THOMSON REUTERS

EDITED TRANSCRIPT

Q3 2019 Qudian Inc Earnings Call - First Session

EVENT DATE/TIME: NOVEMBER 18, 2019 / 12:00PM GMT

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

CORPORATE PARTICIPANTS

Ka Hong Yeung *Qudian Inc. - CFO*
Min Luo *Qudian Inc. - Founder, Chairman & CEO*
Weichen Zhao *CEO Assistant*

CONFERENCE CALL PARTICIPANTS

Alan Kuang *Aletheia Capital*
Daphne Poon *Citigroup Inc, Research Division - Associate*
Jacky Zuo *China Renaissance Securities (US) Inc., Research Division - Analyst*
John Cai *Morgan Stanley, Research Division - Research Associate*
Sanjay Jain *Aletheia Capital*

PRESENTATION

Operator

Hello, ladies and gentlemen. Thank you for standing by for Qudian Inc.'s Third Quarter 2019 Earnings Conference Call. (Operator Instructions)

Today's conference call is being recorded.

I will now turn the call over to your host, Mr. Ben Zhao, CEO Assistant for the company. Ben, please go ahead.

Weichen Zhao ***CEO Assistant***

Hello, everyone, and welcome to Qudian's Third Quarter 2019 Earnings Conference Call. The company's results were issued via Newswire services earlier today and were posted online. You can download the earnings press release and sign up for the company's distribution list by visiting our website at ir.qudian.com. Mr. Min Luo, our Founder, Chairman and CEO; and Mr. Carl Yeung, our CFO, will start the call with their prepared remarks.

Before we continue, please note that today's discussion will contain forward-looking statements made under the Safe Harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the company's results may be materially different from the views expressed today. Further information regarding these and other risks and uncertainties is included in the company's 20-F as filed with the U.S. Securities and Exchange Commission. The company does not assume any obligation to update any forward-looking statements except as required under applicable law.

Please note that Qudian's press release and this conference call include discussions of unaudited GAAP financial information as well as unaudited non-GAAP financial measures. Qudian's press release contains a reconciliation of unaudited non-GAAP measures to the unaudited most directly comparable GAAP measures. We also posted a slide presentation on our IR website providing details on our results in the quarter. We will reference those results in our prepared remarks but will not refer to specific slides during our discussion.

I will now turn the call over to our CEO, Min Luo. Please go ahead.

Min Luo ***Qudian Inc. - Founder, Chairman & CEO***

Thank you, Ben. I want to first thank all the investors, analysts and media who have taken an interest to join today's call. I'd like to walk you through some of the key factors in our business performance before handing it over to Carl, who will take you through more detail.

This quarter marks our successful evolution to a balanced sheet independent, technology services fee-driven business. In the quarter, we saw big earnings quality improvement as our risk independent open platform became the largest revenue contributor and delivered a staggering 150% growth from our previous quarter. By using our technology as a service offering, we are enabling the regulated licensed institutional partners to really lower the cost to access the massive underserved inclusive consumer finance opportunity.

We are leading the technology application in high-speed precision processing of micro loans while at the same time, syndicating each

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

individual user to multiple lenders. This allows all our lender partners to lower risk while providing enhancement in credit size, allowing open platform to focus on higher-quality borrowers.

We also continue to empower our funding partners' credit assessment decisions with our big data credit application, including regulatory compliant customer behavior pattern, complex networks, address verification, LBS stability, biometric confirmation, machine learning, AI-enhanced collection and real-time credit performance-based risk strategies. The results have been impressive. As of end of the third quarter, our open platform has increased over 1 million outstanding borrowers with 11 licensed regulated funding partners, both more than doubling from last quarter. The rapid uptake and acceptance by qualified borrowers and licensed regulated financial service providers reaffirm QD's presence as a leading consumer finance technology platform.

Recently, there has been noises around nationwide P2P wind-down, collection practices and user data privacy. In this evolving and complex regulatory and commercial landscape, we are confident that Qudian has made the right upgrades to ensure our leadership in the industry. We take regulatory compliance as the #1 priority. Our past efforts in the early adoption of Circular 141, complete avoidance of P2P business model, 100% institutional funding base, disciplined in-house approach to collection and strict respect of our customers' data privacy have all cumulated to our open platform solution. Our approach to work only with licensed and regulated financial institutions, let them lend and be responsible for borrowers risk while QD provides a full set of transaction service using cutting-edge technologies to enhance analytics, user experience, reduce customer acquisition and engagement costs. is very likely to ultimate form of regulatory compliant fintech in China.

We have seen similar user interface and experience as our well-proven loan book business out of users that were qualified to draw loans again in open platform in the third quarter. The repeat ratio stays well above 70%, now very close to 80%.

Overall, at the end of the third quarter 2019, our registered users base grow to 78.3 million, and total outstanding borrowers reached 6.3 million, both the highest in our company's history, illustrating the sustainability and the stickiness of our user demand.

We are excited by the prospect of our tech-driven business model and delivering the right risk-independent and regulatory-compliant approach to our RMB 8 trillion consumer credit opportunity in China. I very much look forward to continue to share with you the remarkable and sustainable financial results and returns from our open platform initiative.

Here is Carl for more detail.

Ka Hong Yeung *Qudian Inc. - CFO*

Thank you, Min, and hello, everyone. First, I'd like to touch base on a couple of highlights from the third quarter.

