[LU] Lufax Holding
Q2 2022 Earnings Conference Call
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Executives
Yong Suk Cho, Chairman and Chief Executive Officer
Gregory Gibb, Co-Chief Executive Officer
David Choy, Chief Financial Officer
Xinyan Liu, Head of Board Office and Capital Markets

Analysts
May Yan, UBS
Chiyao Huang, Morgan Stanley
Winnie Wu, Bank of America Securities
Yada Li, CICC

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Lufax Holding Limited Second Quarter 2022 Earnings Call. (Operator Instructions). After the management's prepared remarks, we will have a Q&A session. Please note this event is being recorded.

Now, I would now like to hand the conference over to your speaker host today, Ms.Liu Xinyan, the company's Head of Board Office and Capital Markets. Please go ahead, madam.

Xinyan Liu: Thank you very much. Hello, everyone, and welcome to our second quarter 2022 earnings conference call. Our quarterly financial and operating results were released by our Newswire services earlier today and are currently available online.

Today, you will hear from our newly-appointed Chairman and CEO, Mr. Y.S. Cho, who will start the call by discussing changes to our management team, and then provide an update of the latest regulatory developments, macro-economic and the COVID impacts, and our latest business strategies. Our Co-CEO, Mr. Greg Gibb, will then go through our second quarter results and provide more details on our operations. Afterwards, our CFO, Mr. David Choy, will offer a closer look into our financials before we open up the call for questions.

Before we continue, I would like to refer you to our safe harbor statement in our earnings press release, which also applies to this call as we will be making forward-looking statements.

Please also note that we will discuss non-IFRS measures today, which are more thoroughly explained and reconciled to the most comparable measures reported under the International Financial Reporting Standards in our earnings release and filings with the SEC.

With that, I'm now pleased to turn over the call to Mr. Y.S. Cho, Chairman and CEO of Lufax. Please.

Yong Suk Cho: I thank you all for joining our second quarter 2022 earnings conference call. I will start today's call with changes to our management team, and then provide an update of the latest regulatory developments, macro-economic and Covid impact, followed by updates on our latest business strategies.

Earlier this month, our Board approved the resignation of Chairman Ji Guangheng and my appointment as Chairman and CEO of Lufax. We would like to thank Chairman Ji for his contributions to Lufax, and wish him every success in his new position as Deputy General Manager of Ping An Group.

We have also appointed Chen Dongqi as our General Manager, and David Choy as our CFO, and Y.J. Lim as our CRO. Greg is continuing to serve as our Co-CEO. In addition to continuing to oversee our wealth management efforts, Greg will oversee our finance, treasury, IT, IR functions, having CFO and CTO reports to him, and play a lead role in developing new business initiatives, which we'll share more about at a later stage.

Dongqi joined Puhui in 2013 and has held various senior management positions, including serving as the General Manager for Puhui since 2020. Prior to joining Puhui, Dongqi served in multiple Ping An subsidiaries starting from 1996.

David has served as the CFO for our retail lending business since joining 4 years ago. Before joining us, David was the head of the Treasury Department of Ping An Group, and has served in various leaders roles within Ping An Group finance, planning functions for 11 years.

Y.J. joined Puhui in 2008, and has been overseeing the risk management function of our retail lending business for almost 14 years. Prior to joining us, YJ served in key risk management positions with several global banks, accumulating 25 years' experience in consumer risk management.

Greg, Dongqi and I, together with management team, will continue to drive Lufax's business development, strategy, operations in the future.

On the regulatory front, our observation is that the overall regulatory environment is improving. Recently-released policy statements seek to balance incentivizing and regulating the platform economy to bolster its healthy development over the long term. We have also seen positive recognition for the role credit enhancement plays in supporting credit availability for small businesses.

In terms of the PBOC requirement of no direct data connection with financial institutions, we can continue our current partnership model with funding partners through our guarantee company. Under this bank-guarantee model, we are not required to work with third-party credit agencies. As to the April 29 rectification process, we have completed most of April 29 rectification-related initiatives and have detailed action plans for the few remaining items.

