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Earnings Call

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Call Participants

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Chairman of the Board & CEO

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Chief Financial Officer

Rick Chan
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Jessie Shen
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Laura Li
CGS-CIMB

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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to OneConnect Second Quarter 2023 Earnings Call. [Operator Instructions] Please note, this event is being recorded. I'd now like to hand the conference over to your host, Mr. Rick Chan, the company's Head of Investor Relations. So please go ahead, Mr. Chan.

Rick Chan
Head of Investor Relations

Thank you, operator. Hello, everyone, and welcome to our 2023 second quarter earnings conference call. Our financial and operating results are released earlier today and 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 question-and-answer session, our management team will be available to you.

We have our Chief Executive of Ping An OneConnect Bank, Mr. Michael Fei; our CTO, Mr. Li Jie; Head of Digital Banking, Ms. Ellen Jia and Head of Strategy, Corporate Planning and Product Management, Ms. Jessie Shen. In today's conference, our management team will make statement in Mandarin or in English. For those in Mandarin, a consecutive translation will be provided. In case of any discrepancy between the Mandarin version and the English version, our statement in the original language shall prevail.

Let me quickly cover the safe harbor statement before we start. 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 our call to our Chairman and CEO, Mr. Shen Chongfeng. Mr. Shen, please.

Chongfeng Shen
Chairman of the Board & CEO

[Interpreted]

Hello, everyone. I'm Shen Chongfeng. Thank you for dialing in OneConnect's 2023 Q2 and H1 earnings release. 2023 continues to feature accelerating changes unseen in a century. As our economy and the society as a whole return to normal, China is now at a key junction of economic recovery and industry upgrades. While the macro environment is stabilizing and improving, it still has a lot to overcome before full recovery.

Committed to the business philosophy of "value, win-win, cooperation and quality development", OneConnect continues to proactively adjust business structure, focus on product upgrade and execute our Stage 2 strategy of broadening customer engagement, which led to steady growth and strong momentum for improvement in the first 6 months of 2023, while we gear up for a crucial stage of growth.

We delivered solid financial performance in the first half of 2023. Net loss attributable to shareholders narrowed significantly at 66.1% or RMB 372 million. Gross margin now at 36.7% was up by 1.4 percentage points from 35.3% in the same period last year. As we continue to pivot towards value creation and proactively adjust business structure by phasing out high customization and low gross margin business with limited value, revenue saw a small dip in the first 6 months year-over-year. Admittedly, this means revenue will contract in the short term, we nevertheless remain confident that it is only when we "lighten the load" will we be able to travel faster and further over the medium to long term. At the same time, thanks to the management's consistent efforts and hard-work, product standardization, implementation efficiency and productivity of internal operations have all improved as we execute Stage 2 strategy. This has laid a solid foundation to turning profitable in the medium term.

Next, I'll share with you business highlights in the first half of 2023. Now if you could, please go to Page 3 and 4 of our slides. 2023 is a crucial year during our Stage 2 strategy of broadening customer

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engagement where we are devoted to "one body two wings" business structure, that is focusing on financial institutions while expanding ecosystem and overseas.

Next, please go to Page 5. We successfully expanded customer coverage in this quarter, kicking-off cooperation with financial institutions and regulators, including SBF, Old Mutual, OCBC Wing Hang Bank, Office of Hong Kong Government CIO and Zhejiang Mintai Commercial Bank. To further execute "deepening customer engagement" strategy, we are also working closely with our existing partners by continuing to cross-sell and initiate new projects. For instance, new deals are signed with HuaXia Bank, Postal Savings Bank of China, Dajia Insurance and China Continent Insurance, to name just a few financial institutions partners. OneConnect will continue to empower their digital transformation journey.

Next, on Page 6. In Q2, products in digital banking continue to see new upgrades. Product coverage in retail business has been further expanded with new scenarios, including AI customer service, training and double recording as well as rich enterprise marketing scenarios incorporated into our application. Daily log-in rate has averaged 96%. In digital credit, remote interview, which is 100% self-developed, added another 100 new mature risk indicators. Risky loan identification accuracy is over 80%. On top of higher product standardization, delivery efficiency also improved. Implementation cycle for SaaS projects has shortened to 2 weeks, which has empowered banks to achieve speedy and effective improvements within their desired timeframe.

We established the implementation, transformation taskforce this quarter and introduced Guidelines to Implementation Transformation, aimed to strengthen cost control, improve project gross margin and enhance delivery efficiency so as to make us more competitive in the market.

