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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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Jie Li
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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to OneConnect's Third Quarter 2023 Earnings Call.

[Operator Instructions]

Please note, this event is being recorded. Now I would like to hand the conference over to your speaker host today, Mr. Rick Chan, the company's Head of Investor Relations. Please go ahead, Mr. Chan.

Rick Chan
Head of Investor Relations

Thank you, operator. Hello, everyone, and welcome to our 2023 3rd 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 you opening remarks and business highlights. Afterwards, our CFO, Mr. Luo, Yongtao will bring you latest the corporate development and over a closer look into our financials. And then in question-and-answer session, our management team will be available to you. We have our CTO, Mr. Li, Jie; and Head of Corporate Planning and Product Management, Ms. Jessie Shen.

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. 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 involve a number of risks and uncertainties that could cause actual results to differ materially. Please note that we will present both IFRS and non-IFRS financial measures. With that, I'm now pleased to turn the call to our Chairman and CEO, Shen, Chongfeng. Mr. Shen, please.

Chongfeng Shen
Chairman of the Board & CEO

Hello, everyone. I'm Shen, Chongfeng. Thank you for taking the time to dial in OneConnect's third quarter earnings release. On behalf of OneConnect, I'd like to welcome investors, analysts and friends from media to join this call. It's a great pleasure for me to share with you what we have achieved this quarter.

A couple of days ago, the Central Financial Work Conference has highlighted the importance of technology innovation in finance, green finance, financial inclusion, pension finance and digital finance. As an important part of digital economy, digital finance is the pillar of its development.

We witnessed new excitement for AI caused by GPT. This new round of disruptive technology with AI at its center has opened up greater possibilities for digital transformation in the financial industry. According to a research paper by McKinsey, generative AI alone can generate another $200-340bn for the banking industry, which represents 2.8%-4.7% of total industry revenue. Together with a new round of industry structural upgrade in China, steadily economic recovery, and the transition from previous growth drivers to new ones, we are very excited about demands in digital financing and our performance ahead.

Our strong growth momentum in the first half of this year continued. We achieved solid performance in the third quarter. Net loss attributable to shareholders in the first 9 months narrowed by RMB 414 million or 60% compared with the same period last year. Gross margin improved by 0.9 percentage points year-over-year to 36.1%. These metrics mean we are well on track to becoming profitable by medium term.

Now please go to Page #3. Centered around our business philosophy of "value, win-win cooperation and quality development" we achieved significant progress in 3 core initiatives, namely "strengthening customer

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expansion, focusing on product upgrade, as well as deepening loss reduction and improving efficiency". At the same time, the company has also fine-tuned ROI management of projects and cost management, which will put us closer to medium-term strategic target of "breaking even and becoming profitable".

Next, on Page 4. In terms of products, upgrades continue, further contributing to quality operations. To enhance value creation and proactively adjust business structure, OneConnect has been up with saving out high customization, low gross margin and low-value products and strengthened resource management of products to be phased out.

We have also shifted our focus on upgrading and growing standardized on products and services -- and pivoted towards charged volume services.

OneConnect has also adjusted R&D spending, including pooling resources on core hit products and gradually increasing contribution from new products. Thanks to these efforts, product interactions accelerated and metrics like product standardization and delivery efficiency has been improved.

Next, on Page 5. 2023 remains a key year of Stage 2 strategy, that is "broadening customer engagement". During this stage, we are committed to "one body, two wing", where we focus on financial institutions while expanding ecosystem and overseas.

Next, on Page 6. In digital banking, we landed a new small management contract with a national joint bank this quarter, with contract value exceeding over RMB 10 million.

We further expanded digital transformation into accounting and financial operations management scenarios. With portfolio strategy, the offering runs simulations to select multiple decisive metrics, which are used to guide A&L management and help banks to transform from experience driven to digitally driven. It also enables banks to shorten simulations of budget scenarios from 1 week to 30minutes, and conduct daily metric reviews instead of monthly reviews.

Additionally, we also landed an economic capital project in a large national commercial bank, which represents the last use case of Measures for the Administration of Capital of Commercial Banks. Our product aims to achieve transformation to capital efficient development. With risk-adjusted return on capital as the core standard for capital allocations, we provide measurement tools for banks and their branches, building a flagship case for the application value of economic capital management system.