On the customer front, the Covid-19 resurgence in China in the second quarter has had negative impact on small business owners, creating challenges for our operations, with April and May being the most adversely impacted months. Our C-M3 monthly flow rate, which is leading risk indicator, peaked in April at 0.83% and decreased to 0.61% in June. We believe in terms of the domestic credit environment, the worst is now behind us.

Nonetheless, domestic and international macro uncertainties, including Covid-19 resurgence, inflation and recession fears continue to persist, and will likely place near-term pressure on our business operations and growth prospects. In the face of this difficult macro operating environment, we will remain prudent in our operations and are prioritizing quality over volume growth for the balance of this year.

While we remain cautious, key initiatives launched last year are starting to bear fruit for the medium term. We believe the sourcing contribution from Ping An has bottomed out and is now stabilized, contributing about 22% of our new loan sales in the second quarter. Our reduced loan growth this year is largely the result of a proactive focus on quality. Our selective tightening of credit standards by customer segment and geography has resulted in a meaningful narrowed scope of new business sourcing in the first half. However, as a result of careful targeting of new growth by our direct sales team in better-performing regions, we have been able to offset some of the sourcing contraction brought by these tighter credit standards.

As of June, the percentage of high-quality talents in our direct sales force increased as we continue to execute our channel transformation. Our direct sales made up 53.6% of new loan sales in the second quarter, up from 49% a year ago. As and when the Covid impact recedes in negatively-impacted regions, we will be able to quickly adjust our credit policy and fully deploy our strengthened sales force for accelerated new business growth. While the specific timing for acceleration requires more observation, we are confident that when it occurs, we are very well positioned to adjust quickly.

In fact, in the second quarter, we witnessed a 17% increase in number of loan applications per direct sales year-on-year. Market demand and policy support is clearly evident, and it is now a matter of picking the right timing to expand our customer sourcing scope.

Finally, I would like to share some updates on our business strategies. In the long term, we will continue to focus on serving the financial needs of small business owners who represent an important and growing share of China's middle class wealth formation, and enhance our capabilities in the small business owner or SBO segment.

In the second quarter, our loans to small business owners made up 86.1% of new loan sales versus 77.6% a year ago. Going forward, we will expand our offerings to meet all rounded needs of SBOs, such as providing industry insights, online tools and other value-added services to help SBOs with their mid-and-back office functions. On these service foundations, we move to offering comprehensive financial services including lending, wealth management, and insurance products through expanded partnerships. This strategic direction seeks to extend our customer lifecycle, deepen data-driven insights, strengthen customer loyalty, and optimize our customer acquisition and management costs.

For our wealth management business, we will continue to focus on serving customers in the online fund distribution space, helping them to achieve their financial planning objectives through improved content and tools both pre-and-post-investment. The online technology developed historically in the wealth management business for dynamic customer management will be further leveraged and aligned with future services for small business owners.

Lufax has a long and proven history of making adjustments to anticipate and respond to the changing operating environment. In response to today's environment, we are further integrating our mid-and-back office and technology teams, and realigning our structure to achieve greater nimbleness and optimized resource allocation. Recent adjustments create more shared resources to better position our company for future growth opportunities. The scope of this adjustment will not trigger material changes in our revenue or cost structure in the near term.

Overall, we are confident in the steps we have taken, and will continue to support the growth and development of small and micro businesses and the real economy at large. We also plan to adjust our dividend distribution to twice a year from once a year to deliver value to our shareholders.

With that, I will turn the call over to Greg, who will share our business updates in detail.

Gregory Gibb: Thank you, Y.S.. I will now go through our second quarter results and provide more details on our operations. Please note that all numbers are in RMB terms and all comparisons are on a year-over-year basis unless otherwise stated.

The second quarter was both a difficult and steadying time for the economy and our business -- difficult for our business in terms of needing to be very selective in new growth, while facing increased credit costs resulting mostly from Covid; steadying in that our early-stage risk indicators peaked in April and are now showing signs of recovery while we continue to pursue ongoing improvements in our operations.

Through this period, we have remained committed to providing inclusive funding solutions to small business owners, with 86.1% of new loan sales disbursed to small business owners, up from 77.6% in the same period last year. However, our committed stance on prioritizing quality over volume for the last several quarters resulted in second quarter total income growth of 3.1% year-on-year.