We delivered another solid quarter of non-GAAP net income of CNY 1.06 billion, a 52.9% year-over-year increase, despite the overall industry credit weakening driven by macroeconomic environment and reduced liquidity as noncompliant players exit the credit market. This came as a result of our risk-independent open platform initiative really taking off, generating CNY 993.3 million in revenues for the third quarter, representing a staggering 150% quarter-over-quarter growth. This risk-independent, fee-based revenue contributes now to over 90% of our net profit as it carries little marginal operational costs, and we assume no credit risk.

The number of outstanding borrowers in open platform also increased to over 1 million from [415,179] (corrected by company after the call) in the second quarter, driving total outstanding borrower base throughout our ecosystem to 6.3 million, a new record in company's operating history. In the third quarter, 669,000 first-time borrowers draw loans from our platform and to us, with minimum customer acquisition costs, demonstrating that an innately affordable and attractive service does not require costly marketing to successfully grow. Again, our open platform makes our service now even more attractive as the higher-quality borrowers can now access more appropriately sized credit rather than before, that frankly, our previously over-conservative credit sizes because we have self-restrained limits per borrower by underwriting using our own balance sheet only.

The total balance through the ecosystem, including open platform, has grown further to CNY 38.4 billion despite what we believe to be a temporary credit down cycle, and it solidifies our strong execution capabilities to succeed by quickly navigating the various changes in

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

macro environment, online consumer finance industry, regulatory environment and partnership landscape.

Building on the innovations in the open platform, we will continue to pursue our tech-driven growth strategy to connect the 300 million-plus creditworthy but underserved consumers in China to over 5,000 licensed domestic financial institutions.

In the risk-taking side of the business, as a result of our commitment to delivering risk-adjusted returns and our overall conservative risk appetite, we swiftly reduced credit volumes and paused credit trial programs. The proactive management of market-driven risk was proven effective in stabilizing delinquency rates. To enhance comparability to peers and transparency in our disclosures, our M1+ vintage measured by current receivables at risk stayed below 3.4%, while our M6+ vintage charge-off rates was below 1.6%. We look to continuously enhance transparency, and will continue to disclose both total and current receivables at risk standards, while current at risk may be a more direct comparison to some of our peers' disclosure standards.

Although risk remains well managed, we believe the recent exit of many smaller players may create further liquidity pressure for the Chinese consumption credit sector. As such, we expect to continue a conservative approach on our risk-taking book into the final quarter of 2019, thus revised our full year guidance accordingly to CNY 4 billion, representing a significant 57% increase from CNY 2.55 billion for what we achieved in 2018.

Now given the strong momentum in our open platform and its risk-free fee-based business model, we think we have established a solid basis for an opportunity to see QD be revalued at a more reasonable valuation while our current market value approximates net assets. Therefore, another USD 195 million of shares were announced and, most recently, fully repurchased under our accelerated stock repurchase program, bringing our total buyback amount to USD 572 million since we became a public company. This very large, cumulative share buyback since we became public reflects our confidence in Qudian's growth prospects and upholds our commitment in creating shareholder value.

Since our inception in 2016, we have gone through stages of business and regulatory compliance upgrades from license-based lending to risk undertaking loan facilitation for financial institutions to now becoming a technology-based, fee-driven platform. Our consistently strong financial results have demonstrated our long-standing commitment to deliver value to our shareholders. And we are honored to be only of the 3 U.S.-listed Chinese stocks selected to soon join the MSCI China Index, one of the most influential indices that track stocks with exceptional liquidity and widespread investors' interest.

Now let me share with you some key financial results. In the interest of time, I will not go over line by line item. For more detailed discussions of our third quarter 2019 results, please refer to our published earnings press release. In addition, a most recently updated PowerPoint presentation deciphering all the numbers are uploaded in our website.

Total revenues were CNY 2,590.9 million or USD 362.5 million, which increased by 34.3% from [CNY 1.9 million] (corrected by company after the call) for the third quarter of 2018. Transaction service fees and other related income substantially increased to RMB 993.3 million or USD 139 million from nil in the third quarter of 2018 as a result of the fast ramp-up of open platform initiatives.

Cost of revenues decreased by 70.5% to RMB 206.3 million or USD 28.9 million from CNY 698.5 million for the third quarter of 2018 primarily due to the decrease in cost incurred by the Dabai Auto business and a decrease in funding costs associated with the on-balance-sheet portion of our loan book business.

Sales and marketing expenses decreased by 45.4% to CNY 65.5 million or USD 9.2 million from CNY 120.1 million for the third quarter of 2018. This decrease was primarily due to the scaling down of the Dabai Auto business.

Non-GAAP net income attributable to Qudian's shareholders increased by 52.9% to CNY 1.06 billion or USD 148.6 million or CNY 3.34 or USD 0.47 per diluted ADS.

This concludes our prepared remarks. We'd like to open the call to questions. Operator, please kindly go ahead.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Sanjay Jain from Alethia Capital.

Sanjay Jain ***Aletheia Capital***

Can you hear me?

Ka Hong Yeung ***Qudian Inc. - CFO***

Sanjay, good to hear from you.

Sanjay Jain ***Aletheia Capital***

Congratulations on great results, especially the performance in open platform. I just wanted to clarify the economics of this business. As I understand, the APR in open platform is closer to 36%, and they are paying you 9.5% in the third quarter. So in percentage of loan terms, that is 15%, 16%. So your partner is roughly left with 15% to 20%. And then they have to bear a cost of funding of their own, which is, say, 3%, 4%, 5%. And so the only way this economics work for your partner is if the credit loss is relatively quite low at, say, 5%, 6%, and currently, I believe it is even lower than that.

