

Lufax Holding Ltd NYSE:LU

FQ1 2021 Earnings Call Transcripts

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Co-CEO & Director

Guangheng Ji

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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Lufax Holding Limited First Quarter 2021 Earnings Call. At this time, all participants are in listen-only mode. After the management's prepared remarks, we will have a question-and-answer session. Please note, this event is being recorded. Now I'd like to hand the conference over to your speaker host today, Mr. Yu Chen, the company's Head of Board Office and Capital Markets. Please go ahead, sir.

Chen Yu

Thank you very much. Hello, everyone, and welcome to our First Quarter 2021 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 Chairman, Mr. Ji Guangheng, who will start the call with updates on the impact of regulatory developments as well as our efforts in supporting the growth of small micro businesses. Our co-CEO, Mr. Greg Gibb, will then provide a review of our progress and details of our development strategies in the quarter. Afterwards, our CFO, Mr. James Zheng, will offer a closer look into our financials before we open up the call for questions. In addition, Mr. Y.S. Cho, our Co-CEO; and Mr. David Choy, CFO of our retail credit facilitation business, will also be available during the question-and-answer session.

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'll be discussing 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. Ji Guangheng, Chairman of Lufax.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Hello, everyone and thank you, for joining our first quarter 2021 earnings call. Before we go through the detailed quarterly results, I would like to provide some general updates on 2 aspects of our business. First, the recent regulatory developments and their impact on our business; and second, our achievements in supporting small and micro businesses.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Let's start with the recent regulatory development and the impact on Lufax.

First, with increased clarity on regulations in the first quarter, we have witnessed how regulatory authorities impose various reform requirements on leading tech platforms. We believe that the intention of the new regulation has 3 folds: first, all financial businesses must be rootedly financed and powered by technology; second, our financial activities should be placed under regulatory oversight; third, the development of the sector must be built on the basis of compliance. These policy directions are largely in line with our previous expectations.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Regulatory compliance has always been a key focus for Lufax. Although we were not directly affected by the recent announcement, we have always upheld our commitment to provide socially responsible, trustworthy and convenient financial services.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] For our credit retail product facilitation business, we promote responsible lending practices and educate borrowers on rational borrowing. These efforts help us keep our credit services independent from other incompatible businesses and prevent the misleading customers would act as lending practices.

For borrowers to use the proceeds for our loans, we are different from most online consumer creative business as we focus on serving the smaller macro business owners. We support the development of China's real economy, and our mission is fully aligned with national policies.

On data security, we have strictly adhered to the principal compliance minimum and necessity. First, the data we collect that are used for the purpose of risk assessment are preclude all payment information, which is strictly compliant with the requirements listed in the regulation on the administration of credit scoring industry. Second, our data related to Ping An Group has customer consent and has been scrubbed thoroughly to remove sensitivity. Third, our risk modeling and analysis processes are executed in full compliance with industry rules and regulations.

Going forward, we'll continue to abide by regulatory guidelines, foster prudent innovation, ensure operational compliance, prioritize protection of personal data and improve financial service efficiency and inclusiveness through technology.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] For our wealth management business, we continue to wind down our P2P products in response to regulatory requirements. Thanks to our strong operations and risk management capabilities, P2P products now account for only 0.9% of our total client assets. We have achieved a smooth and compliant transition process as we gradually phase out our peer-to-peer product, making our business more aligned with regulatory guidelines.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Overall, we are fundamentally different from other leading platforms in terms of business model and target customer base.

On regulatory compliance, we have adhered to the principle of preemptive diagnosis and swift operational adjustments for timely optimal results to keep our operations in line with regulatory trends. As policy trends become clearer, we believe it will benefit industry leaders such as Lufax in the long term.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Next, I would like to provide an update on our achievements in supporting small and micro businesses. First, we help small and micro businesses to overcome the hurdles of limited access to capital and high cost in financing. Second, we leverage our unique offline-to-online model to provide better services to small business -- small micro businesses.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Lufax has always been committed to promoting inclusive finance. To expand small and micro businesses' access to finance, Lufax has provided credit facilitation services to more than 15 million customers as of March 2021, facilitated over RMB 580 billion of outstanding balance of loans and extended unsecured loans to nearly 4 million customers residing outside of Tier 1 and Tier 2 cities.

To improve financing affordability, we have adhered to regulatory guidelines and implemented an all-in cost saving of 24% for all new loans since September 2020. We will remain committed to exploring additional ways to lower the financing cost for small micro businesses.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Lufax's unique offline-to-online business model and technology capabilities have enabled us to support the financing needs of small and micro businesses very effectively.

Recently, we noted investor interest in the development of our offline sales team. I would like to mention that our decision to establish an offline sales team was based on the key characteristics of our core customers. Most of our core small and micro business owners have an average age of 39, and the business has average annual revenue of less than RMB 10 million, and average pay of less than 20 employees. Their borrower profiles make it difficult for them to qualify for traditional bank loans. They also lack the time or experience to apply loans online.

