in previous earnings release, our Cloud Services businesses has entered into a stock stage and revenue will remain at a stable level, which is subject to actual usage volumes of our clients. Third quarter's revenue is in-line with company expectations. Post Implementation and Other revenue was up by 19.2% to RMB 78 million from RMB 65 million in the same period last year, accounted for 7% of total revenue. Such improvement was mainly driven by the robust growth of the virtual bank business in Hong Kong as a key part to our strategy in the Great Bay Area and overseas. PAOB's revenue kept improving multiple times faster than our overall business.

Let's turn to the revenue mix by product type. Gamma Platform, our strategic focus for innovation was the biggest chunk of our revenue which accounted for 49% of total revenue in the third quarter. AI customer service, core banking systems and other initiative businesses kept presenting remarkable growth. Revenue growth from overseas insurance business contributed to the increase of Digital Insurance revenue, with the proportion of 21%. Meanwhile, Digital Banking make up 28% of total revenue and the PAOB accounted for 2%. For the revenue mix by product type in the nine months of 2022, Digital Banking, Digital Insurance, Gamma Platform and PAOB contributed 28%, 19%, 51% and 2% of total revenue respectively.

This quarter we continued to commit to our Stage II strategy where we focus on potential from Premium Plus customers. The total number of Premium Plus customers continued to grow this quarter, by 9 customers to 163, with most of them being our existing customers, the increase also testifies our success in deepening engagement with existing customers. We are happy to see that more and more Premium Plus customers are using multiple products from our different product lines.

Gross profit was RMB 375 million in the third quarter and the gross margin of 35.1% remains at a flat level against the same period last year. On a non-IFRS basis, gross margin was 38.4% compared to 42.2% in the prior year. This was a mixed result caused by different factors. On one hand, with product integration and upgrades being a key initiative in our Stage II, we continue to optimise our production strategy, improving ROI and product standardisation and

proactively phase out projects requiring heavy customisation. On the other hand, usage volume of products with relatively higher gross margins, such as P&C claims-related products and loan products in risk management decreased due to the intense macro circumstances.

We are pleased to see that we are well on track to our breakeven target as we make prominent progress in loss reduction this quarter. First of all, our research and development expenses came to RMB 287 million from RMB 323 million. As a percentage of revenue, it amounted to 26.9% compared with 30.4% in the prior year. We continue to implement our second stage strategy on product integration. Our products, on an overall point of view, are more and more mature gradually. At the same time we commit to improve our development efficiency by optimising our talent structures. Looking forward, we will keep spending most resources on research and development, to upgrade and develop products to strengthen our competitiveness in the market.

Sales and marketing expenses for the third quarter of 2022 decreased to RMB 94 million compared with RMB 131 million in the prior year. The percentage of revenue decreased to 8.8% from 12.3%. The improvement was benefitted from enhanced sales capability and efficiencies. We managed to further reduce our total sales labour cost while remaining revenue growth. Meanwhile, telecommunication, marketing and travel-related expenses also decreased compared with the same period of 2021, partially due to the COVID control policy.

Regarding general and administrative expenses, they came to RMB 167 million from RMB 170 million in the same period last year. As a percentage of revenue, it decreased to 15.7% from 15.9%. Notwithstanding some one-off expense included, we managed to decrease general and administrative expenses by various stringent cost control measures.

Benefitted from all above, our net loss narrowed to RMB 133 million from RMB 270 million in the same period last year, and the margin improved by 12.9 percentage points, from -25.3% to -12.4%, continuing to deliver double-digit improvements.

On this page you can find a comparison of costs in the past three years and the first nine months in 2022, which shows clearly the path towards breakeven by mid-term. We will continue to implement higher ROI product requirements and phase out products which are missing our standards. We will also maintain stringent cost discipline to curb the expenditures. With all these measures, we are confident about breakeven with regard to our business plan.

I would like to reiterate the key focuses of OneConnect in 2022, third party revenue growth and cost discipline towards path to profitability. Due to the current circumstances, we are still facing pressure on all the total and third party revenue growth. However, we do believe that the growth will recover once the COVID control measures ease and the macro situation rebound. We can also see the product integration and optimisation will further improve our revenue growth and profit improvement.

Lastly, we have summarised key financial metrics in the third quarter and the first nine months as well as the adjustments in the non-IFRS gross margin for your references. Thank you.

Danielle Gao Thank you, Yongtao. Operator, we are ready for questions. Please open the line.

Operator Thank you. If you would like to ask a question, please do so now by pressing star followed by the number one on your telephone keypad. When it is your turn to speak, I will instruct you and your line will be open. As a reminder, that is star followed by the number one on your telephone keypad. Our first question today comes from Timothy Zhao with Goldman Sachs. Please go ahead.

Timothy Zhao I have two questions. The first one is about industry. Could management share some colour on how the management team looks at the IT spending of the financial industry, including Ping An and third party customers. And also in that bigger industry context, how should we look at the industry IT spending to next year and how that will impact our revenue growth. And, secondly, on the overseas business, I see that our overseas business has progressed in different business lines and in different regions. Could management share our strategy in terms of overseas expansion on the high level and how should we think about revenue contribution for next year? Thank you.

Danielle Gao Thank you, Timothy. Chongfeng will take your first question and Michael and Bin Ru will take your second question.