Next on Page 7. In digital insurance, we have made significant R&D investment in new solutions. To address pain points of small and medium-sized auto insurers, namely risk assessment, cost management and risk management, we are prepared to launch an end-to-end solution covering "claim settlement + underwriting + service" which stems from PAG's experience in auto-insurance operations in over 3 decades. The beta version is expected to come out late this year, the official 1.0 version will be unveiled in Q2 2024.

Next, on Page 8. For Gamma Platform, we further integrated AI into key nodes in operations. For instance, our AI interview robot incorporates AI technologies including smart conversation, digital personality and visualized risk management when reviewing retail loan applications. The solution improves automatic loan approvals by over 30%. In online wealth management services, our AI robot boosts customer conversion by 40% with the help of AI technologies like knowledge graphs and smart recommendation, as well as scenarios like preset scripts and card templates.

Next, on Page 9. With more new landmark projects this quarter, we also further expanded cooperation in two wings, namely ecosystem and overseas. We landed a DaaS project in public utilities worth over 10mn, taking up operation and maintenance, as well as system construction in this area. On top of that, we kicked off cooperation with a top national bank in asset liability management, with a contract worth over 10mn. OneConnect's offering will help the bank improve their Fund Transfer Pricing mechanism, as well as enhance business data pricing mechanism and analysis visualization.

We are also proud to say that HKEX's brand new IPO settlement platform FINI, to which OneConnect provided technology support, is expected to be officially launched soon. With the new platform, the IPO turnaround time from pricing to trading will be shortened from T+5 to T+2, which marks an important milestone for HK's capital market.

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Next, on Page 10. Our hard work has brought in multiple awards from third-party and renowned media institutions. We won the first prize of science and technology progress of Guangdong Province in 2022 and made it into IDC global FinTech Top 100 list conducted for a number of consecutive years. Ping An Financial Cloud received awards from China Academy of Information and Communications Technology.

This September and October, we hosted Retail Banking Digital Transformation Summit and Remote Banking Development Summit in Shenzhen and Shanghai respectively. In our exchanges with executives from banks, we noted first hand that the industry is under operation and management pressure as a result of narrowing interest rate margin and increasing NPL ratio. Commercial banks, especially medium and small sized city and rural commercial banks are in urgent need of leveraging third-party capabilities, enhancing operation management and improving digitalization. That means broader market and possibilities for top FinTech companies in the industry.

There are still 2 months to go this year. As the Chinese economy gradually warms up, we will continue to improve operating strategy, target at business structure adjustment and product upgrade, maintain stable financial performance and make steady progress towards medium-term target. Additionally, we will focus on improving revenue from third party, seek opportunity to expand international cooperation, capitalizing on digital transformation along the "Belt and Road Initiative" in regions such as SEA and Middle East. Thank you.

Next, I'll hand it over to Mr. Luo to brief you on a recent Board resolution and our financial performance in this quarter and the first 9 months of this year.

Yongtao Luo
Chief Financial Officer

Thank you. Good morning, everyone. I'm pleased to share with you some updates about our latest corporate development. Yesterday, we entered into a share purchase agreement with the Lufax and PAOB. OneConnect agreed to sell and Lufax agreed to acquire 100% share of PAOB at consideration of HKD 933 million in cash. Upon closing, OneConnect will cease to hold any interest in PAOB and PAOB will cease to be a subsidiary of OneConnect and will no longer be consolidated into the financial statement of OneConnect.

PAOB was established in December 2018. It obtained 1 of the 8 virtual banking licenses in Hong Kong in May 2019 and opened the business in September 2020.

PAOB was the first virtual bank to provide flexible and efficient banking services with a focus on SMEs and was the first virtual bank to participate in the SME financing guarantee scheme launched by the Hong Kong Mortgage Corporation. In terms of credit assessment, PAOB adopted alternative data to support its credit decisions, allowing it to better understand SMEs' financing needs and perform high quality credit risk assessment. As of the first half of 2023, the revenue of PAOB was HKD 75 million or 3.6% of OneConnect's total revenue and the net loss was about HKD 87 million.

The purchaser, Lufax is a leading financial services enabler with a strong capital base, rich product lines and mature risk control and technological capabilities. It offers financing products designed principally to address the needs of small business owners. Lufax has established relationships with financial institutions in China as funding and credit enhancement partners to enable general unsecured loans and secured loans under its core retail credit and enablement business model. Lufax is also listed on New York Stock Exchange and Hong Kong Stock Exchange.