Next, please go to Page 7. Also in banking segment, as we continue to land new projects in Smart Finance Transformation, Smart Business Analysis and Decision-making, OneConnect has incubated a series of products and solutions that can boost the efficacy of operation analysis and profitability in commercial banks. "Super Brain" for our digitalized management, for example, improves decision-making in banks by offering more frequent, monthly and even daily operation reviews and tracking. This offering also leads the market with profitability forecast variance less than 3%. Regulatory filing system has gone through more iterations to include new functions and adapt to self-control technology.

Next, on Page 8. In digital insurance, Claims Core Systems has been further upgraded. The customer end now utilizes the VoLTE technology to enhance remote survey experiences. The operation and, on the other hand, is equipped with a brand new panel, which improves claims personnel efficiency by over 25%, cuts survey and operation costs by more than 30%. In addition, in the first half of this year, we also introduced remote operation platform module in digital insurance, enabling more to be done online and in a smarter manner.

Next on Page 9. We achieved new breakthroughs in "Two Wings", meaning expanding ecosystem and overseas, which are also key initiatives of OneConnect Stage 2 strategy. We launched cooperation with Hong Kong Government CIO and regulators like Xiamen Financial Regulatory Administration, jointly building flagship projects, including iAM Smart Mobile Information Portal and private equity fund reporting and supervisory system.

Turning to overseas. We launched cooperation with SB Finance this May to help them improve product delivery efficiency and cut operation costs. This project marks an important milestone in our long-term strategic relationship. We are also working with OCBC Wing Hang Bank to establish seamless online account opening, which lowers costs while enhances customer experience.

Next, on Page 10. OneConnect, as well as our products, have been awarded by many renowned institutions this quarter, including 2023 National May Day Labor Award Certificate from the National Federation of Trade Union. KPMG China Fintech Excellence Award, Best SME Bank of Hong Kong from Asiamoney 2023, to name just a few.

Looking forward, both challenges and opportunities abound. Across the world, integration of finance and technology has become one of the most relevant trend. And in China, digital transformation has become more strategically important than ever. The Digital Development Plan issued by the State Council earlier this year, maps out the overarching architecture and strategic guidance to accelerate building of Digital

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China. We therefore see higher demands for digital transformation from the banking industry. As financial institutions embrace digital transformation in their strategic plans and ramp up investment, China's digital economy could exceed RMB 60 trillion or USD 8.84 trillion by 2025, according to an estimate by the China Academy of Information and Communications Technology. It is fair to say that there are huge upside and potential in IT services for banks.

Considering our business recovery trails behind the macro-environment, revenue in the first 6 months was still under pressure, but we did pick up positive signs amid a mild macroeconomic recovery, which makes us cautiously optimistic about our business outlook.

In the following months, we will continue to leverage our unique edge, seize strategic opportunities brought by digital transformation in banks, introduce high-value offerings and expand contract value with third-party customers. We are confident that with more targeted customers, customer stickiness and engagement will also improve, and we will be able to land OneConnect Stage Two strategy of broadening customer engagement.

We are committed that only quality development will bring us further and better and ultimately help us achieve our vision.

Next, I'll hand it over to Mr. Luo to brief you on our financials.

Yongtao Luo
Chief Financial Officer

Okay. Thank you. Good evening, everyone. We achieved a strong second quarter, showcasing resilience in our operational outcomes. Just as Mr. Shen said, we delivered revenue of RMB 973 million in the second quarter of 2023, decreased by 14.1% compared to the same period last year, primarily due to a decline in transaction-based and support revenue. Revenue generated from third-party customers decreased by 7.1% to 319 million in the second quarter. The number of Premium-plus customers decreased year-over-year to 121 from 134 for the same period in 2022, primarily caused by fewer customers in digital banking segment due to slower-than-expected recovery of banking activities. We are thrilled to see that net loss attributable to shareholders was 82 million, at an all-time low level, and the corresponding net loss ratio to shareholders improved greatly by 13.2 percentage points on a year-over-year basis to negative 8.4%.

Now let's turn to our revenue mix by customer. In the second quarter, our third-party revenue decreased by 7.1% to RMB 319 million compared to Q2 last year, contributing 32.8% of total revenue in Q2 2023. Third-party revenue growth remains a key focus of our second stage strategy. Once macro further improves and as we continue to advance our initiatives, we believe revenue from third party will improve.