But when I come to the profile of the customers, that's where I'm trying to basically understand, find out what is the difference between open platform and loan facilitation. I believe, open platform, the income is CNY 4,000 to CNY 6,000 per month instead of CNY 3,000 to CNY 5,000 in loan facilitation, but you are lending CNY 15,000 per borrower versus CNY 5,000. And if I remember correctly, you used to keep the monthly installment to RMB 300, but now it must be around RMB 1,000. And I believe you are restricting the number of platforms a customer would have borrowed from to 4.7 to 5.2. That is the range, actually, under open platform that they would have borrowed on average from 5 platforms versus 6 or 7 or more in loan facilitation.

So I'm just trying to understand the differential in income versus the differential in monthly installment and then the 5% credit cost here versus 10% or more in loan facilitation. How does it work?

Ka Hong Yeung ***Qudian Inc. - CFO***

Fantastic, Sanjay. And given your question, we really appreciate how much insight you have in our business, most of which -- substantially, all of which are very, very accurate. So you know our business very, very well, and thank you for that.

Now regarding the open platform initiative, as you said, the economics only makes sense to my funding partner if the loss rate is lower, and it is lower now. Now why is it lower? There are several aspects that creates a better credit assessment. In addition, it's our overall direction with our funding partners in an overall macroeconomic down cycle to focus on the high-quality borrowers. Now how do we do that? Number one, the open platform borrower numbers, as you can see, is about 1 million. It is a subset of our total outstanding borrower base of 6.3 million. I would believe there is still substantial room to grow from that because we do have a credit line that are approved to over 33 million people -- of our customers. So there's still substantial room to grow.

Now in that subset, we have created a very, very innovative and where --we are very excited by that, a so-called credit syndication process, where all of our funding partners who have their own independent know-how in credit assessment come to the same platform, and they do their own independent credit underwriting. With that, if my borrower may be borrowing from other platforms, one funding partner may not know, but another funding partner will know. Now we bring all that information together in a process where it's open -- that's why it's called open platform -- and we share that information and quickly decide on a credit that the borrower can borrow. So we're really bringing more heads to the table than before. And that's what explains the credit sort of delinquency to be significantly lower than just the loan book business.

We're excited by how we created this using a lot of advanced technologies in transaction clearing and high-speed processing, precision processing. And we're delivering the right service to our funding partners. And you can see that exciting growth. We went from 4 funding partners in the second quarter to now 11, and we look to now grow close to 20 as we really found a solution to a problem that all my

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

funding partners face: Number one, bring the cost down, and we have to achieve that consistently even with loan facilitation, right? But number two, the core worry for everybody who lends, namely my regulated license financial funding partners, is how do you get a better credit. And by bringing more heads together, it just works. It just works really well. So that's that.

Now we do believe there are a substantial number of Chinese clients. Let's forget all the acronym, okay? Let's focus on the real user, okay? There is a substantial, massive amount of underserved, underbanked, under credit borrowers that just have massive disposable income, but they may not have a disposable capital to buy what they want. You mentioned that at CNY 15,000, which is the current loan balance right now across my open platform, it's right now about CNY 14,000, okay? The actual monthly repayment is somewhere around CNY 1,000, principal plus interest, okay? Now does that mean pressure to my borrowers? In fact, not really.

Even if you look at a person who is making, just on average, CNY 5,000, which is not massive a month, what's special about the Chinese underbanked consumer spaces, if you are a factory worker, if you are a construction worker, even restaurant waitress, one amazing thing that's different in China versus anywhere else in the world who will pay their loan situation is they all have dormitories provided for, and they all have 3 meals provided for, which makes the entirety of their income truly disposable. And they don't really have to worry about basic life needs, which makes this class of users safer and better. It's just that we were not doing our business right before. The customers, the high-quality customers were there. But we were too self constrained on risk. We were not letting people borrow over CNY 10,000 even if they can deserve CNY 20,000, CNY 30,000. And with the open platform, now we can achieve that.

So we've opened up a gold mine that was already in our ecosystem. We just didn't mine it before.

Sanjay Jain ***Aletheia Capital***

Okay. If I can follow-up...

Sanjay Jain ***Aletheia Capital***

Yes. I mean that is helpful, for sure. But one small observation on that and one clarification. So the small observation is that, how do you define underbanked or underserved if these customers are the ones who are borrowing from anywhere between 4.7 to 5.2 platforms as of now when you are lending to them another CNY 14,000 in the open platform? So that's just an observation. You don't have to respond to that.

But the bigger question I have is that you are making 15%, 16% off of this loan simply for reference. And the bank is making another 7%, 8%, 9%, 10% return on that loan after their funding costs and credit costs, assuming that the credit cost remains in that range of 5% to 7%. So I'm just wondering whether this is too profitable. I mean there's too many people in the food chain making too much money. How would you respond to that? How does it resolve itself?

Ka Hong Yeung ***Qudian Inc. - CFO***

Yes. Thank you, Sanjay. No, first of all, we cannot agree with you more regarding your observation. We are a fairly transparent and direct and honest company. There's no doubt borrowers in the online industry space is stacking, okay? Let's not shy away from the reality, and we would like to openly say that, right?

But there are ways if you think about these borrowers. Again, they may have taken 2 or 3, maybe even 4 or 5 loans, but the loan size per their monthly disposable income is still well manageable. You can see the losses there that we have even on the open platform is still fairly manageable, very well contained. Now why is that? Because the traditional Chinese financial institutions, as you are aware, like the traditional bank credit card issuers, are generally quite conservative on personal credit. I have a personal experience. Frankly, even with my type of income, one largest credit card issuer only grants me CNY 50,000, okay, in my credit line. A more commercial, global credit card issuer offered me over 20x that amount, and I can definitely repay any of that. So number one, the banks have been quite conservative on personal credit.