OneConnect is a technology-as-a-service provider for the financial services industry in China with an expanding international presence. Taking into account the current business strategy of the group, the directors and management of OneConnect focus on technology-driven products and services and allow us to better deploy appropriate resources. Upon completion of the disposal, OneConnect will continue to focus our Stage 2 strategy and to enhance existing technology solutions and products.

As I just mentioned, upon closing, the disposal will bring us HKD 933 million in cash. The company currently intends to apply the process from the disposal as general working capital to improve the core business operations of OneConnect and to focus on our technology capabilities and products to facilitate the long-term business development.

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And we believe that the strong financial and technology capability from Lufax will help PAOB to achieve sustainable and healthy progress going forward. The Board and management team are undertaking strategic review of our businesses from time to time with a view to maximizing returns to the shareholders.

Next, let's go through the financial results of Q3 2023.

We have achieved a solid third quarter. In Q3, we have made substantial progress in loss reduction, which is consistent with our strategic goal to achieve midterm profitability. Although we have experienced a revenue decline in the past few months, it is during these time that we have the opportunity to showcase our resilience and ability to adapt. We will be exploring new opportunities, assessing our current processes and making necessary adjustments to ensure that we can regain growth momentum in the near future.

In the third quarter of 2023, we delivered revenue of CNY 844 million, decreased by 21.1% compared to the same period last year, primarily due to the decline in transaction-based and support revenue. Revenue generated from third-party customers decreased by 12.6% to CNY 307 million in the third quarter. The number of Premium Plus customers decreased year-over-year to 154 from 163 for the same period in 2022, primarily caused by fewer customers in digital banking segment due to slower-than-expected banking IT spending.

We are thrilled to see net loss attributable to shareholders was CNY 91 million, and the corresponding net loss ratio to shareholders improved by 1.6 percentage points on a year-over-year basis to a negative 10.8%.

Now let's turn to our revenue mix. In the third quarter, our third-party revenue decreased by 12.6% to CNY 307 million compared to Q3 last year, contributing 36.4% of total revenue in Q3. Third-party revenue growth remains the key focus of our second stage strategy. We will continue to seek opportunities that align with our growth objectives, fueling further expansion of our third-party revenue streams.

In the third quarter, revenue from Lufax decreased 48.5% to CNY 61 million and contributed 7.2% of our total revenue. The revenue decline from Lufax was mainly due to Lufax's business operations optimization, resulting in lower demand for Business Origination and Risk Management services. Revenue from Ping An Group decreased 20.6% to CNY 476 million and contributed 56.4% of our total revenue. Revenue decline from Ping An Group was primarily due to a decline in transaction volume, such as Operational Support and Risk Management products. The services provided to Ping An Group are core technology solutions, which have been deeply embedded into Ping An Group's daily operations.

Looking ahead, we will continue to fully support Ping An Group's business reforms and look for new cooperation. In the first 9 months of the year, revenue from third-party customers decreased 8.9%. Revenue from Lufax decreased 42.1% and revenue from Ping An Group dropped by 13% for the corresponding period in 2022.

Moving on to revenue mix by business type. Let's take a look at our Q3 results first.

Implementation revenue decreased by 13.4% on a year-over-year basis to CNY 175 million, mainly due to lower revenue contribution from new customers as financial institutions recovering from the pandemic still takes time. Revenue from Business Origination services decreased by 70.9% year-over-year to CNY 27 million, primarily due to the declined transaction volume and our proactive actions of phasing out lower value products in the Digital Banking segment. Revenue from Risk Management services decreased by 26.3% year-over-year to CNY 77 million, mainly due to reduced transaction volumes in banking loan solutions because of slower-than-expected banking activities in the third quarter.

Revenue from Operation Support services decreased by 33.5% on a year-over-year basis to CNY 195 million, which was primarily caused by reduced demand from auto insurance customers and banking customers. Revenue from Cloud services platform was CNY 297 million, stable on a year-over-year basis in the third quarter. Revenue from Post-implementation Support and Other Services decreased by 30.3% year-over-year to CNY 34 million in the third quarter. The decline was primarily due to lower demand for auto ecosystem synergies. Revenue from PAOB, Virtual Banking business in Hong Kong, increased by 30.4% to CNY 37 million as compared to the third quarter last year.