In the second quarter, Revenue from Lufax decreased 31.9% to RMB 73 million and contributed 7.5% of our total revenue. The revenue decline from Lufax was mainly due to Lufax business operation optimization, resulting in lower demand for our operation support and risk management services.

Revenue from Ping An Group decreased 14.9% to RMB 581 million and contributed 59.7% of our total revenue. Revenue decline from Ping An Group was primarily due to a decline in transaction volume as the overall recovery of financial institutions takes a bit time. 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. We observed some macro-level recovery that leave us cautiously optimistic.

In the first half of 2023, revenue from third-party customers decreased 7.0%. Revenue from Lufax decreased 38.9% and the revenue from Ping An Group dropped by 9.2% for the corresponding periods in 2022.

Moving on to revenue mix by business type. Let's take a look at our Q2 results first. Implementation revenue increased by 36.4% on a year-over-year basis to RMB 233 million, mainly contributed by projects from new customers as well as consistent delivery efforts on existing contracts, especially expanding customer demand for digitalized management product in the second quarter.

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Revenue from Business Origination services decreased by 69.4% year-over-year to RMB 32 million, primarily due to declined transaction volumes in channel marketing products.

Revenue from Risk Management services decreased by 20.7% year-over-year to 73 million, mainly due to reduced transaction volume in banking related risk analytics solutions because of slower-than-expected recovery of banking activities in the second quarter.

Revenue from Operation Support services decreased by 21.4% on a year-over-year basis to RMB 249 million, which was primarily caused by a reduced demand on banking customer services products and auto ecosystem services in the second quarter.

Revenue from Cloud Services Platform was RMB 322 million, decreased by 12.7% on a year-over-year basis in the second quarter, mainly due to reduced transaction volume. Revenue from Cloud Services Platform continued taking up the biggest chunk of our total revenue, and it remains our development focus going forward.

Revenue from Post-implementation Support and Other services decreased by 46.2% year-over-year to RMB 30 million in the second quarter. The decline was primarily due to lower demand for auto ecosystem services.

Revenue from PAOB, our Virtual Banking business in Hong Kong, increased by 39.7% to RMB 34 million as compared to the second quarter last year.

If we look at first half of 2023, implementation revenue increased 29.3%. Revenue from Business Origination dropped 63%. Risk Management revenue decreased 24.3%. Revenue from Operation Support declined 17.6%. Cloud Services Platform revenue decreased 7.6%. Revenue from Post-implementation Support and Other services dropped 33.7%. And PAOB increased 45.2%.

As you can see, we are developing more solutions around technology infrastructure. We will remain committed to diversifying our product mix and adopting a stable and sustainable stock-based charging model. Meanwhile, we strive to expand our businesses by acquiring more new customers and projects.

Let's get into revenue mix by product sectors. Gamma Platform sector, the focus of product innovation in recent years contributed the biggest chunk of our revenue, declined 6.6% in the second quarter of 2023 to 513 million and accounted for 52.7% of total revenue. The decline was mainly caused by reduced transaction volume of Cloud Services Platform usage.

Digital Banking sector, which accounted for 24.2% of total revenue reduced by 33.9% on a year-over-year basis to RMB 235 million. That was mainly caused by reduction in transaction volume of our Business Origination and Risk Management services, which were related to our initiatives to phase out lower-value products and the unfavorable macro circumstances.

Digital Insurance sector, which accounted for 19.6% of total revenue, decreased by 6.4% to RMB 191 million in the second quarter of 2023, primarily due to reduced demand in auto ecosystem services.

In each sector, we phased out products with low margins, products with low technological value-added as well as those with limited potential for revenue growth or product standardization.

In addition, our Virtual Banking sector, as I just mentioned before, saw continued expansion, accounting for 3.5% of total revenue in the second quarter.

Let's now take a look at customer numbers. In the first half of 2023, the number of Premium-plus customers decreased to 121 as compared with 134 for the same period last year, primarily caused by fewer customers in digital banking sector, due to slower-than-expected recovery of banking activities. We believe as we continue to advance our initiatives, we expect our customer base further expand and more Premium-plus customers will use our products and services.

Now let's take a look at gross margin. We are very glad to see our gross profit reached RMB 353 million in the second quarter of 2023. Gross margin remained stable at 36.2% as we continued our product integration and deepening engagement with Premium-plus customers. On Non-IFRS basis, gross margin was 39.3%.

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In the first half of this year, our gross margin improved 1.4 percentage points to 36.7% and Non-IFRS gross margin was 39.8%.