Number two, even for the industry participants, we believe the Chinese consumer leverage taking our household is still at the very early stage of leverage. Admittedly, the growth is very fast. So the leverage opportunity is still massive. We still think that we're still far from the safety sort of red lines. Now how do you combat stacking with stacking, right? Number one is, in a previous world, there were too

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

many small players. There were capital being deployed in the P2P space, which we were not involved. So we wouldn't know, really, the right number. There's nowhere we can seek to help.

But now as more and more larger platforms become compliant, okay, copying our business model from loan facilitations and now talking something similar like our risk-free open platform, more and more of them are supported by regulated licensed banks. And we share a lot of these funding partners. And these funding partners know the best, right? That's why we're going in the direction of open platform. These funding partners from the licensed banks, consumer finance companies, trust companies who participate in this industry would know this better than us. So they will be more equipped to handle stacking. They are more conservative in handling this type of risk, while we can significantly add on the value of significantly reducing user acquisition, engagement cost, the transaction clearing, billing as well as collection service. So it's really bringing the best of both worlds together. And this transaction, if you think about the syndication process, can only happen at our platform or maybe a third-party platform, independent of just one single bank doing this. So 1 platform reduced the risk for 10, 11 banks now, right? So it just makes sense.

I do observe you had a comment about the massive profitability that we're enjoying under the current model. My view is a conservative view, is that, over time, the margin must come down. We're not going to be taking close to 10% of the transaction dollar volume. We may be taking closer to somewhere between 5% to 8% over the longer period.

Now so far, though, my take rate in the first quarter to second quarter to now third quarter that we've initiated, and now the loan balance we created for our partner is not small, it's over CNY 12 billion, has been consistently close to 10%. So, so far, my partners are happy with this. They're happy to share these economics with us, helping them build an inclusive finance infrastructure to bring the technology into the game so they can actually have a chance to access this market. But over time, as competition sort of increases, we would see the take rate to come down, frankly speaking.

Sanjay Jain *Aletheia Capital*

Makes sense. I mean this is right now a fantastic situation for you with competition eroding in the marketplace. And quite possibly, your partners probably don't even understand fully the economics of this business or can the economic...

Ka Hong Yeung *Qudian Inc. - CFO*

No, they do, I promise you. They're banks. They're very sensitive on interest fees.

Sanjay Jain *Aletheia Capital*

Good for you if they don't. But anyway, that's very, very helpful. If I may also get a second question on credit trial program. How many borrowers do you have outstanding from that now and the loan amount or percentage of loans from the credit trial program? And the asset quality, what would it be excluding the credit trial program borrowers, please?

Ka Hong Yeung *Qudian Inc. - CFO*

Sure. So I'm not at liberty to disclose that specific amount, but it's not big because we have seen delinquency basically kept stable right now at a D1 of 10% to 12% range. So as we pause the credit program, it just paused. And we see that actually to improve over the next year. We have strong conviction the credit delinquency D1 will improve over next year as small and noncompliant banks exit.

Now how much of it from a user or loan balance perspective, it's not the majority, obviously. Just giving you a sense of range, it's about probably 20% from each angle that are outstanding right now. So we did enjoy a very large uptake in -- obviously, you observed the active borrower base over the last 2, 3 quarters. And we will go through that through the end of this year, and that quality will improve significantly into next year.

Sanjay Jain *Aletheia Capital*

Yes. Fair enough. And I must say that your number of new borrowers is quite impressive despite the shutdown of the trial program in the third quarter. So if I can have one small clarification on the loan syndication part. When you do a loan syndication with multiple partners, will your share of the syndication indication be subordinate to the other partners? Will there be waterfall concept? And is that the mechanism through which you cover credit risk or not?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Ka Hong Yeung ***Qudian Inc. - CFO***

No. We follow very, very strict practice of not subordinating because if we were to subordinate, if you look at that loan as a whole, we would be basically first loss takers, and we will have to bring that all risk -- the whole risk into our balance sheet. So we do not actually provide any subordination. There's actually a very good commercial reason why we do not subordinate. Because the loan has a certain capacity, right, you don't want to over-extend the borrower, right? And each funding partner knows that. They're experts in lending. These are banks.

But the problem is each person has a specific limited capacity, and it's a first come, first serve. So if you're at the back of the queue, number one, you may not be the one getting your money into the hands of a good borrower. Number two, if a loss does take place, what happens is the first lenders get paid the first dollar. So you don't want to be the last in the queue either. This absolutely explains why the massive growth in open platform because my funding partners are rushing to the best borrowers as quickly as possible, right, because they don't want to be the ones left behind. There's a really good commercial reason why. We've designed it that way so that it encourages growth. We do not take any risk. And I think this is the real ultimate form of fintech in China.

Sanjay Jain ***Aletheia Capital***

Very, very interesting. So you would be the first lender if you want to be, in every case, I imagine, because you are one who's originating the customer. And suppose there are 3 lenders, and in one of the months, the borrower does not pay CNY 1,000 as he's supposed to, but say, he pays CNY 500, how will that be allocated among the 3 lenders then?

Ka Hong Yeung ***Qudian Inc. - CFO***

Yes. It's -- it will be separated in several different bills. Basically, whoever puts up the credit first will be first in line, okay? So that -- obviously, it's a syndicated process, yes. But there is a slight timing gap difference between different lenders reporting back to the platform how much they're willing to lend. So the first dollar, the first 500 always goes to the first lenders. Yes, in a lot of cases, we would be participating and will probably be the first in queue. This would tremendously enhance our credit quality, just bear with me, over time because we're now in the risk-assessment game not alone anymore. All my banks are helping us, and we are helping each other. This is the wonderful part of syndication.