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If we look at the first 9 months of 2023, Implementation revenue increased 13.5%. Revenue from Business Origination dropped 65.4%. Risk Management decreased 25%. Revenue from Operation Support declined 23%. Cloud services platform revenue decreased 5.2%. Revenue from Post-implementation Support and Other Services dropped 32.6%. And PAOB increased 39.6%.

As you can see, we have been diligent in identifying and improving underperforming areas of our business and we focus on enhancing revenue structure. We will remain committed to integrating our product mix and adopting a stable and a sustainable stock-based charging model.

Let's turn to revenue mix by product sectors.

Gamma Platform sector, the focus of product innovation in recent years, contributed to the biggest chunk of our revenue, declined slightly 2.4% in the third quarter of 2023 to CNY 457 million and accounted for 54.1% of total revenue. The decline was mainly caused by reduced transaction volume of our open platform products.

Digital Banking sector, which accounted for 23.9% of total revenue, reduced by 41.4% on a year-over-year basis to CNY 201 million. That was mainly caused by a reduction in transaction volume of our Business Origination services and Risk Management services, which were related to our initiatives to phase out lower-value products and the impact from the lower-than-expected banking activities.

Digital Insurance sector, which accounted for 17.6% of total revenue decreased by 35.2% to CNY 149 million in the third 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 technology value-added as well as those with limited potential for growth. In addition, Virtual Banking sector, as I just mentioned, accounting for 4.4% of total revenue.

Customer numbers. In the third quarter of 2023, the number of Premium Plus customers decreased to 154 as compared to 163 for the same period last year, primarily due to fewer customers in Digital Banking sector. 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 the gross margin. We are very glad to see our gross profit reached CNY 295 million in the third quarter of 2023. Gross margin remains flat at 35%. And on a non-IFRS basis, gross margin increased by 1 percentage point to 39.4%. In the first 9 months of this year, our gross margin improved by 0.9 percentage points to 36.1%, and the non-IFRS gross margin increased by 0.6 percentage points to 39.7%. In the first 3 quarters of 2023, the continued efforts in product integration, standardization and delivery efficiency improvement, together with execution on quality growth helped improve our gross margin. We will stick to that strategy and continue the endeavor of achieving profitability.

Moving on to expenses and net loss attributable to shareholders. You can see that we are well on track to our midterm break-even target.

First of all, our research and development expenses came down 19.9% to CNY 230 million from CNY 287 million in the same period of last year. As a percentage of ratio, it slightly increased to 27.3% due to the reduction of total revenue. In the third quarter, our continued investment in technological innovation and organizational capability remains unchanged. As our products were more upgraded and integrated, we further improved our product delivery efficiency. Looking ahead, we will keep investing in research and development at a more measurable and reasonable pace to enhance our product competitiveness in the market.

Our sales and marketing expenses for Q3 decreased 18.3% to CNY 77 million compared with CNY 94 million in the third quarter of 2022. 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 44% to CNY 94 million from CNY 167 million in the prior year. As a percentage of revenue, it decreased to 11.1% from 15.7%. The decline in general and administrative expenses was primarily due to stringent cost control measures and a reduced labor cost.

It is worth mentioning again that under a challenging business environment, our net loss attributable to

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shareholders improved substantially to negative CNY 91 million from negative CNY 133 million in the same period last year. And the corresponding net margin to shareholders improved 1.6 percentage points to negative 10.8%. This achievement reflects our commitment to enhancing our financial health and demonstrates the effectiveness of our actions on our journey towards profitability.

The next page demonstrates the trend of our net margin improvements to shareholders in the past few years. From this page, you can see a clear trajectory of our path to profitability over the years. Our first 9 months of this year results continue to reflect that the effects of our disciplined execution of cost control accompanied by improved operational efficiency, marking another milestone in the path to breakeven. We will continue our product integration efforts and strive to improve operating efficiency and business margins.

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

Next page, we list key financial metrics of the third quarter of 2023.

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

Thank you.

Rick Chan
Head of Investor Relations

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

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Question and Answer

Operator

[Operator Instructions] We now have our first question from Lydia Lin from Morgan Stanley.

Lydia Lin

Morgan Stanley, Research Division

[Interpreted] My question is about the Board management changes in Ping An level. And are there any new business updates or operational or priority changes in OneConnect business that we have observed? And the second question is all these big projects that we have signed up in third quarter this year, when can we expect them to be recognized as our revenue?