As Mr. Shen mentioned, in the second quarter of 2023, the continued efforts in product integration and delivery efficiency, together with execution on quality growth helped to improve our gross profit margin. We will stick to that strategy and continue the endeavor of achieving profitability.

Moving on to our expenses and the net loss attributable to shareholders, you can see that we are well on track to our mid-term breakeven target.

First of all, our research and development expenses came down 36.5% to RMB 240 million from RMB 378 million in the same period of last year. As a percentage of revenue, it decreased to 24.7%, compared with 33.3% in the prior year. In the second quarter, we continued implementing our Stage two strategy that focused on product integration. As our products were upgraded and integrated, we further improved our product delivery efficiency. Looking ahead, we will keep investing in research and development at a more measured and reasonable pace to enhance our product competitiveness in the market.

Our sales and marketing expenses for Q2 decreased 40.4% to RMB 65 million compared with RMB 109 million in the second quarter of 2022. As a percentage of revenue, sales and marketing expenses decreased to 6.7% from 9.7%. The improvement in sales and marketing expenses mainly benefited from our continued efficiency improving efforts and decrease in marketing and advertising activities.

Our general and administrative expenses decreased 29.3% to RMB 135 million from RMB 191 million in the prior year. As a percentage of revenue, it decreased to 13.9% from 16.8%. The decline in general and administrative expenses was primarily due to stringent cost control measures and a reduced labor cost of employee benefits expenses.

It's worth mentioning again that under a challenging business environment, our net loss attributable to shareholders improved substantially to negative RMB 82 million from negative RMB 245 million in the same period last year, and the corresponding net margin to shareholders improved significantly by 13.2 percentage points from negative 21.6% to negative 8.4%.

The next page demonstrates the trend of our net margin improvements to shareholders in the past three and a half years. From this page, you can see a clear trajectory of our path to profitability over the years. Our first half year results reflect that the efforts of our disciplined execution of cost control, accompanied by improved operational efficiency, marking another milestone in the path to breakeven. In the second half of 2023, we will continue our product integration efforts and strive to improve operating efficiency and business margin.

Looking ahead to the rest of the year, although we continue to see a degree of unpredictability at macro level, our focus remains on improving third-party revenue. We will continue to enhance gross profit margin, focus on cost control and operational efficiency improvement to stay well on track to profitability.

Next page, we listed key financial metrics of the second quarter and the first half of 2023.

Lastly, we summarized the adjustments in Non-IFRS gross margin for reference.

Thank you!

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Question and Answer

Rick Chan
Head of Investor Relations

Thank you, Mr. Shen. Thank you, Mr. Luo. Operator, we are ready for questions.

Operator

[Operator Instructions] Our first question today comes from Timothy Zhao from Goldman Sachs.

Timothy Zhao
Goldman Sachs Group, Inc., Research Division

[Foreign Language]

I will quickly translate for myself. Could management share some color on IT spending recovery in the financial industry in the second quarter and also July to mid-August? My second question is, could management share the outlook for third-party revenue in second half 2023 and also some key drivers by product?

Rick Chan
Head of Investor Relations

Thank you for your question. The questions will be taken by Mr. Chongfeng Shen.

Chongfeng Shen
Chairman of the Board & CEO

[Interpreted]

On your first question about IT spending recovery in the second half of 2023, well, banks are more prudent with IT spending in the short run, but over the medium to longer span, IT demands from banks are on the rise. In the short term, some financial institutions prioritize lower cost and higher efficiencies, which means reducing IT spending, but the regulators provide solid support over the medium to long term, especially the state council rolled out the digital development plan this February. So, we see clear demand for digital transformation.

Digital transformation will focus on the following aspects in the future, which OneConnect's offerings readily matches, such as banks' self-controlled risk management capabilities in technology applications, digital operations, data security and home developed technology. These are banking segment products that we invest most heavily on. Self-controlled technology is another key area with increasing investments. We have noticed that the financial institutions are increasing their IT budget to satisfy requirements for home developed technology.

Next, on your question about growth drivers and product growth drivers for third-party revenue in the second half of 2023. We landed several high-value contracts in the first half of 2023. We will continue to execute Stage 2 strategy of deepening customer engagement and focus on product integration and upgrades by improving products, cross-selling new products and deepening customer relationships, upgrading new functionalities as well as expanding customer coverage.

By segment, thanks to consistent product innovations, we see good momentum and growth drivers from all segments. Life insurance and digital insurance, new engines for overseas and Gamma Platform are expected to drive growth. By business volume, digital credit and digital retail banking as well as digital insurance remain to be our solid foundation.