We have taken a firm stance on cost control with total second quarter expenses, excluding credit and asset impairment losses, and other financial costs and losses, declining 11% year-on-year. Nonetheless, the increase in credit losses, where we directly bear risk through our guarantee company, led to a profit decrease of 37.9% in the second quarter versus a year ago.

Our net profits in the first half decreased by 15.2% versus a year ago. While these results are clearly below the expectations we set for ourselves at the beginning of the year, we believe our strategy provides protection on the downside, will allow us to adjust quickly as the macro environment radically recovers.

Now, let's take a closer look at the several of the core drivers for our business model and operating performance. As Y.S, just mentioned, first, we believe that the recent policy and regulatory announcements are positive for our business model medium-term. Supporting small businesses is only becoming more important in China's current economic priorities. On the regulatory front, there is increased recognition of the role that credit enhancement can play in helping funding availability for small business owners.

In the second quarter, excluding our consumer finance subsidiary, credit insurance provided by our 7 insurance partners to customers covered 76% of new loans. The role of our guarantee company and its role in data transmission to our funding partners has recently been clarified. We have received feedback that we will not need to share data with funding partners through a third-party credit agency under current bank-guarantee model.

In the second quarter, the average APR for loans facilitated portfolio-wide reached 21.4%, down from 21.8% in the previous quarter. We will continue to leverage our unique business model and take guidance from central policy initiatives to continue to enhance our market positioning.

Second, our channel transformation continues to push ahead. New business sourced from Ping An channels in the second quarter dropped to 22% from 31% a year ago. Importantly, new customers sourced in the first half of this year are of better quality than those sourced in the second half of last year. In regions where we have been successful in hiring higher-quality direct sales, the growth and productivity improvement has also been stronger. When combining our channel adjustments with selective regional growth, differentiated by superior credit performance, we are managing to optimize the overall quality of our new business in otherwise difficult market conditions.

Third, we are seeing improved funding costs across our partner network. In the second quarter, overall bank and institutional funding costs have decreased by about 10 basis points. This improvement is driven both by the benign interest rate environment and strong demand by funding partners. Demand amongst our funding partners reflects both their desire for our quality assets and their need to increase exposure to the small business owner segment. Our number of funding partners in the second quarter reached 78, about a 10% increase over the first quarter.

Fourth, our balance sheet remains robust. As of end of the second quarter, our net assets stood at 97 billion with 43 billion cash on hand, and the leverage ratio for our guarantee company stood at roughly 2x, demonstrating our resilience in the face of risk fluctuations. We believe that our strong capital position will enable faster resumption of growth when the macro environment stabilizes.

At this point in the cycle, our unit economics are holding up reasonably well. Despite the decrease in the effective interest APR, we have observed relative resilience in terms of the take rate, reflecting ongoing improvements made in funding costs, credit insurance costs, and early repayment impact over the last 12 months.

In terms of net margins, sales and operating expenses in the second quarter have improved somewhat versus a year ago to offset partially the increased credit costs we bear through our guarantee company.

Let me dive further into the change in credit costs, as this has had the largest impact on our overall profitability. Total credit costs in the second quarter were 3.5 billion, an increase of 152% versus a year ago. The increase was mainly due to increased risk sharing through the guarantee company and the deterioration in underlying credit quality driven largely by the Covid resurgence. As a reference, excluding the consumer finance subsidiary, the self-guarantee portion of new loan sales increased from 16% in the second quarter of 2021 to 22% in the second quarter of 2022.

If we further look into the early risk indicators, in December 2021, the C-M3 monthly flow rate was 0.53%. In April, following the Covid resurgence in Shanghai and other regions, the portfolio C-M3 flow rate peaked at 0.83%. In June 2022, the C-M3 indicator stood at 0.61%. In the 2020 Covid wave, the C-M3 flow rate peaked at 0.98% and then returned to pre-Covid levels within a 3-month period. Given the weaker macroeconomic environment today versus 2020, we anticipate that the return to normalized C-M3 flow-through rates will require a more extended period. This reality, combined with uncertainty on potential for further Covid outbreaks, is the foundation for maintaining a prudent stance.