With this in mind, we have a sales and service team of nearly 57,000 representatives in over 280 cities. By leveraging our proprietary technology applications, our service team is able to provide professional, convenient and flexible credit services. For example, the verification of borrower background information is conducted automatically through artificial intelligence online, thus significantly reducing manual effort in information gathering and decision making, substantially

improving the efficiency of our lending process. In the future, we plan to launch a series of new technology applications to further enhance our customer experience, empower our offline sales team and improve our operational efficiency.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Moving forward, Lufax will continue to adhere to the nation's guidelines on green finance and inclusive finance by executing our mission of providing inclusive and compassionate financial services. We view it as our responsibility to provide individuals and small and micro business owners across China with easy access to timely, convenient and high-quality financial services.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] In conclusion, although recent regulatory developments have impacted the industry, our business was not materially affected, thanks to our preemptive interpretation of regulatory intention and proactive adjustment. These efforts have also enabled us to achieve solid operating results in the first quarter.

Our management team will continue to embrace regulatory oversight while maintaining active dialogues with the authorities. We will also improve our capabilities in technology, pricing and risk management to streamline our operations, optimize our cost structure and enhance our operating efficiency. We are confident in our ability to maintain the stable growth of our business and continue to provide compassionate financial services to our customers.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] I will now turn the call to Greg, who will share our business update for the quarter.

Gregory Dean Gibb

Co-CEO & Director

Thank you, Chairman Ji. Before I begin, please note that all numbers are in renminbi and all comparisons are on a year-over-year basis, unless otherwise stated.

Lufax had a strong first quarter. We exceeded our guidance and delivered strong top and bottom line growth. In the first quarter, total income increased by 16.9% to CNY 15.3 billion, and net profit increased by 18.7% to CNY 5 billion. This is exceeding our earlier guidance of CNY 4.2 billion. Our net margin reached 32.6% in the first quarter, an 11 percentage point improvement over the fourth quarter of 2020.

4 key trends underpinned our first quarter performance. First, we experienced a significant rebound in our retail credit facilitation unit economics while keeping all-in costs for new borrowers below 24%, the take rate based on loan balance was 10% in the first quarter of 2021, recovering from 9.1% in the fourth quarter of 2020. Funding cost optimization and credit insurance premium reduction were key drivers of this improvement as insurance partners lowered their pricing on the basis of better credit and customer quality. We also reduced our sales commissions in January and improved our

operating efficiency. As a result, our net margin and lending facilitation essentially returned to the levels we saw prior to price reductions in 2020.

As mentioned, reduction in credit insurance premiums is closely linked to credit performance. In the first quarter, our C-M3 flow rate for all loans facilitated was 0.4% versus the COVID peak of 1% in February 2020. The 30+ days past due delinquency rate for all loans facilitated stabilized at 2% as of March 31, 2021, on par with December 31, 2020. The 90+ day past delinquency rate for total loans facilitated improved to 1.1% as of March 31, 2021, from 1.2% on December 31, 2020. All of the aforementioned operating metrics exclude our consumer finance subsidiary and legacy products, which represents less than 1% of our total loan business.

Second, we observed steady volume growth while improving our business mix. On the retail credit side, our new loans facilitated grew by 17.3% to CNY 172.4 billion in the first quarter, largely in line with our expectations. We continued to focus on serving small business owners and improving the risk profile of our borrowers. In the first quarter, excluding the consumer finance subsidiary, 75.7% of the new loans facilitated were dispersed to small business owners, up from 65.9% for the same period of 2020.

High quality borrowers, defined as G1 to G3 borrowers by our own internal classification system, contributed 65.9% of new general unsecured loans facilitated in the first quarter, compared to 58.7% for the same period of 2020. The improved borrower quality led to a sustainable decline for credit insurance premiums and expected credit loss levels.

On the wealth management side, our total client assets exceeded our guidance and reached CNY 421.1 billion as of March 31, 2021. Our focus on mass affluent customers who invest more than CNY 300,000 on the platform has paid off as the contribution to our total client assets reached 76.3% as of March 31 of this year.

Third, we continue to make progress on executing our plans for a more sustainable risk-sharing business model. It is encouraging to see that our funding and insurance partners have remained supportive and are embracing the new risk-sharing business model. As of March 31, 2021, our outstanding balance of loans facilitated with guarantees from third-party insurance partners decreased to 86.8% from 95.1% a year previously. Moreover, new loans facilitated with guarantees from Ping An P&C accounted for 78.3% of new loans facilitated in the first quarter, down from 92.5% a year ago, while our funding partners borne the risk for 5.5% of new loans facilitated in the first quarter. Loans where we bear the risk accounted for 12.5% of new loans facilitated in the first quarter, up from 1.3% in the same quarter of 2020. The balance of loans where we bear the risk was CNY 45.7 billion as of March 31, 2021, representing around 2x leverage of our licensed guarantee company's net assets of CNY 19.2 billion.

