

360 Finance Inc (QFIN US)

Strong recovery on well-controlled asset quality

QFIN's 2Q20 non-GAAP net profit rose 270% QoQ / 36% YoY to RMB942mn, 12.3% above our forecast. Better-than-estimated earnings was mainly driven by robust loan origination (+22% YoY) and lower provisions for contingent liabilities, thanks to well-controlled asset quality. We expect business trend to stay solid with continued recovery from the COVID-19 shock. Decent profitability ensures ample room to absorb regulatory pressure on APR. **QFIN remains our sector top pick.**

- **Loan growth on track to meet full-year guidance.** 2Q20 loan volume was up 13.8% QoQ / 21.8% YoY to RMB 58.9bn. Total origination in 1H20 amounted to RMB 110.7bn, 50.3% of the upper bound of RMB 200-220bn full-year target. With Chinese government calling for rising policy support to boost consumption, QFIN's FY20 loan growth is likely to top management's guidance.
- **Steady expansion of user base.** Total no. of registered users/ approved users/ borrowers grew 5.2%/6.1%/5.7% QoQ, respectively. Acquisition cost of new approved user stayed low at RMB 168 (-36% YoY). With above-peers registered user base of 149mn and greater room to lift borrower conversion, QFIN sees little pressure in acquiring new users thus could better control marketing expense and borrower quality.
- **Fast asset quality recovery.** Despite a rise in M3+ delinquency rate to 2.82%, leading indicators improved notably in 2Q20. D1 delinquency fell 108bp QoQ to 6.2%, even lower than pre-pandemic level, and M1 collection rate climbed 2.2ppt QoQ to 88%. Management kept 2.5-3.5% full-year vintage loss forecast and expected the ratio to fall below 3% in 2H20. As such, we anticipate a sequential decrease of provisions in coming quarters.
- **Decent take rate and ROE create buffer for lower APR.** QFIN's 2Q20 IRR stood at 27.2%, equivalent to 15.4% nominal APR. Funding cost dropped 50bp QoQ to 7.2%, lowest in the sector. Annualized net revenue take rate and ROE picked up to 9.3% and 53.6% based on our estimate, leaving solid buffer for potential interest decline to cope with regulatory change. Management indicated current breakeven IRR at 16%, without considering the effect of associated volume increase due to lower pricing.
- **Maintain BUY and US\$20.3 TP.** We keep earnings forecast unchanged. Our TP of US\$20.3 is based on 1.7x target P/B and FY21E BVPADS of RMB83.7. Near-term catalysts include accelerating loan origination and further retreat in funding cost, as financial institutions tend to cooperate with industry leaders amid regulatory uncertainties.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	4,447	9,220	13,506	15,638	18,366
Net income (RMB mn)	1,193	2,502	2,962	3,985	5,193
EPADS (RMB)	11.8	16.6	19.5	25.7	32.8
YoY growth	608.1%	41.2%	17.2%	31.9%	27.7%
Consensus EPADS (RMB)	NA	NA	11.7	24.1	31.8
P/E (x)	8.4	5.9	5.1	3.8	3.0
P/B (x)	3.19	2.01	1.68	1.18	0.86
Dividend yield	0%	0%	0%	0%	0%
ROE	46.1%	42.9%	36.9%	36.8%	33.7%

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	US\$ 20.30
(Previous TP	US\$ 20.30)
Up/Downside	+44.1%
Current Price	US\$ 14.09

Internet Finance Sector

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Stock Data

Mkt Cap (US\$ mn)	2,067
Avg 3 mths t/o (US\$ mn)	20.1
52w High/Low (US\$)	18.06/6.37
Total Issued Shares (mn)	179.7
Source: Bloomberg	

Shareholding Structure

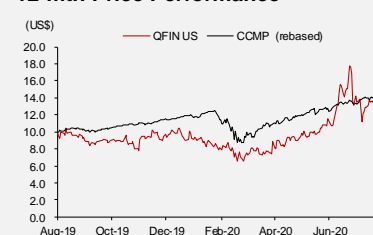
360 Finance Management	17.7%
FountainVest	11.5%
TT International	8.9%
Aspek Management	6.3%
Source: Company data	

Share Performance

	Absolute	Relative
1-mth	7.1%	-2.4%
3-mth	56.6%	28.3%
6-mth	77.2%	43.6%
12-mth	41.0%	-3.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte

Related Reports

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Figure 1: QFIN's 2Q20 results summary