In the second half of this year, we do expect our lending facilitation unit economics take rate to be negatively impacted by increased credit insurance costs on new business, as our credit insurance partners price up in response to Covid's resurgence in the first half. We are reviewing possible pricing adjustments to reflect the change in credit insurance costs. However, we do not expect absolute credit costs to increase substantially in the second half, as we believe the worst is already behind us based on the early risk indicators. But a return to our historical unit economic levels, both top and bottom line, will certainly have to wait until 2023 with a hoped improvement in the overall macro-economic conditions.

We believe we are planting the right seeds for the medium term, and are taking a prudent approach, but continue to build on strong underlying fundamentals to be able re-engage in net new business growth when the timing is right. It is with this in mind that we turn to our guidance of the second half.

For the full year 2022, we expect our new loans facilitated to be in the range of 563 billion to 590 billion, and our client assets in wealth management to be in the range of 390 billion to 430 billion.

We expect our total annual income to be in the range of 60.3 billion to 61.7 billion, and our net profit to be in the range of 13 billion to 13.4 billion for the full year 2022. This suggests flat to slightly negative revenue growth for the full year, and a decline in annual profits of up to 22%. If non-cash foreign exchange losses are excluded from the calculation of net profit, the decline in annual profits will be approximately 17%.

These forecasts reflect our current and preliminary views on the market and operational conditions, which are subject to change. Surprises to the upside derived from possibly more aggressive economic policy support are more likely to be visible in 2023.

Finally, we are fully aware of potential delisting risks in the U.S. and are ready to initiate a Hong Kong listing plan as soon as permissible and subject to relevant regulatory requirements.

As Y.S. mentioned earlier, starting from this year, we will be distributing our dividends twice a year to deliver greater value to our shareholders. Our Board has approved a dividend distribution of USD 0.17 per ADS for the first half of 2022.

I will now turn it over to David for more details on our financial performance.

David Choy: Thank you, Greg. I will now provide a close look into our second quarter results. Please note that all numbers are in RMB terms, and all comparisons are on a year-over-year basis unless otherwise stated.

Our total income for the first half grew by 8.4%, in which the total income for second quarter grew by 460 million, or 3.1% year-over-year growth.

Our total expenses for the first half grew by 24.1%. The increase in the total expense is primarily driven by the significant increase in credit impairment cost and also foreign exchange revaluation losses due to USD appreciation; while our operating-related expenses actually decreased by 11 % due to operating efficiency and optimizations.

Net profit for the first half decreased by 15.2%, and the same quarter, net profit decreased by 37.9%.

Next, let me highlight some of the key changes in the financials. First of all, we still achieved positive top line growth amidst a very difficult second quarter for China. Total income increased by 3.1% in second quarter year-over-year, or 8.4% in the first half. As we are dedicated for building up a more sustainable business model, the total income mix of our retail credit facilitation business continued to evolve.

During the quarter, while platform service fees decreased by 23.1% to 7.4 billion, our net interest income grew 55.3% to 5 billion, and our guarantee income grew by 117.3% to 1.9 billion. As a result, our retail credit facilitation platform service fees, as a percentage of total income, decreased to 45.2% from 62%.

And as the trust funding model provide significantly lower funding costs in fulfilling the ABS business model, we continued to utilize them more in our funding mix; whereas the respective accounting treatment on revenue under this model is recognized under the net interest income. We find that our net interest income, as a percentage of total income, actually increased to 32.8% from 21.8% a year ago.

Moreover, as we continued to better utilize our guarantee company's abundant capital to bear more credit risk by ourselves, instead of by our P&C insurance partners, we generated more guarantee income, reaching 12.7% of the total income, compared with 6% a year ago.

In terms of wealth management, our platform transaction and service fees increased by 14.7% to 467 million in the second quarter from 407 million in the same period of 2021. This increase was mainly driven by the increase in fees generated from our current products and services, partially offset by the runoff of legacy products.

Turning to our expenses, we are cost conscious and our operating expenses, excluding credit and asset impairment losses and other losses, actually decreased by 11%. In the second quarter, our total expenses grew by 2.5 billion or 29% to 10.9 billion from 8.5 billion in the same period of 2021, primarily driven by increase of credit impairment costs. Credit impairment losses actually increased by 152% to 3.5 billion in the second quarter of 2022 from 1.4 billion in the same period of 2021.