Again, these figures do not include our consumer finance subsidiary. We expect the net assets of our guarantee companies to continue to increase as our retained earnings grow, providing organic support to future business growth. Under a 20% to 30% risk-bearing business model and a 10x leverage cap for our guarantee companies, we have ample room to grow our total loan guarantee balance without any additional capital injection this year. The existing capacity of our guarantee company supports a doubling of the current business scale.

Fourth, our wealth management client assets and take rates have remained stable despite accelerated P2P runoff and discontinuation of bank deposit products. As of March 31, 2021, our total client assets increased by 18.7% to CNY 421 billion versus a year ago despite accelerated P2P runoff and discontinuation of bank deposit products.

First quarter revenues from wealth management business increased by 52.8% year-over-year. In the first quarter, we accelerated the runoff of CNY 15.4 billion in P2P products. Of that, March 31, 2021, legacy products accounted for just 0.9% of total client assets compared to 20.6% a year ago. We expect the runoff of our remaining legacy products to be completed in the second quarter.

As a result of regulatory restrictions on bank deposit products, deposit-related client assets decreased CNY 9.1 billion in the first quarter. Our take rate for the wealth business was 28 basis points in the first quarter, with some fluctuation due to decrease in deposit products, offset by continued development in standard wealth and insurance products.

Next, our upgraded guidance for the first half. We expect continued growth momentum in the second quarter with steady

business development, further cost optimization and strong credit performance. Therefore, we are increasing our first half of 2021 guidance for total income growth to be between 17% and 18%, up from our previous guidance of 11% to 14%. We are also increasing our first half of 2021 guidance for net profit growth to be between 19% and 22%, effectively doubling our earlier guidance of 7% to 10%.

In the first half of this year, we expect growth in new loans facilitated to be between 12% and 15% growth, down from our prior guidance of 20%. This is really due to our greater focus on improving product mix and margins. We plan to prioritize the growth of unsecured loans over secured loans as unsecured loans provide higher operating margins, but with smaller ticket sizes.

We expect overall unit economics for new loans this year to be largely in line with the average for new loans in 2020. Our expectation is that wealth management client assets will grow 9% to 12% in the first half from the same period of last year as we will continue to focus on higher-margin asset management funds and insurance products.

Finally, I do want to share our priorities for technology development. Our focus is on 4 fronts. First, we continue to expand our use of legally compliant big data and AI capabilities to augment our strengths in the end-to-end risk management for small business owners. Second, we are developing industry content and real-time planning tools to better support the productivity of our unique O2O sales force. Third, we are integrating infrastructure and services across our lending and wealth management customers to capture greater business synergies. We have already begun to integrate lending and wealth client sourcing with the third party channels, and we'll move to an integrated APP for all services by -- during the course of this year. Fourth, we are exporting our technology and proven online operating models via cloud solutions to our banking partners in China, Hong Kong and Southeast Asia, to extend our market reach and deepen these important ecosystem relationships.

We will measure our progress in technology deployment by our ability to increase customer sourcing and financial institution partnerships to enhance our O2O sales productivity and to promote deeper product cross-selling and finally, to achieve greater operating efficiencies. With the ongoing changes in regulation, we believe that our ability to combine our DNA in prudent financial services with innovative technology will enhance our competitive differentiation and sustain our growth trajectory for the long run.

I will now turn the call over to James Zheng, our CFO, to go through the financial details.

Xigui Zheng
Chief Financial Officer

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

As Greg mentioned, we have experienced significant rebound in retail credit facilitation unit economics driven by lower funding costs, insurance premiums and optimization of operating expenses. As a result, we have delivered strong financial results in the first quarter.

Our total income was CNY 15.3 billion, up 16.9% year-over-year. Our net profit increased by 18.7% to CNY 5 billion in the first quarter, and our net margin further expanded to 32.6%.

Now let's take a closer look into our Q1 numbers. During the first quarter, our total income increased by 16.9%, driven by strong business volumes and increased take rate. On the back of this growth, our retail credit facilitation business is seeing a change in revenue mix as our business and risk-sharing model evolves. While platform service fees decreased by 9.4% to CNY 9.7 billion, our net interest income grew 111.7% to CNY 2.9 billion, and our guarantee income grew 597.5% to CNY 551 million.

In addition, other income directly linked to delivering services to our financial partners increased 241.8% to CNY 1 billion. As a result, our retail credit facilitation platform service fees, as percentage of total revenue, decreased to 63.4% from 81.8%. As we continue to fund more with consolidated trust plans providing lower funding costs, our net interest income, as percentage of revenue, increased to 19.1% from 10.5% in the previous year. And as we share more credit

risk, generating more guarantee income, our guarantee income as percentage of total revenue increased to 3.6% from 0.6%. Through expanded services to our credit enhancement partners in account management, collections and other value-added services, our other income as percentage of total revenue increased to 6.8% from 2.3%.

In wealth management, our platform transaction and service fees increased by 52.8% to CNY 625 million in the first quarter from CNY 409 million in the same period of 2020. The increase was mainly driven by the increase in fees generated from our current products and revenue recognition arising from accelerated P2P run off.