In the previous sort of non-fintech world, syndication does happen over a big loan portfolio, but the buyers or the lenders get holding a bag, don't know what's the asset inside. What we've done is we created a technology to know so that all my partners know exactly what they're dealing with on a very detailed single individual borrower level.

Sanjay Jain ***Aletheia Capital***

An incredibly well-designed product, I must say, incredibly -- entirely in your favor, which is fantastic for me as a Qudian shareholder.

Operator

(Operator Instructions) Your next question comes from the line of John Cai from Morgan Stanley.

John Cai ***Morgan Stanley, Research Division - Research Associate***

So then I will focus on the risk. I see the PPT online that shows that the day-1 delinquencies is rising up to 12% now if we exclude the open platform and adding back the open platform, probably around 11%. So I just wonder, what's the latest trend? Is it under control now? And given this is the case and we have made a credit-related loans, including provisions and the guarantee-related loans, roughly CNY 1 billion in this quarter, I just wonder, how much provisions we need to make going forward? And what's the growth strategy under this risk environment?

Ka Hong Yeung ***Qudian Inc. - CFO***

Thank you, John. And yes, and I really would encourage all interested parties to look at our presentation posted online. We've enhanced the disclosure to our company, and we're holding the standard of what a fintech company should disclose in our presentation. So a lot of the information is there to help you understand the business, and I think we're setting benchmarks across all our peers.

So on Page 23 of the presentation that's uploaded on the web, we want to be transparent, and we disclose our D1 delinquency, which

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

represents a daily moving real-time assessment of the entire portfolio's risk. One thing is right. John observed that it's about a 10% to 12% range, and now it's stabilized around 12%. One thing I have to correct is open platform is not at 10%. 10% is after blending open platform, the entirety of the loan book plus open platform, what the D1 delinquency rate would be. Open platform D1 delinquency rate is significantly lower due to the reasons I just discussed with Sanjay. So that's kind of that.

So it's -- we posted up there. It's real time. We update it frequently. We have seen a very good stabilization of that. So the acceleration decline of D1 delinquency up that curve has stopped. So I think that's the first part. And if we look further into the strategies that we've deployed in the last 2, 3 months last quarter and the quarter before, we actually do expect that delinquency to stabilize into Q4 and will actually likely to reverse in Q1, now granted that the macro situation and liquidity remains constant, okay. But we are conservative on our view.

As you know, we have always been a conservative company with lower leverage loan book-to-equity ratio with more buffer on margins to protect equity from losses. So we are taking more provisions in the quarter. Our M1+ delinquency coverage ratio is actually covering real M1 by well over 120% in the quarter. And like John mentioned, the number is right. It's about 1 billion on and off balance sheet together. And we expect that number to be similar into Q4. And it will actually start to reverse into the next first quarter to second quarter 2020.

We have seen this before. Our company is well experienced in facing shocks in liquidity. Although our -- we're only a 5-year old company, we have seen many credit cycles in the Chinese consumer credit sector. The first decline was in 2017, December. We've managed through that, and we delivered still in the first quarter 2018 CNY 300-plus millions of earnings. We've seen another uptake with the P2P crackdown through the summer of 2018, and this is, I think, the final phase of P2P exiting. So the future beyond Q4 looks very optimistic. Is that helpful, John?

John Cai ***Morgan Stanley, Research Division - Research Associate***

Yes. So how does that impact our growth strategy, just to follow up, I mean, for Q4 and the next year?

Ka Hong Yeung ***Qudian Inc. - CFO***

Yes. So we appreciate this important question. I think our strategy is very clear, clearly laid out in the third quarter results. Our company strives to be a technology company rather to be a lender. So over time, you expect our leverage to continue to decline. We'll take less and less risk on book over time because we have found that our funding partner appreciates our sort of cost-saving aspect of the business just as much as the risk-taking part of the business. So given the demand is insatiable, given that we have the relationship, given we have the customers, all our focus now is to become a tech company. And I think that's a better way to go from the overall regulatory shifts and changes. Our shareholders will be much more protected from any regulatory noise. We've demonstrated this before. We completely avoided the P2P business model. So the direction for us is clear: less and less and less in risk taking. If the opportunity allows, if the opportunity really allows, we wouldn't have a loan book at all.

John Cai ***Morgan Stanley, Research Division - Research Associate***

Sure. Yes. I think -- so just one quick follow-up on one number. I think -- I see this 6.3 million outstanding borrowers, including open platforms and the loan facilitation business. I just wonder if -- what's the number for pure loan facilitation, meaning excluding open platform? I'm not sure if you have it handy.

Ka Hong Yeung ***Qudian Inc. - CFO***

It's about 6 million. It's about 6 million.

Operator

(Operator Instructions) Your next question comes from the line of Jacky Zuo from China Renaissance.

Jacky Zuo ***China Renaissance Securities (US) Inc., Research Division - Analyst***

Just 2 questions from me. Firstly, about the customer acquisition strategy. I've seen that our sales and marketing expense actually have been quite low versus peers. And some of our peers actually spend very aggressive sales and marketing budgets, especially this year. So how do you view the user growth and borrower growth and especially when our competitors are very aggressive on this?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

And second question is about the lending license from the regulators. They've been discussing to give license to capable P2P or online lenders such as consumer finance company license or online microlending license. Will you consider that as an alternative business model in the future to get a license and be a licensed lender?