Chongfeng Shen
Chairman of the Board & CEO

[Interpreted] The Board conducts strategy reviews on the company's business from time to time, and OneConnect has established solid strategy planning and is very well organized. We have found very professional and good replacements for resigned directors. We are confident that the current management team will continue to achieve quality development. And for the future, our focus will be on the development of quality products as well as to enhance operation efficiency.

Rick Chan
Head of Investor Relations

Thank you very much. For the second question, it will be taken by Mr. Luo.

Yongtao Luo

Chief Financial Officer

Regarding the second question, for several major projects that we landed this year, we expect that this project will last from 2023 to 2024. And for this year, revenue will come in for some of these projects. Based on the milestones that we can recognize, we believe that more revenue streams will come in steadily next year.

Yixuan Li
Guotai Junan Securities, Research Division

[Interpreted] Other than Ping An Group and Lufax, median and small financial institutions are also customers of OneConnect. The central government recently released some policies on financial institutions. How does management team look at the corresponding business impact?

Rick Chan
Head of Investor Relations

Thank you for your question. And the question will be taken by Mr. Shen.

Chongfeng Shen
Chairman of the Board & CEO

[Interpreted] As I've mentioned in the opening remarks, the Central Financial Work Conference has highlighted the importance of technology innovation in finance as well as green finance and digital finance. So for small and medium-sized financial institutions, especially rural and city commercial banks, their main focus will be about to better serve the real economy and to be more compliant with the regulatory

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requirements.

There are targets of better serving financial industry, better serving real economy, being more compliant with regulations as well as the new trend in digitalization. So the implication on small and medium-sized institutions is that there will be urgent needs to enhance their digital capabilities, both in their everyday businesses as well as in their internal operations.

For OneConnect, our offerings including digital transformation in retail banking, credit management as well as asset liability management, additionally these products are a testament to our hard work in focusing on products and serving small and medium-sized institutions. And therefore, we are very confident about our development in the following years.

Operator

[Operator Instructions] We now have our next question from Alan Kuang from Citigroup.

Alan Kuang
Citi, Research Division

[Foreign Language] I just have a quick follow-up on the transaction announced today. Could management share a little bit more color on the rationale behind the divestment of PAOB to Lufax? And I'm wondering if management has any planned -- shareholder return plans regarding the proceeds which from the divestment.

Rick Chan
Head of Investor Relations

Thank you for your questions. For first question, it will be taken by Mr. Shen. And the second one would be taken by Mr. Luo.

Chongfeng Shen
Chairman of the Board & CEO

[Interpreted] PAOB is the virtual bank for SME financial services in the Greater Bay Area. Its strong performance showcases OneConnect technology capabilities.

When we acquired for virtual license in Hong Kong back in 2019, we wanted to use our end-to-end performance platform solution to better serve prospective financial institution customers in Hong Kong and overseas and meet increasing demand for digitalization from financial institutions. And for these purposes, we have achieved greatly.

OneConnect is a technology service provider for financial institutions in China. We conduct strategy reviews on our businesses from time to time to be more focused with our businesses and to maximize returns for our shareholders. Given our current business strategy, the company believes the disposal is a good opportunity for us to focus more on technology-driven products as well as services that are less cash demanding and allocate more resources to technology products and services. After the disposal, OneConnect will continue to pivot to existing technology offerings.

Yongtao Luo

Chief Financial Officer

Proceeds from this disposal will be used as working capital to improve our cash position and operations. As of September 30, cash, not including cash from PAOB, amounts to CNY 1.79 billion in OneConnect. That means we have sufficient funding for long-term development. And with this disposal, we believe it will help us improve sustainability and healthy development of our business.

Under our current strategy, the proceeds will be used to focus on developing technology products and capabilities. And this will help us to meet with our long-term strategic goals and business development.

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Thank you.

Operator

I would like now to hand over back to Rick for any closing remarks.

Rick Chan
Head of Investor Relations

Okay. Thank you, operator. Thank you, everyone, for joining the call today. If you have any questions, feel free to contact our IR team, and we appreciate your interest in following us and look forward to speaking with you soon. Thanks.

Operator
This concludes today's call. Thanks for joining. You may now disconnect your lines.

[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.

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