Now moving on to our expenses. In the first quarter, total cost grew by 17.1% to CNY 8.5 billion. Total expenses, excluding credit impairment losses, financial costs and other losses, however, grew by only 10.1% as a result of improved operating efficiencies in most cases. Our sales and marketing expense, which includes borrower and investor acquisition expense and the general sales and marketing expense, increased by 5.5% to CNY 4.2 billion during the first quarter. Our borrower acquisition expense, which is a major component of overall sales and marketing expenses, increased by only 0.2% to CNY 2.6 billion from a year ago, mainly driven by further optimization in sales productivity and sales commission. Our investor acquisition and retention expense decreased in the first quarter versus the year before, mostly driven by the improved acquisition efficiency as we leverage data to achieve greater precision in investor profiling and targeting.

Our general sales and marketing expense, which is mainly comprised of payroll and related expenses for marketing personnel, brand promotion costs, consulting fees, business development costs as well as other marketing and advertising costs, increased by 24.8% to CNY 1.5 billion in the first quarter from CNY 1.2 billion a year ago. This increase was mainly due to lower base in first quarter of 2020, resulting from the postponement of certain marketing campaigns due to COVID-19 at that time.

Our general and administrative expenses increased by 24.1% to CNY 854 million during the first quarter from CNY 688 million a year ago. This increase was mainly due to lower base in the first quarter of 2020 and subsequent headcount expansion to support new business development, including the consumer finance business. General administrative expenses as a percentage of revenue decreased to 5.6% from 7.4% during the fourth quarter of 2020.

Consistent with the growth of our outstanding balance of loans facilitated, and in turn, the expanded loan repayment volume, our operations and servicing expenses increased by 17.7% to CNY 1.5 billion during the first quarter from CNY 1.3 billion a year ago.

Our technology and analytics expense increased by 8.2% to CNY 447 million during the first quarter as we continue to invest in technology research and development. Our credit impairment losses increased by 109.8% to CNY 1.1 billion during the first quarter of 2021 from CNY 502 million during the same period of last year. This increase was due to increased loan-related risk exposure as our business model continued to evolve, leading to higher credit impairment losses upfront.

Excluding the consumer finance subsidiary, the proportion of loans for which we bear the risk accounted for 12.5% of new loans facilitated in the first quarter, up from 1.3% from the same period of 2020. It is worth noting that the increase in impairment losses is purely a function of the increase in the proportion of credit risks borne by us, while the overall credit profile of our borrowers continue to improve. High quality borrowers, defined as G1 to G3 borrowers by our internal classification system, contributed to 65.9% of the new general unsecured loans facilitated in the first quarter of 2021 compared to 58.7% for the same period of last year.

In addition, our loan quality indicators, such as flow rate, DPD30+, DPD90+ have stabilized and in some cases, improved substantially from a year ago. Our finance cost decreased by 36.3% to CNY 284 million in the first quarter from CNY 446 million a year ago, mainly due to the decrease in interest costs.

Additionally, our effective tax rate decreased to 26% during the first quarter of 2021 from 27% in the same period of 2020. Consequently, our net profit increased by 18.7% to CNY 5 billion during the first quarter from CNY 4.2 billion in the same quarter of 2020.

Our basic and diluted earnings per ADS were CNY 2.09 and at CNY 1.96 in the first quarter of this year. As of March 31, 2021, we had a cash balance of CNY 24.5 billion compared to CNY 24.2 billion as of December 31, 2020.

Now let me provide you with some guidance for the first half of 2021. For the second quarter of 2021, as we prioritize improvement in our loan mix and unit economics, we expect our new loans facilitated to be in the range of CNY 145 billion to CNY 155 billion; and wealth client assets to be in the range of CNY 410 billion to CNY 420 billion. As we maintain our growth momentum and we continue to improve our operating efficiency, we expect our total income to be in the range of CNY 14.9 billion to CNY 15.1 billion and the net profit in the range of CNY 3.7 billion to CNY 3.9 billion in the second quarter.

As indicated before, our quarterly financial results are subject to seasonality and fluctuation as a result of accounting treatment. However, as our underlying unit economics improve, our second quarter guidance translates into an estimated year-over-year net profit growth of 19% to 22% in the first half of 2021, a level which we believe should be sustainable for the remainder of the year.

These forecasts reflect our current and preliminary views on the market and operational conditions, which are subject to change. This concludes our prepared remarks for today. Operator, we are now ready to take questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from Winnie Wu with Bank of America.

Yi Wu

BofA Securities, Research Division

And congratulations to Lufax for a very good first quarter results. And I have 2 questions. First, regarding the guidance upgrade. Compared to the guidance provided at the full year result, I think bottom line number for first half is now 11% higher than previous version, which is actually a quite significant upgrade. So just want to see if management could elaborate on some of the key drivers.

And also the outlook for full year, I think James just mentioned, it's like that momentum to continue into second half. So hopefully, it means the strong growth momentum will be maintained for the rest of this year. So that's first. And key drivers for the earnings upgrade and potentially some outlook for second half of this year as well.