Ka Hong Yeung ***Qudian Inc. - CFO***

Thank you, Jacky. And first of all, congratulations on the new role, and great to hear from you in your new capacity. First of all, your question on customer acquisition, it's always a question that all the smart analysts ask, and to us, the answer has always been we are not in a rush to acquire customers. We have always had a problem of too much demand. One number I don't disclose anymore, but I can still sort of roughly share this is since the end of 2018 to now, one small part of the open platform is about just referring customers away to other platforms. That number stood at about 3 million at the end of the second quarter. It grew to 5 million to end of third quarter. So not only we don't have a problem of acquire customers, we just had too many customers. We actually sent 5 million people to other interested parties. So it just goes so far as to the demand that we're facing. So we've really no rush to get customers.

We have some rough numbers in terms of how we think about next year and the year beyond. Anything further, I'll be lying to you. So we do have some sort of shape or form of next year and beyond. We believe with our sales and marketing, we'll be well positioned to deliver very attractive, strong results like we've done before for the next 12 to 24 months. Beyond that, we have a strategy in place, which is the ecosystem part of the open platform where we partner with many, many app partners such as, we talked about before, Changba. We are also, in addition to that, in about 8 different app ecosystems by now. Pretty successful because all my app partners want a way to monetize.

But this is our view and our view only. We don't believe the current credit environment in China as P2P is unwinding and liquidity is shrinking is the right time to acquire customers. So we have the channels. We absolutely have the dollars. We have more cash and more profit than any of my peers. And we can spend that anytime we think is the right timing. So as we don't expect there's a need to do this in the next 12 months, we would spend that dollar wisely at the right time to deliver better results over the course of our growth cycle.

So number two, regarding lending license, we've had deep thoughts about this. We started our business with 2 proper micro Internet lending licenses. And in fact, we've had a pretty restrained use and froze them over that period. We are not too interested in new forms of licenses because that could be policy-driven, and the regulatory structure behind that could be unstable over time.

We found a better way. The way where we do open platform where we allow licensed lenders, 100% licensed lenders, to lend, we don't touch the loan from a lending perspective, but we just service the loan. It's probably the better way to conduct fintech. And it just makes us sleep better at night. It should make all of our shareholders sleep better at night over time. So that's our direction, to be a tech company.

Operator

(Operator Instructions) Your next question comes from the line of John Cai from Morgan Stanley.

John Cai ***Morgan Stanley, Research Division - Research Associate***

So I do find the presentations very useful. I just noticed that there is a relatively new balance sheet item, which is called risk assurance liabilities. Is there any more colors on these items? Because I noticed that on the presentation, Page 27, this -- about the breakdown of operating expense, it seems that these changes of risk assurance liabilities contribute positively to our income. So it's a negative -- it's an income contribution instead of risk. So just probably a little bit more explanations on these items and how it works would be helpful.

Ka Hong Yeung ***Qudian Inc. - CFO***

Sure, John, and thank you for the observation. They're very, very insight -- and we love to explain that. This is an absolute positive contribution to our net income. The specific amount is CNY 160 million in the third quarter. That grew from CNY 32 million in the second quarter of 2019.

Now the mechanism behind this is we actually have a finance guarantee license, okay. And that contributes to the part of this

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

transaction's structure in our loan facilitations over the risk-taking business model. And as receivables go into this guarantee companies just as the same as our loan facilitation [sort of for] by banks, we actually have to recognize this income upfront as well as the risk upfront, okay? What happens is we have been consistently overconservative on the potential unrecoverable receivables from there. So as the loan performs much better than our original accounting assumptions, we have to reconcile that over that quarter basis. So we actually were a little bit too conservative on the risk assumption, and it drove a CNY 160 million positive contribution in Q3.

So it's the same thing as our loan facilitation, but it's part of the guarantee part of the transaction that we provide under a proper license, no less.

Operator

Again, your next question comes from the line of Alan Kuang from Aletheia Capital.

Alan Kuang ***Aletheia Capital***

I just wanted to clarify my understanding of Qudian's growth strategy because I believe, during the previous Analyst Day, we have discussed about the D1 delinquency ratio and was saying that there was kind of quality concerns. Hence, we are going to derisk and reduce the credit exposure with risk-taking business. And I do believe we've shown 1x leverage at one point. But it looks like based on the disclosure we saw in the presentation that there's still a fair bit of off-balance-sheet loans on the risk-taking business. I'm just wondering if there's any changes in your growth strategy and if you will continue to reduce the off-balance-sheet portion going forward? Because we understand that the -- if you use your own funding to lend, you do not have to pay any funding costs, so the economics are a lot more attractive, therefore, you are able to bear a lot more credit costs. I'm just wondering if there's any change here in the growth strategy on that front.

Ka Hong Yeung ***Qudian Inc. - CFO***

Thank you, Alan. And really, again, appreciate, in fact, all my analysts that cover the stock to come to Xiamen and take interest in us and understand the company.

The strategy remains the same as we discussed. And it's very clearly laid out now that we want to be a tech company, and we can be a tech company, given the capabilities.

So number one, if you see my total loan book-to-equity ratio, that number was 2.3x in Q2. Now it's 2.2x in Q3, consistent with the deleverage sort of strategy. And this number is, frankly, the lowest amongst all my peers. So we are better equipped to handle risk than any of my peers.

So talk about risk management. I think QD is really in a good position, and we really know how to handle this.