For our growth drivers in the short term, growth in third-party revenue primarily comes from banking and overseas, second by Gamma Platform and digital insurance. Over the longer run, with rich Ping An Group experiences, advanced technologies, we see growth drivers from all segments that include integration in

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banking, digital insurance, life insurance and overseas replication of our previous cases all likely to drive our growth.

Operator

[Operator Instructions] Our next question is from Lydia Lin from Morgan Stanley.

Chenyueya Lin
Morgan Stanley, Research Division

[Foreign Language]

Okay. So I'm going to translate it to English. So first question is we understand that cost control is the major priority for the company at current stage, but we are also curious on how will the company to manage to expand the customer base and to improve the ARPU when cutting the sales and marketing expenses significantly? And second question is whether the company is providing or increasing the efforts in providing products that can help the banks to improve their sales?

Rick Chan
Head of Investor Relations

Thank you for your question. The first question will be taken by Jessie and the second one will be taken by Mr. Chongfeng Shen, Jessie please.

Jessie Shen
Head of Strategy, Corporate Planning and Product Management

So on your first question about how to increase our ARPU, for the following 6 months of 2023, we will continue to execute product upgrades as well as our Stage 2 strategy of deepening customer engagement. Our first effort will be to upgrade our products, improve our product functionality so as to increase product premium for our customers.

Our second effort will be to add more modules to our products. For instance, we will improve our ARPU by cross-selling more products. For instance, when we sell cloud platform from our Gamma Platform, we will also try to cross-sell product from banking segments and other segments.

Rick Chan
Head of Investor Relations

Thank you, Jessie. Mr. Shen will take the second question please.

Chongfeng Shen
Chairman of the Board & CEO

In our digital retail banking segment, we have an offering named Smart Banker. This app mainly serves relationship managers for retail bank branches to help them better improve their services to customers. The Smart Banker also plays a very effective role in the digital transformation of retail banking.

Operator

[Operator Instructions] Our next question is from Laura Li from CGS-CIMB.

Laura Li
CGS-CIMB

Let me translate my questions. First question is, I want to know about the current status of cost controlling program, which specific area will be the primary focus for cost controlling efforts moving forward? Second question is about the third-party revenue with a key competitive advantage to ensure the third-party revenue currently. That's my question.

Rick Chan
Head of Investor Relations

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Thank you for your question, Laura. The first question will be taken by Mr. Luo and the second one taken by Mr. Shen.

Yongtao Luo
Chief Financial Officer

[Interpreted]

Firstly, we are happy to report that we have achieved significant success in cost reduction. As you can see by marked loss reduction progress in the first half of this year. By optimizing headcount and reducing costs, our operating expenses have decreased by a big margin.

For our next stage, we will firstly maintain prudent cost discipline to save more costs. Whereas for resource allocation, our priorities will be about improving productivity and return on investments that can better enhance our business development.

To be more specific in terms of R&D expenses, we will make more deliberate and reasonable choices to skew our resources on the research and development of products with higher quality. As for sales and marketing expenses, we will ensure enough resources are provided to ensure healthy and sustainable growth of our business.

Chongfeng Shen
Chairman of the Board & CEO

[Interpreted]

Next, I'll answer your questions on our competitive edge over our peers. Compared to our competitors, we provide technology plus business services and rich optimized AI-powered financial scenario experiences, which include AI customer service, collection and marketing. We also offer mature products and solutions, for instance, risk management platform for retail and wholesale banking and data security. Our business workflow has been proven by Ping An Group and can be readily replicated to other financial institutions with limited customization and high market recognition. These have been wildly used by Ping An Group internally and by external financial institutions.

In addition to making sure our own offerings satisfy requirements for home developed technologies through consulting plus implementation model, OneConnect has also involved itself in the shift for self-controlled technology with many banks.

Also to add more comments on the previous question raised by another analyst, OneConnect not only helps banks lower their costs and improve their efficiency, we can also empower banks to expand their business in retail, credit and risk management.

Operator

We will now conclude today's call, so I will hand back to Rick for any closing remarks.

Rick Chan
Head of Investor Relations

Thank you very much, operator. Thank you, everyone, for joining us on the call today. Time's running out. If any questions, please feel free to contact our IR team, and we appreciate your interest in following us and look forward to speaking with you again.

Operator

Thank you, everyone, for joining today's call. You may now disconnect your lines, and have a lovely day. [Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]

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