Second is also back to the regulatory front. I think Chairman mentioned that there's more regulatory clarity. And I think investors are still concerned regarding stuff like will there be further window guidance to reduce APR, and what about some of the latest requirements like data? Like Ant was talking about, they need to have a credit bureau license to provide the loan facilitation business.

So hopefully, second question, if management can give us also some expectation if there's further requirement from regulator regarding particularly on data and APR front?

Gregory Dean Gibb

Co-CEO & Director

Thanks, Winnie. I'll take the first part and then turn the regulatory question over to Chairman Ji in a second. The guidance upgrade really results from a number of improvements that really exceeded even our own expectations, I think, at the end of Q4 last year. We've seen continued improvement in funding cost. As we continue to improve the mix of our borrowers, the credit insurance costs are coming down. So those are 2 significant drivers that allowed the take rate to go back up to 10% in Q1. And these advantages that we're gaining on both the credit insurance costs should continue -- to actually continue to improve as we move through the rest of the year.

And then on our own operating costs, we continue to see efficiencies in our sales force, our commissions, our productivity. And so these are really the main drivers that allow us to really upgrade our profitability. And the net margin side of the business, of course, directly benefits from that. And we are seeing very good recovery, not only in the take rate line, but also in the net margin line. And these are things that we think will continue through the rest of the year.

So as James indicated, we're projecting 19% to 22% profit growth for the first half, and this is something that we think is a level that can be sustained for the balance of the year.

Chairman Ji, on the regulatory question.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] In terms of window guidance, the first one, I need further requirements to reduce APR further. So far, based on our dialogues with the regulators, we've asked if there's a specific number of targets you'd like us to go through. And we have not received any answer from the regulators, apart from that as an industry leader, you should continue to show or demonstrate your willingness to lower the financing costs, but there's no specific number mentioned. Based on our own judgment, we think below 24% where we are today is pretty safe at the moment.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] So of course, we emphasize the regulators will always want lower financing costs. And we will continue to maintain very active dialogues with them. In fact, I'm flying over to Beijing this afternoon to speak to a few of the authorities.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] So we are looking or we are hoping the regulator understands, for a market to exist and to develop in a healthy way, all participants in the market needs to have enough room to maintain and grow their operations.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] If the APR continues, if the APR ceiling continues to go down endlessly during that process, you will see the exit of many credit providers in the industry. I personally don't think that's what the regulator wants to see.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] As we enjoy lower funding costs and lower credit and CGI costs as a result of better risk management and lower operating costs as a result of improved efficiency -- improvement in efficiency, we hope to pass on those cost savings to lower the overall all-in cost for our borrowers.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] So we do have our own road map in terms of lowering future cost for our borrowers as we optimize the aforementioned cost.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] In terms of the credit bureau license or credit scoring license, I want to point out again that we have been using a guarantee license as the main entity

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] The guarantee model has existed for many, many years. And in the process, using the guarantee company to collect information and collect customer data, in fact, the scope is much smaller than what a smaller company would collect.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] So far, we have received no window guidance or any other communications from the regulators on this front.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] Of course, we will be adhering to more strict data protection, data privacy rules.

Guangheng Ji

Chairman of the Board & Chairman of Executive Committee

[Foreign Language]

Chen Yu

[Interpreted] If we do receive anything further, we'll be letting everybody know.

Operator

The next question comes from Piyush Mubayi with Goldman Sachs.

Piyush Mubayi

Goldman Sachs Group, Inc., Research Division

Congratulations on a good set of numbers. Can I just take you through 2 particular questions? One is when you talk about the loan book growth that you saw and with SME being a greater percentage, could you take us through color on how that is playing out, the sort of growth rates we can continue to expect into the second quarter? And as realized, you mentioned the guidance to second quarter, but you also mentioned that the levels are sustainable for the rest of the year. So could you just take a step back and take us through where you think this growth in the loan book is going to come from? And what the size of the loans you're seeing as possible?

And the second question has to do with the far better cost controls that you demonstrated in the quarter. Where it's clear that -- and you pointed out that it's lower sales -- lower sales commissions that you're paying out for the quarter as well as better sales productivity, could you just take us through these 2 aspects and to look through the rest of the quarters? And whether this is a structural change we're seeing in the business and we can model the new levels of sales and marketing spend?

Xigui Zheng

Chief Financial Officer

Okay. Piyush, your line's a bit blurry. Can I just repeat your questions to make sure we...

Gregory Dean Gibb

Co-CEO & Director

I'll repeat that as I go, and then I think Y.S. will probably add in. I think on the first question, Piyush, you're asking is really about loan growth that we've seen in the first quarter, and that is it sustainable for the balance of the year.

Our view is that we're seeing quite good and strong demand from the market. I think we've seen a number of indicators that say that SME owners, SMB businesses are increasingly using money to grow their businesses and not to repay debt. And so I think there's a healthy environment there for our customer base. And so the one that -- if there's one thing to point to when we look at growth on the second half, we will be prioritizing more at the unsecured side. We see the greatest needs there. We also see our greatest competitive advantage there. And so that's something that we will drive a bit more. So that has the benefit of really maintaining the revenue growth, in particular, in the second half as we meet that demand.