Total expenses, excluding credit and asset impairment losses, finance costs and other losses, decreased by 11% to 6.3 billion in the second quarter of 2022 from 7.1 billion in the same period of 2021, as we further improved our operating efficiency.

Our total sales and marketing expenses, which mainly include expenses for borrowers and investor acquisition costs, as well as general sales and marketing expenses, decreased by 19% to 3.5 billion in the second quarter. This decrease was in line with the decrease in new loan sales, the commission-based compensation structure. Of course, the continual optimization of productivity of our direct sales force also provides us with flexibility in our cost structure.

Our general and administrative expenses also decreased by 4.5% to 762 million in the second quarter from 798 million in the same period of 2021, thanks to our stringent cost control measures as usual.

Our operation and service expenses mildly increased by 7.1% to 1.6 billion in the second quarter from 1.5 billion a year ago, primarily due to the increase of trust plan management expenses, which is in line with the increase in consolidated trust plans.

Our credit impairment losses increased by 152% to 3.5 billion in the second quarter from 1.4 billion a year ago. This was mainly driven by two factors. First, the provision and indemnity losses driven by the increased risk exposure as we move towards a more balanced risk-taking model. As a reference, the company bore risk on 21.2% of its outstanding balance, up from 11.3% as of June of last year, 2021. Secondly, the change in credit performance due to the impact of the Covid-19 outbreak also contributed to the increase in credit impairment losses.

Our asset impairment losses increased to 352 million in the second quarter from 2 million a year ago, mainly due to the impairment losses of one legacy equity investment in an associate company, which is unrelated to our core business, which we already planned to discontinue.

Other losses were 527 million in the second quarter compared to other gains of 301 million a year ago, mainly due to the foreign exchange losses on our U.S. dollar debt exposure in the second quarter of 2022, as we witnessed a huge market volatility of U.S. dollars and RMB in April.

As a consequence of the aforementioned factors, our net income decreased by 37.9% to 2.9 billion during the second quarter from 4.7 billion in the same quarter of 2021. Meanwhile, our basic and diluted earnings per ADS during the second quarter were RMB1.27 or USD0.19 and RMB1.23 or USD0.18 respectively.

On the balance sheet side, our balance sheet remains strong and solid with cash at bank balance increased to 42.9 billion. As of June 30, 2022, we had a cash balance of 42.9 billion in cash at bank, as compared with 34.7 billion as of December 2021. In addition, liquid assets maturing in 90 days or less amount to 42.3 billion as of end of June 2022.

As of end of June 2022, our guarantee company's leverage is only at 2.03x, whilst regulatory requirement allow us to leverage up to 10x. All these provide strong support for the company to remain resilience in face of economic downturn and continuity in our dividend payout.

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

Questions and Answers

Operator: Thank you. (Operator Instructions). May Yan from UBS.

May Yan: My question is on asset quality. Like Greg mentioned that the flow rate seemed to have bottomed out. And what's the recent trend in July and August? And given the Chinese economy, it doesn't look like it's going to improve much in the next few months, or in the near term. What's your expectation then in the second half of this year for our asset quality?

Yong Suk Cho: Okay. So your question about asset quality, May. So we said if you look at our sequence, mostly in the flow rate, it peaked in April at 0.80% and decreased down to 0.61% in June. So we strongly believe the worst time is already over. However, we understand the current macro-economic situation, environment, is not as good as back in 2020. So we take very prudent steps and we anticipate that the return of flow rates to previous levels will require a more extended time. And it might be at a relatively higher level throughout this year. So we estimate the asset quality will remain at current levels in the second half as it relates to our credit impairment costs.

May Yan: Thank you. Can I follow-up a bit?

Y.S. Cho: Sure, please go ahead.

May Yan: Yes, understand that. And I think the overall larger concern has been on the property sector. I don't know if you're -- maybe that has something to do with secure the portfolio. I understand the secure portfolio is probably 20% or less of the total. But has the property sector situation impact for your asset quality at this point?

Y.S. Cho: Actually, I'll be happy to discuss the secured portfolio. It takes about 20% of total loan balance. We have house-secure loans. And then for that loan, our LTV s not more than 70% and then so from the house, the property market, actually don't have any notable impact from secured loans.