(RMB mn)	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY
Operational indicators							
New registered users (mn)	14.2	16.7	9.0	6.6	7.4	11.0%	-48.2%
New approved users (mn)	3.2	3.6	1.9	1.4	1.6	15.1%	-50.0%
New borrowers (mn)	2.1	2.2	1.2	0.9	1.0	6.7%	-54.5%
Loan origination	48,378	55,965	53,121	51,770	58,905	13.8%	21.8%
Loan balance	61,289	70,568	72,155	73,116	78,480	7.3%	28.0%
P&L							
Loan facilitation service fee	1,794	1,891	1,628	1,471	1,532	4.2%	-14.6%
Interest income	234	410	585	609	628	3.1%	168.1%
Guarantee income	-	-	-	1,006	1,077	7.0%	NA
Other revenue	152	282	187	97	103	6.6%	-32.2%
Total revenue	2,227	2,583	2,401	3,183	3,340	4.9%	50.0%
Origination and service expense	(256)	(374)	(459)	(348)	(400)	15.0%	56.0%
Sales and marketing expense	(838)	(903)	(432)	(223)	(269)	20.6%	-67.9%
General and admin expense	(127)	(114)	(120)	(109)	(109)	0.7%	-13.5%
Provisions	(112)	(250)	(1,128)	(2,161)	(1,407)	-34.9%	1156.4%
Other cost and expense	(65)	-	-	(159)	(161)	1.5%	149.0%
Total operating expenses	(1,397)	(1,641)	(2,139)	(2,999)	(2,347)	-21.7%	68.0%
Other gain (loss)	830	942	262	184	993	439.3%	19.7%
Income tax	(173)	(189)	93	(45)	(166)	270.1%	-3.9%
Net profit	618	734	430	183	877	377.9%	41.8%
Net profit (Non-GAAP)	692	756	516	255	942	269.8%	36.2%
Key ratios							
Net revenue take rate (% of avg loans)	14.4%	14.2%	7.1%	4.8%	9.3%	4.6ppt	-5.1ppt
Net yield (% of avg loans)	4.3%	4.5%	2.4%	1.0%	4.6%	3.6ppt	0.3ppt
Leverage (loan/equity)	10.4x	10.5x	10.0x	12.0x	11.2x	-0.8x	0.8x
ROE	44.5%	46.3%	24.6%	11.0%	53.6%	43ppt	9ppt
M3+ delinquency rate	1.02%	1.07%	1.31%	2.17%	2.82%	65bp	180bp

Source: Company data, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Loan facilitation fee	3,866	7,088	6,587	8,003	9,551
Interest income	268	1,310	2,470	2,827	3,436
Guarantee income	-	-	3,913	4,220	4,732
Others	314	823	535	589	648
Total revenue	4,447	9,220	13,506	15,638	18,366
Origination expense	(666)	(1,083)	(1,462)	(1,779)	(2,139)
Funding costs	(72)	(345)	(652)	(754)	(904)
Marketing expense	(1,322)	(2,852)	(1,297)	(1,953)	(2,351)
General & admin expense	(561)	(428)	(573)	(723)	(864)
Provisions	(182)	(1,618)	(5,896)	(5,490)	(5,659)
Total expenses	(2,803)	(6,326)	(9,879)	(10,698)	(11,917)
Operating profit	1,645	2,894	3,626	4,940	6,450
Other gain (loss)	15	74	74	40	40
Pre-tax profit	1,660	2,967	3,700	4,980	6,490
Income tax	(466)	(466)	(739)	(996)	(1,298)
Net income	1,193	2,502	2,962	3,985	5,193

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Cash and equivalent	1,446	2,108	5,453	8,524	13,050
Net loans	811	9,240	9,844	11,966	14,544
Receivables	3,128	4,443	5,651	6,256	6,803
Others	1,965	4,510	5,682	6,258	6,839
Total assets	7,350	20,356	26,630	33,004	41,237
Funding	300	8,066	9,352	11,367	13,817
Guarantee liabilities	1,399	2,947	5,770	5,819	5,942
Other liabilities	1,210	2,128	2,660	2,984	3,451
Total liabilities	2,910	13,141	17,782	20,171	23,210
Additional paid-in capital	4,867	5,117	5,189	5,189	5,189
Retained earnings	(430)	2,071	3,603	7,588	12,781
Others	4	26	57	57	57
Total equity	4,440	7,215	8,848	12,834	18,027

Key operating indicators

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Loans (RMB mn)					
Origination	95,983	198,666	217,669	264,869	318,471
Outstanding balance	43,077	72,155	82,414	99,641	116,182
Growth, YoY					
Loan origination	209.7%	107.0%	9.6%	21.7%	20.2%
Loan balance	253.0%	67.5%	14.2%	20.9%	16.6%
Revenue	464.2%	107.3%	46.5%	15.8%	17.4%
Operating expenses	385.2%	125.7%	56.2%	8.3%	11.4%
Net income	623.8%	109.6%	18.4%	34.6%	30.3%
Total assets	137.1%	177.0%	30.8%	23.9%	24.9%
Total liabilities	23.0%	351.6%	35.3%	13.4%	15.1%
Total equity	504.8%	62.5%	22.6%	45.0%	40.5%
Margin					
PPoP margin	41.1%	48.9%	70.5%	66.7%	65.9%
Operating margin	37.0%	31.4%	26.9%	31.6%	35.1%
Net profit margin	26.8%	27.1%	21.9%	25.5%	28.3%

Profitability

Revenue / avg loans	16.1%	16.0%	17.5%	17.2%	17.0%
Funding cost	9.1%	8.0%	7.5%	7.2%	7.2%
Origination exp / avg loans	2.4%	1.9%	1.9%	2.0%	2.0%
Marketing exp / avg loans	4.8%	4.9%	1.7%	2.1%	2.2%
G&A exp / avg loans	2.0%	0.7%	0.7%	0.8%	0.8%
Net income / avg loans	4.3%	4.3%	3.8%	4.4%	4.8%
Loans / equity	9.7	10.0	9.3	7.8	6.4
Assets / equity	1.7	2.8	3.0	2.6	2.3
ROA	22.8%	18.1%	12.6%	13.4%	14.0%
ROE	46.1%	42.9%	36.9%	36.8%	33.7%

Per ADS data (RMB)

EPADS	11.8	16.6	19.5	25.7	32.8
BVPADS	30.9	49.2	58.9	83.7	115.3
DPADS	-	-	-	-	-

Source: Company data, CMBIS estimates

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