On the cost control side, it really is multi parts, right? So at the top line level, as I mentioned, we are seeing funding costs continue to come down. We are seeing our credit insurance costs coming down. And we expect those credit insurance costs to continue to be optimized because as the new loan book grows as a percentage of the total, then our overall customer mix will improve.

The second thing that goes with that, as you may recall from when we first did the IPO, is that as we move more and more to high-quality SME owners, which now makes up 75% of total new loans, the average ticket size of those loans increase. And so that's been at the rate of, I believe, it is about 10% to 15% increase, which, therefore, allows us to reduce commissions at a proportionate level without reducing the absolute income of the direct sales.

So if you take all that and then the ongoing efforts we're really making on the technology side to really empower our [DS] more to bring more of an online engagement with those customers to deepen both on the lending side and other products, that's what allows us to reduce cost while keeping the top line strong.

I don't know if there's anything that Y.S. wants to add.

Suk Cho Yong

Co-CEO & Director

If I add some more numbers, from January this year, we reduced our sales commission by 50%. But as Greg said, since

we reduced price much, our ticket size increased accordingly. So it will result to more and more income for [that exchange] didn't change at all. So this monthly income is still around CNY 8,500 per month, so which is very stable.

And then it's still about -- more about unit component change. If we compare first quarter this year with the same period last year, our progress in cost improvement is very obvious. Our expected APR decreased from, I think, about 29% per unit, and now it's about 23%. But at the same time, funding cost decreased much. It's now close to about 6%, previously about 7%. And the CGI premium, as we said, it was about 9%. Now it's getting close to 6%, which very indicates our customer mix has been changing a lot since we reduced the high APR.

And then [each will take is basically gone] since changing our price charging [maturity] based on -- through our tools based on the balance charge. So as on the net -- as a result, take rate is about 10%, which is almost exactly the same as 1 year ago. So that is why we estimate constant about the second half, first half -- the overall the profit growth.

Piyush Mubayi

Goldman Sachs Group, Inc., Research Division

Okay. Can I chip in a third question, please? It's very quick, if you don't mind. One of the comments is about the company borrower risk of 12.5% of new loans facilitated. How does this compare to the 20% to 30% range you talked about as a percentage of risk that you take on?

Suk Cho Yong

Co-CEO & Director

Yes. For the question about our sales risk-bearing portion, it changed. The first quarter is about close to 50%. But if you look at our March single month number, our sales risk-taking portion is around 70%. So we plan to complete -- we plan to reach about 20% sales risk-bearing portion for new ones by the end of June or no later than July. That is our commitment and discussion we had with the regulators.

And at the same time, the risk-bearing portion, which is done by Ping An P&C's CGI has been gradually reducing. It's going down to almost 70% right now. So the rest are taken by 5 other insurance partners and then 17 partner banks. We have now 52 partner banks. And then out of 52 partner banks, already 17 banks, they joined our risk-sharing model.

So going forward, you will see that our safe risk-taking portion will go up to 20%. And then Ping An P&C will be further declining. And then you will see that a lot more risks will be directly taken by either by partner banks or other insurance partners.

Operator

The next question comes from Thomas Chong with Jefferies.

Thomas Chong

Jefferies LLC, Research Division

Can you comment about the trend in terms of the wealth management takeaways in the long term? How should we think about investors' adoption of higher NAV products, insurance products and financial advisory services?

Gregory Dean Gibb

Co-CEO & Director

Thanks, Thomas. We would expect the take rate on the wealth management side to improve as we move through the year. And that improvement, in the near term and the longer term, are a combination of factors. So in the near term, it is really about continuing to increase our service to the higher end customer, providing more qualified investor product on the fund side and the asset management side. So those are the drivers in the near term which are pulling upward our overall take rate.

And then if you go out slightly longer term, so if you move kind of more 6 to 12 months out from today, we would expect the insurance business, the insurance products that we have on the platform, continue to grow at a more rapid pace, and those carry attractive economics for the take rate. And we will then, over the longer term, obviously, there's -- we're still in the process of looking at the financial advisory license. And once we have that, we expect that there would be a further lift from the mutual fund side.

So those are in the near term and in the longer term. But generally, we think you should see continued improvement as we move through the quarters of this year.

Operator

The next question comes from Hans Fan with CLSA.

Hans Fan

CLSA Limited, Research Division

I got 2 questions here. One is about the regulation. Clearly that recently, there's a lot of investigations from CBIRC where, regarding the misuse of the consumption loans and business loans for banks for the purpose of property purchase. There's a lot of preventive investigation going on in Shenzhen, Shanghai and Beijing. So we're just wondering, does that really have some any implication on Lufax? And how do we usually control and monitor the use of funds? That's number one question.

And number two question is really on the other income in the financial statements. Because in the first quarter, this notable increase in other income and just want to -- maybe can management just elaborate regarding what's the key drivers of the other income here? And can this be sustainable in the future?