May Yan: Okay. Thank you. Thanks very much.

Operator: Thank you. [Chiyao Huang] from Morgan Stanley.

Chiyao Huang: So I got two questions. The first is how do management see the current Covid control measures are impacting the underground operation of our direct sales?

And second question is also about asset quality. Just wondering what are the coactive measures worth taking to defend the asset quality current stance?

Y.S. Cho: Well, regarding -- answering your first question about that underground operation we have so-called offline-online operation process. So during the Covid-control period, our customers, they have no problem to apply their loans through online app. So we don't see any barriers in loan application and underwriting procedures during -- even during the Covid-control time. And we are catching up quite many corrective measures with the rising concerns on the credit environment.

So we tightened our underwriting policy quite much, starting from Q4 last ear and then continuously through the first half of this year. if you look at our Ping An life channel I would emphasize they still make positive growth. And then more importantly, this is under we tightened our credit policy. Actually, acquisition volume per direct sales increase by almost 20%, so which would indicate market demand is still there. So as soon as we see that the overall economy is becoming better, and we believe we have enough confidence to start our growth again.

Chiyao Huang: Thank you.

Operator: Winnie Wu from Bank of America Security.

Winnie Wu: So just wanted to follow-up on that. It seems the second quarter lockdown, how do the company see the demand from the SME segment? And let's say if China stay with this zero-Covid policy in the next 1 to 2 years, will that change your midterm loan growth target? Previously, I think the company is looking for generally, the double-digit teens sort of the sustainable growth. If the zero-Covid doesn't change, will that impact your target?

And also is there any like sensitivity analysis you've done on every 1 percentage point changing loan origination? How will that impact the net profit growth for the following 1, 2, 3 years?

Yong Suk Cho: Thanks. Yes, the market demand, we know that the overall market demand on loans from SME segment are not as strong as before. This is true because they don't want to invest in the business in this time. However, we also know that our market share is nearly about 1%. And then as I just mentioned, if you look at our application volume, it increased by almost 20% of first half. So the demand is there; we don't have any concern. When we have more comfort on the credit environment, we can go and then can deliver higher sales volume.

And then your question about that the sensitivity, simply put, if you compare our annual ending loan balance, the loan balance at the end of December 31 every year, and then compare the number with our new loan sales in that year, it's very close, it's very close. And then that average loan balance is the key driver of our net margin, net profit, so 1% sales volume drop, it means roughly 1% balance drop. So assuming there is no unique kind of change, it means it's about 1% profit drop.

Gregory Gibb: I think just to follow-up, the thing that I would emphasize is if you look at, as Y.S. said, we really started to tighten credit kind of the end of the third quarter last year, and then more significantly, fourth quarter. And then we had the transformation on channels with the change in Ping on life. If you fast-forward to today, over the last 2 quarters, we've really been self-imposing restriction on our growth because we're not comfortable with the credit quality. What we're really doing region-by-region is cutting out what we view to be the highest potential risk customers.

And so if you look at what's going on today on the ground, two things are happening. One is the new customers that we do do, in regions that we do choose, are of higher quality today than they were 6 months ago. So the key factor for us is the judgment on timing, right? We have more than enough funding; we have more than enough capital. We have full confidence in our credit models, but we need to be comfortable that the macro environment justifies putting our foot back on the grass. And we have our foot on the grass in probably about two-thirds of the regions today, where we actually think there hasn't been as severe a Covid impact, and where we think the dynamics are right to do so. But there's a third of the regions that we're being very cautious on today, and so that's how we're playing it out.

So to your question around if Covid policies continues for the long-term, we will continue to have to be selective on credit quality; we'll have to be -- continue to be selective on region. But we do look at the third quarter now compared to where we were 3 months ago, it is better, right? It is clearly better from the time of the Shanghai lockdown and surrounding regions, but we'll continue to have to look at it region-by-region, quarter-by-quarter.

Winnie Wu: Thank you very much. So on the year 1, year 2, profit impact, I think my question was more about, because of the delay, because the revenue was booked throughout the lifecycle of the loan, so the slowdown this year will probably have delayed the impact. So how is that impacting next year, or year 3 as well?