Secondly, the absolute dollar amount of an on and off loan balance together as a loan book dropped from slightly over CNY 28 billion to now CNY 26.1 billion into the third quarter. We expect that to continue to drop in the Q4 next year as we found a much better growth engine, the open platform. We can do the same business, focus on the high-quality borrowers, earning interesting fee and carry-on growth. So we don't need to leverage. We don't need to take on risk. So strategy consistent.

Operator

(Operator Instructions) Your next question comes from the line of Daphne Poon from Citi.

Daphne Poon ***Citigroup Inc, Research Division - Associate***

So 2 questions from me. The first one is regarding the delinquency rate. Probably just a follow-up. So can you help us to break down like how much of the rise in delinquency rate over the past quarter, either in terms of the D1 delinquency rate or the M1+ loss rate? How much of that is related to the credit trial program? Or put it the other way, excluding the impact from the credit trial program, what would be the loss rate for the first quarter?

And the second question is regarding on the income statement. So if you look at the financing income, I tried to calculate the take rate by

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

the operational balance. It seems the take rate has dropped quite a bit in the third quarter. previous, it used to be around 34%, 35%. This quarter, it's around 31%. But I understand that should be like approximately a proxy to your APR. So would you help us understand, like, what drives the decline here? Yes, so that's my question.

Ka Hong Yeung ***Qudian Inc. - CFO***

Sure. Thank you, Daphne. Again, insightful questions. I appreciate that. Number one, the delinquency rates, assuming we were to take out the credit trial program, I partially answered that to Sanjay as well. It's about 20% less. It's about 20% less. But we wouldn't disclose that number because I don't think it's meaningful.

What's interesting is if you look at my more full disclosure today, we disclosed M1, M6 on both total receivables and current receivables. We found that a lot of peers in our class actually just like to disclose current receivables. So we'd like to post that number up just to make things apple-to-apple, okay? So -- but anyway, that's side one. It's about 20% lower.

We actually stopped the -- paused the credit trial program because we do believe there is a sort of credit cycle going through. But it will finish perhaps by the end of this year into the first quarter. So that's why we are quite convinced that the D1 delinquency rate is now stable and now, in fact, dropped into potentially Q1 and Q2 next year. So that's, I think, hopefully, helpful.

And number two, regarding the take rates on the balance sheet part, which is our on-balance sheet part of the loan book, which is financing income. The take rate is around 33%, 34%. It's about the same. It's about range bound. So if -- I think one thing that could be driving this is maybe slightly more use of trust structures in Q3 than the previous quarter. But I have to double check on that.

But in general, the numbers should be roughly the same, given, number one, the financing costs to do this hasn't changed from on-balance-sheet leverage. Number two, the channel costs really haven't changed. And any provision is kept under the P&L below that line. So I wouldn't see any reason for it, maybe just -- loan duration. I think loan duration may have some small impact to this. But it would just fluctuate around the 30%, 35% range.

Operator

(Operator Instructions) Your next question comes from the line of John Cai Morgan Stanley.

John Cai ***Morgan Stanley, Research Division - Research Associate***

Yes. It's me again. So still about the risk and growth. So probably about our assessment first on why we would expect delinquency to come down in the next year. So there's -- that's my first question.

So secondly, obviously, as mentioned, we rely on the open platform to grow in the coming years. So from a customer perspective, so obviously, our total customer base reported roughly 10% day-1 delinquency. So if we need to keep the delinquency rate at the open platform low, that probably means that we need to acquire some new customer. So what's our strategies on, basically, to support the growth of open platform, particularly on the customer side? And funding seems okay at the moment, but if there's some color to add on the open platform funding, probably the management can give us more details on that as well.

Ka Hong Yeung ***Qudian Inc. - CFO***

Okay. Sure. Thank you, John. So regarding delinquency expectations or how we actually see that evolve, number one, the more recent uptake, partially due to macroeconomic environment, liquidity as well as this credit trial program, 2 of the 3 factors, I think, will roll over very soon. Especially, one thing that's under our control is the credit trial program. So that's paused. Number two is the liquidity shrink from the P2P wind-down should finish in the next 2, 3 months, maybe even longer, 4, 5 months, but it would be over soon. So I think that all contributes well toward delinquency coming down. We have seen this before. It goes up, and it comes back down fairly quickly.

Secondly, on a very fundamental basis, our open platform has done some pretty interesting upgrades to our risk model over the past 10 months of experience we're running it. Because my funding partners are lending using their own credit model and then they decide to let -- and we know that lending does happen or not happen, we are getting much more insight onto the really high-quality borrowers than before, okay? We were -- again, simply, right, we were putting our 1 head to try to solve this problem. Now we have 1 plus 11 heads. We'll

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

grow to 20 heads by the end of this year. So we just have more sort of capable people doing this and institutions.

So I think we are going to start to see some pretty interesting good trends into Q1. Q4 will still be like a tail end of what's happening in 2019, but Q1, we should expect to see some fantastic results from doing all of this. Especially now, we can tap into the PBOC credit records because it's all regulatory compliant, especially now that all my funding partners are supporting other platforms as well, like I said, we can solve the stacking problem much more capable -- capability. So all that should help.

And then regarding the question on open platform on the customer side, we're not worried at all on that growth from the customer side, reason being quite simple. Right now, we have slightly over 1 million active borrowers on open platform. The next year, we're only shooting for slightly over 2 million with an increase in loan balance to maybe around CNY 20,000. And that would actually -- just doing that itself will drive pretty interesting growth for us to become a pretty much all risk-free platform. So we're not far from 2 million.