Suk Cho Yong

Co-CEO & Director

Okay, then let me take the first question, Hans. Thanks for your very tough question. In our base model, our partner bank, as the fund provider, they take the final prospect for this loan purpose management. However, we do -- all we can do within our capacity from sales, application, underwriting and collection, in every stage of operation, we can have attention to loan purpose management. For example, during the application process, the customer to confirm their loan purpose and then they need to sign on the commitment letter that says that the loan proceeds -- I'm very aware loan proceeds cannot go into property market or stock market. And during underwriting process, during unit interview, we ask one more time. And we check -- or rather than check that, we check debt interest payment account. So if the account is repeatedly used by multiple applicants, then we reject.

And then lastly, during [credit] process, after loan, 3 months after loan, we check previous record and the official record of new mortgage. Then we assume customer used our loan proceeds to buy a new house. Then according to the contract, customer must repay as soon as possible.

So this is what we are seeing because we don't have account. But with our capacity, we can do everything we can -- we do everything we can do.

And to better support our partner banks, banks are paying also very high efficiency risk loan proposed management because they are taking final responsibility. And our partner bank's [reprice] are a little bit different from bank by bank. Some banks, they want our borrowers to open their Type 4 accounts so that they can monitor our loan proceeds. And sometimes, they want our insurance partners to make all indemnity for the customers or loan purpose violation case. So those we support.

But however, knowing that our stray cash is about CNY 200,000, so this is quite small case size, which can be used -- this can be used for the property purchase. So we are paying more attention to our secured loan. And then those actions we are taking to help ourselves and to help our partner banks.

Gregory Dean Gibb

Co-CEO & Director

Hans, on the question of other income, a couple of points. One is it's actually directly tied to our core business. And what it involves is the services that we provide to our financial institution partners on account management and also to the extent that they outsource services back to us such as collections. And so this is the number on other income which we will see continue to be strong at least through the balance of this year.

It does also -- the reason you see it popping up a little bit is as we changed our overall pricing structure in September last year in terms of how we gather revenue from various partners, you see this increase in other income. But for the purposes of understanding the overall impact on the economics, at least for the balance of this year, you will see that level of performance in this line item.

Operator

The next question comes from Katherine Lei with JPMorgan.

Katherine L. Lei

JPMorgan Chase & Co, Research Division

I mainly have 2 questions. The first one, I would like to ask about the take rate. Because just now, management mentioned about that you will pass on some of the benefits of lowering funding costs and insurance cost to the borrowers, right? So now I think the take rate has improved back to the first Q 2020 level. So what was your target take rate? How much benefits do you expect that you pass on to consumers? And do you expect take rates within this year to stay at this level or continue to improve? And then within, like, say, 3, 5 years, where do see the take rate goes? So this is the first question.

Second part of my question is mainly on clarifications of questions asked previously by my peers. So mainly on like the risk-bearing portion, because for the disclosure, in the disclosure, that about 12.5% of new loans, the risk-bearing is -- Lufax is a risk-bearing loan by Lufax. So what is that on existing stock of loans? Maybe you have talked about that just now, but then I didn't get it because the line is a bit blurry. And also that for the portions of risk bearing by third parties, what is the portions on the stock of loans? Is that often new loans? Can you just clarify your numbers on that?

Suk Cho Yong

Co-CEO & Director

Okay. About the take rate. Which plans? Now our take rate for new business is back to about 10% level, which is almost same as last year. And then going forward, we try to deliver 10% take rate and then we are confident. And that if we can further improve, further optimize our cost lines, like funding costs or insurance premium or our borrower acquisition cost, then we can return our debt to our consumers, so we can be more price affordable and competitive.

But my view is, so within this year, as soon as we can keep 10% take rate, we can -- as soon as -- as much as we have a room, we can further reduce our overall APR by probably 1% or 2%. But it depends on our progress on how much we can further save our operational cost and our funding cost and then our insurance cost.

And the second question about the 20% risk bearing, right? To expand the full nuance and then now [you are talking] about our balance. So in terms of total balance, because our loans are 3 years duration, so although we are taking more safe risk-bearing portion up to 20%, it gradually affects our overall portfolio. So in terms of total portfolio, our sales risk-weighted portion is about 8.7% as of first quarter this year. And therefore, Ping An P&C, they take about 83%.

Operator

The next question comes from Jacky Zuo with China Renaissance.

Jacky Zuo

China Renaissance Securities (US) Inc., Research Division

I have 2 questions to ask. Number one is a follow-up on your take rates. So could you help us go through your unit economics for the existing balance in Q1 and for new loans in Q1 and probably in April? That would be very helpful.

And second question is also related to regulation. So regarding the Ant Financial rectification plan, they plan to move their consumer credit, i.e. Huabei and Jiebei, to consumer finance company under their license. So I just want to check whether we have any change in terms of our consumer finance license? And I just want to check personally our progress on where consumer finance the company sits usually and any change towards this -- our business regarding this financial -- sorry [this license].

Gregory Dean Gibb
Co-CEO & Director

Okay. On take rate, do you want to go first, Y.S.?