Chongfeng Shen (as translated) So, I will answer your question about the development of financial institutions and the industry. The macro environment and the pandemic have put the business development of banks under pressure. So, over the short term some financial institutions may cut their IT investment to lower cost and improve efficiency. But looking forward, over the mid to longer term, we do see market demand from banks, especially on digital transformation. Banks need to boost their operational efficiency, mainly from risk management and operation support. And we see great digital transformation demands from the following areas: in-house risk management capabilities for technology applications; digital operations, data security and IT application innovation. And these are also the key focuses of our R&D investment in Digital Banking and Gamma Platform. During economic downturns, medium and small-size banks are more in need of a head to toe digital transformation. And that means small and medium-sized banks need business + technology solutions. Thank you.

Tan Bin Ru I'll take the question on the Southeast Asia or the overseas question. So, I think Southeast Asia we have positioned as a region that has more than USD 2 billion growth potential and in the next two years with the global economy entering into potentially recession, actually you see Southeast Asia as the one bright spot that has the highest GDP growth, that region having more than 5% GDP growth. So, we continue to be very bullish about Southeast Asia growth. Today we are servicing more than 100 customers in over 20 countries. The revenue ticket size is very positive because the sales are in US dollars and the ability to price the same solution in US dollars, which brings us much more profit.

And then going into Q3, in fact, in Q3 this year we started two collaborations. One is the Pismo collaboration so that we combined what is good from the East with what is good from the West in terms of SaaS core banking. So, in this collaboration we launched in Q3. We are foreseeing good results coming potentially next year. And then in Q3 we also

launched the ADGM entity. We actually had the entity earlier on. It's just that we did the product and the actual entity launch with the FinTech event in Abu Dhabi last quarter.

So, at this moment I think we are seeing good enough growth. Q3 growth is very good for us. We doubled Q3 compared to year on year. For percentage of revenue, I remember we started off initially in the earlier year single digit through the revenue and then we were in the early teens. As at this quarter, we are about 20% of external revenue of OneConnect and we continue to see the growth continue to grow.

Michael Fei Thank you. Let me talk about the Hong Kong business. I think the overseas business for OneConnect we have two parts. One is the Southeast Asia, which Bin Ru just described, and then there is Hong Kong. In Hong Kong we actually have three different segments. We have the technology services for financial institutions in Hong Kong. That's very similar to Bin Ru just described, the market, so I will not repeat that.

The other two segments, one is the virtual bank, the other is the credit reference agency business. We have two very valuable licenses in Hong Kong. For POAB I think Mr Shen has already introduced in his main presentation that we continue to be one of the better performing virtual banks among the eight. I think the reason for that was that, first of all, we have a very different positioning. We are different from the rest of seven in that we are dedicated to serve SMEs. Our second competitive value is that we had OC at our back. So, we had a lot of the technologies. We had a lot of experiences that we can actually adopt from OC mainland and then implement in the Hong Kong market.

I think as a next step, we will continue to focus on SMEs. We will continue to use leading technology to help the SMEs in the Hong Kong market and then gradually extend to a broader segment around the supply chain, around the GBA area. We will partner with more and more partnerships and use alternative data to serve SMEs. If you were in the FinTech week last week, you will notice that during the HKMA's formal launch of CDI, Commercial Data Interchange, POAB is actually the largest contributor of CDI usage in Hong Kong. So, we expect to continue to move on, to continue to grow very rapidly in our revenue and continue to improve our bottom line.

Now, the second valuable license we have is the credit reference agency. We are one of the three companies that were granted the license earlier. We formally received the license earlier this week from Hong Kong Banking Association. So, we are starting to do the initial data-loading, which means we will get all the data from the various banks and we estimate to launch our formal services in the second half next year.

We were very optimistic about this one because I think given the more and more closer connection between mainland China and Hong Kong, for OneConnect as one of the mainland-based companies that has a license in Hong Kong, we are uniquely positioned to leverage on our strong technology leadership and our experience in the mainland to try to connect the client information in mainland China as well as Hong Kong so that we can provide more holistic credit reference reports to the banks and also, I think our technology advantage will not just providing reports, but will also be able to provide risk management services to the banks and other financial institutions for them to use our services.

I think as a whole we are very optimistic about the growth of our business in Hong Kong.

Timothy Zhao Thank you.

Operator Our next question comes from Tianen Zhou with Orient Securities. Please go ahead.

Tianen Zhou The first one is a quick finance question about the cash and what is our current cash position. And the second one is after Mr. Shen's lead, what's the biggest change during the last one year. Thank you.

Danielle Gao Thank you, Tianen, and our CFO, Yongtao Luo, will take your first question.

Yongtao Luo (as translated) I will answer your question about our cash position. So, as of the end of September we now have around RMB 2.37 billion of cash. Among which there are RMB 420 million under our virtual bank, and the rest is with our other entities. And we see significant improvements in our cash control measures. Firstly, we have narrowed our losses back remarkably and this has benefitted our cash position. Secondly, we also increased our efforts in the collection of account receivables. As a result, we see decreased turnover days of account receivables and shortened account age. At the same time, our other measures in cash management have all paid off. So, with sufficient cash position and healthy business operation, we are confident that the cash will be enough to sustain us until we reach breakeven.

Chongfeng Shen (as translated) So, I'll answer your second question about what has changed over the past year. I have three main messages. The first is that our products are more focused. The second is that we have deepen the engagement with our customers. The third is that we further controlled cost and improved our operational efficiencies. Looking forward, we remain committed to our second stage strategy, that is further deepening customer engagement and achieve product standardisation, sales standardisation as well as delivery standardisation so that OneConnect will remain committed to Business + Technology strategy. Thank you.

Operator Those are all the questions we have time for today. So, I will hand back to the management team for any concluding remarks.

Danielle Gao Thank you everyone for joining the call today. If there are any questions, please feel free to contact our IR team. We appreciate your interest in following us and looking forward to speaking with you again. Thank you.