Gregory Gibb: There's clearly a roll-on effect of this, right? If you had last year portfolio this year, then your banks for next year get somewhat impacted, that's for sure. But generally, the way we look at this business is on each new loan, new economics, over a 2 to 3-year period and so we're comfortable with that. It's really a question of then how do you add year-by-year, or quarter-by-quarter? And then you can really project down the road.

So there's no question that you can see that our revenue growth through the second quarter this year was 3%, and that's because of actions we started to take 3 quarters ago, right? And so we will have to be a bit more prudent in our guidance around the medium-term. But I think that when we look about kind of more medium to long-term, it's really finding the right time to re-engage. And then you kind of know what the path is from there.

Winnie Wu: Yes, thank you very much.

Operator: Thank you. Yada Li from CICC.

Yada Li: I'm Yada from CICC, and we have two questions for today. The first one is about the insurance cost. I'd like to know that what is the trend of our insurance costs in Q2 2022, and how to view the trend in the next 2 quarters. And if the pandemic repeats and when we see the macro economic uncertainty intensify, how can we ensure that we have enough, the insurance partners, to provide the credit enhancement?

And the second one is about we adopted a prudent business development strategy this year. And however, when the business grows, it's not our primary goal. Are there changes to our direct selling team through teamwork, and how to control the operating costs brought by a large direct selling team at this stage?

David Choy: Okay. Thank you, Yada. I guess your first question is about the insurance cost. Yes, as we all know, insurance itself is a risk business. I do -- and we all trust our insurance partner ability, and we know how to price risk in the long-term and sustainable perspective, but for short-term, volatility do exist. And it does add volatility to risk cost, but I think in the long-term, it will get normalized fitting into our business model.

What I want to emphasize is that Lufax, we have established extensive credit enhancement sharing mechanism with our partners. Quarter 2 as an example. We take around 22% of risk from the new sales And second, we do have sufficient capital to increase our self-guarantee ratio and further reduce the pressure on credit enhancement or the pressure on the insurance cost.

Just to mention and emphasize again, our guarantee company’s leverage is only about 2x where the regulatory requirement can allow us to go up to 10x. And we are currently considering to increase the self-guarantee ratio when we feel timing is appropriate. So this is my comments on your first question. And I don't see any issue to have our insurance company partners to continue to work with us because we are building up business relationship and partnership from a very, very long-term perspective.

Your second question I think about with the changing of our business development strategy, and what kind of change DS team in terms of the routine work and the impact to operating costs. I think the core duty of our DS team hasn't primarily changed at all; it still remains the core for business customer acquisition. But we are actually adding more context to them in building stickiness with our small business owner customers, and to know more about them on their risk to help us better price our customers. So we do expect them to cooperate with the collection team to commit and build more connections with customers. And I don't think it will take too much time and it won't incur additional cost to them.

In terms of the cost, as you know and as all know, our cost structure is very flexible. Our commission-based structure allow us to be resilient in tough times and have energy to source. So I don't think we have extra burden for us for cost

Gregory Gibb: I'd just add, on the specifics of the numbers, if you look, new loan sales year-on-year are reduced by about 15%. Then if you look at our direct sales headcount, we're down about 10% from the end of last year, so we -- but the reduction in the total salesforce is coming mostly from removal of a middle-layer of management. So our actual number of frontline people has not decreased by that much, which goes back to the point that YS has made, which is the total amount of new loan growth is actually increased year-on-year for the first half.

So while we've optimized the structure of the salesforce, what they do hasn't changed, but their productivity has actually been improving while we've been maintaining an overall headcount control through the way we deploy those resources. If you actually look through the second quarter, sales and marketing expenses are optimized versus a year ago by about 19%. So as the volumes change, we are adjusting our expenses accordingly. And so I think we're in quite good positioning for our overall cost optimization.

And the only issue that we have to deal with, I think, in the next 2 quarters is our insurance partners, where there's more than enough capacity, will price up because of the changes in the first half. But this is something that's rolling on a quarterly basis. So as the risk flows through as we move in towards next year, then there will be repricing again. So overall, we maintained quite a bit of flexibility on that front.

Operator: Thank you. I'll now hand over at this time to the management team for closing remarks.

Xinyan Liu: Okay. So this concludes our earnings conference call. Thank you for attending this call. Thank you.