Suk Cho Yong
Co-CEO & Director

Sure. About take rate for hold balance. First quarter this year, our take rate is 10%, 10%. And then more importantly, if you look at -- if you understand our take rate for new business, because that really affect our future profitability. Take rate for new business in the first quarter is also 10%, despite the effective APR is obviously lower than our portfolio. So that means we report 10% take rate can be secured unless we take significant change in terms to our effective APR. So we are constant with 10% take rate throughout this year. And then for new business, second quarter, third quarter, so as said, we estimate about 10% take rate for new business without much change.

Gregory Dean Gibb
Co-CEO & Director

Second question, consumer finance. Ant is moving its business into consumer finance here.

Xigui Zheng
Chief Financial Officer

Yes, maybe I'll comment on that and then Y.S. could add. I think where Ant has come from historically is that what they used mostly was a micro-lending license and co-lending with bank partners. And now that the entire industry has to take on more risk-bearing, they're obviously, at the same time, looking for something that is as capital efficient as possible from a leverage perspective. So microfinance companies typically carry a cap leverage of 3 to 5x. There's some differences by geography, but it's roughly in that range.

For Ant to use their consumer finance company, that gives them the opportunity to bear risk at a 10x leverage for capital. So I think that's why you see Ant and their various announcements moving their model more towards the consumer finance license.

Our risk bearing, as Chairman Ji mentioned, is really done through a guarantee company that operates nationwide. And that guarantee company, where we're bearing the risk of up to 20% on all the loans going forward, operates at a 10x leverage ratio. So for us, we've already achieved what we think in the market is kind of the best efficiency in terms of bearing risk and then putting capital against it.

So given our business model is different, right, and the Ant business model has been around traditionally, those smaller ticket, shorter duration loans that does fit well under consumer finance license. Our business model, which has been focused on the small business owners, larger tickets, relatively speaking, for longer duration, is best suited by the use of the guarantee company.

So I think things that Ant are doing and versus what we do, they're driven by different factors.

Suk Cho Yong
Co-CEO & Director

Right, right. So if we choose between smaller license and a consumer finance license, our [indiscernible] finance license is better in terms of leverage ratio, and they can also do a nationwide loan disbursement, right. No regional limitation. But our case, let's understand our borrowers. The average case size is way above CNY 200,000. Many of them get CNY 300,000 and up to CNY 1 million for unsecured loans. But consumer finance license, it does not support a large case size lending. The maximum size you can do with this consumer finance license is CNY 200,000. But actually, with our regulatory window guidance, we said half receive of CNY 50,000 or maybe [ticket size]. So which is not very active with our current business model.

Gregory Dean Gibb
Co-CEO & Director

So I think the result of that, I think at the back part of your question is, today, the consumer finance balances as a percentage of total is less than 1% of our facilitated amount. It's a new business. It's got about 300,000 borrowers. As we move in the second half of this year to integrate more our online services across wealth and lending, we believe the consumer finance license will be very helpful to serving a lot of our wealth customers and some of their consumption needs. So we would expect the business to continue to show healthy growth. But as a percentage of the total, even by the end of this year, it will still be probably less than 2%.

Operator

The next question comes from Chiyao Huang with Morgan Stanley.

Chiyao Huang
Morgan Stanley, Research Division

Congratulations on the solid quarter. I have basically 2 questions. The first one is related to the loan economics of the loans that we are providing guarantees as we move closer to the 20% risk taking. So basically, I want to ask how much in terms of the loan balance that we are taking a risk, how much we can charge on the top line level? And then how much we can charge in provision cost in terms of the loan balance that we are taking risk?

And the second question is in terms of the overall industry. So if you view the SME loans and the asset class, I wonder how does management think of the supply and demand side of this industry with all the regulatory changes and the changes of [where] how do you see the supply of these assets and the demand for these assets evolve over time. That's my question.

Suk Cho Yong
Co-CEO & Director

Yes, for guarantee portion, 20%. I want to emphasize, no matter you take 20% or 25% or 30%, it does not fundamentally change our profitability. If you take more of credit risk, it comes with risk premiums. So actually, it can be a little bit more profitable by taking more risk. And then I'll explain for the full portfolio. Now we have about 8.7%, the risk taken. And therefore, new business, about 70%. So talking about interest rate, supply and demand, demand are sure [steady] about 60 trillion, more than 6 trillion of demand. But supplies, we see that the unsecured largest trade size is [acquisition] loan. We don't see much competitors. We don't see any other companies are providing similar services for small business owners. Either they do, like for other banks, we see that more and more banks they're getting to this market with each of the products. So there's a potential that we get on our secured product lines, but our major business lines, unsecured larger case size [brings that pressure] on that we still do not see any surprise from banks or other Internet finance companies. So I think this market is pretty much secured. It's very competitive. And then I don't think it is for others to get into this market. Just to have to meet scheduled pre conditions like offline channels, underwriting model and then collecting infrastructures, all those things.

Operator

This concludes the question-and-answer session and today's conference call. You may disconnect your lines. Thank

you for participating, and have a pleasant day.

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