The backdrop is not -- again, not from us. My funding partners come and create this whitelist to all my sort of borrowers [who approve their] credit limit, and that whitelist stands at over 21 million people. Not all them will borrow, but 21 million and we're shooting to get 10% out of that into next year should be achievable.

Granted -- look, I want to be absolutely transparent. This -- the growth of open platform is not like a linear shape, okay? This is funding partners. These are massive, licensed regulated financial institutions. I mean if they found something they loved, they would grow the balance very quickly. And then once they get to a certain balance, it would plateau. And then you got to get the new funding partners to come in to bring that next level of growth, and we have achieved that. We wish started the business with 1. We had 4 in the second quarter, and now we've got 11 actively lending to the open platform, granted that about 6 of them, 6, 7 of them are still small. So we're still growing those. So that's the reason why we account for the risk. If we account for the staggered growth of open platform, I do want to be slightly more conservative on 2019 but for a very temporary period.

Does that help with the dynamics and the shape of strategies and growth, John?

John Cai ***Morgan Stanley, Research Division - Research Associate***

Yes. Yes. So I think because the funding partner has -- make a whitelist of 21 million people, it seems there we have good quality. I just wonder this sort of like quality borrower reserve, we could probably utilize it because -- to basically avoid risk environment at the moment. Is that an option or not?

Ka Hong Yeung ***Qudian Inc. - CFO***

That's right. We're doing exactly what you mentioned. We are focused on the higher-quality borrowers. We've just simply left that behind. If you compare our average loan balance on my loan book with any of my peers, we're talking about, really, Qudian being risk conservative, right? My average loan balance of my loan book versus was, what, CNY 4,000, CNY 5,000, under 5,000 for sure. All my peers are close to CNY 10,000, if not more, okay? So we are super conservative. We just didn't want to go beyond that. But with open platform, all of my good borrowers can now get access to the credit enhancement, get to a more appropriate credit size than before.

So that's all it is. That's all it is. And these are the best-quality borrowers. We're not just saying we're focused on quality borrowers. We're doing it, and we're delivering it.

Operator

Your next question comes from the line of Sanjay Jain from Aletheia Capital.

Sanjay Jain ***Aletheia Capital***

Encouraged by John in terms of follow-up question. Just one clarification on loan facilitation. Suppose one of your partners says that, look, on basis of the economics as I see today, I'm neutral between open platform and loan facilitation, but if as a sensitivity, we consider a spike in credit costs, then I'm on the hook or I'm liable to incur more losses or less profits if the credit costs spike. So if a partner says I still want some or all of my partnership be in loan facilitation, what do you say to them? Do you walk away or you will still do some?

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

Ka Hong Yeung ***Qudian Inc. - CFO***

Thank you, Sanjay. We take probability as a serious consideration because that actually -- that margin helps us and protect us from our loan book risk. So if we can generate that profit, and we will. So if the partner comes and they're sitting between the fence, obviously, we measure which side of the profitability makes sense. For now, actually, open platform, we actually earn a greater yield. That yield is really because of the risk on open platform for us and all my peers because we're allowed to do the syndication without the focus on the high-quality borrower is significantly lower, and we share that upside, okay, that reduction in risk. So everybody makes more money.

So right now, in general, more or more of my partners are wanting to transfer the open platform because they make more money, face less risk. And most importantly, most, most importantly for us and all my funding partners, this is the most regulatory-compliant structure because there is no third party involved in guaranteeing risk. The banks are doing exactly what they're supposed to do, lend and put stuff on balance sheet. So I think if you consider that whole package, open platform should be more attractive, and that's why you see more growth.

Sanjay Jain ***Aletheia Capital***

Fair enough. But you have stopped the loan facilitation business completely?

Ka Hong Yeung ***Qudian Inc. - CFO***

We will decide. Now obviously, we -- number one, we have a much lower leverage, so we do have that leverage capacity if we want. Right now, it's not the time to leverage. If the time is right, we will absolutely leverage and deliver massive growth. But right now, we want to be risk conservative.

And the guidance of sort of where we want to be in terms of leverage is literally 1 to 3x, okay? So if open platform does really well, we can possibly reduce to 1 from 1 aspect. If the risk continues to increase in the market, we will deleverage to 1x, right, just to do a per-equity lending through my assisted lending model. So it doesn't matter if the world falls apart tomorrow. We'll still be around, right?

If the risk becomes right, we will releverage to earn that interest margin, to earn that spread, but we will not do it at more than 3x to keep things still safe. So that's kind of how we manage this business, manage that between 1 to 3x, depending on risk.

Sanjay Jain ***Aletheia Capital***

Okay. So you have temporarily shut it down, but you can always bring it back if you feel that the risk has improved.

Ka Hong Yeung ***Qudian Inc. - CFO***

Yes, and I'll tell you a specific number, if my D1 delinquency starts to drop below 10%, we will start leveraging up.

Operator

There are no further questions at this time. I would now like to hand the conference back to the management team. Please continue.

Ka Hong Yeung ***Qudian Inc. - CFO***

Thank you again for joining us today. If you have any further questions, please feel free to contact Qudian's Investor Relations department through the contact information provided on our website. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may all disconnect.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Briefs are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT BRIEFS REFLECTS THOMSON REUTERS'S SUBJECTIVE CONDENSED PARAPHRASE OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT BRIEF. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019 Thomson Reuters. All Rights Reserved.

©2019 Thomson Reuters. All rights reserved. Republication or redistribution of Thomson Reuters content, including by framing or similar means, is prohibited without the prior written consent of Thomson Reuters. 'Thomson Reuters' and the Thomson Reuters logo are registered trademarks of Thomson Reuters and its affiliated companies.