Lufax Holding Ltd. (LU US)

A tech-based financial service provider in China with strong earnings recovery in 2021

- Lufax (the Group) is a leading technology-based personal service provider in China
- Strategic focus to serve growing middle class and affluent population results in high operating efficiency and ROAE. Early signs of recovery was seen in 4Q20 and we expect better growth momentum for 2021
- Solid synergies from Ping An Group with increasing support from the latter
- High policy risk is expected upon expanding operational scale and product complexity
- Initiate with **BUY**; TP at US$ 21.45 implies 3.47x 21E P/B

Company Report
Initiation
Rating: BUY
TP: US$ 21.45

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Price (per ADS)	US$ 17.35
Est. sh price return	23.63%
Est. dividend yield	0.00%
Est. total return	23.63%
Last Rating &TP	na
Previous Report Date	na

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (US$)	20.17/11.56
Total issued shares (mn)	1,231.15
Market cap (US$ mn)	42,721
Avg daily turnover since IPO (US$ mn)	103.17
Major shareholder(s) (%):	
Tun Kung Company Limited	39.4
Ping An Group	39.0

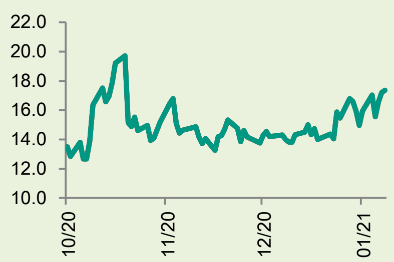
Source(s): Company, Bloomberg, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	21.16	11.15
3-mth	4.64	(9.85)
6-mth	na	na

*Relative to MXCN
Source(s):Bloomberg, ABCI Securities

Share performance since IPO (US$)



Source(s): Bloomberg, ABCI Securities

A unique business model that taps into a growing market. Established in 2014, Lufax is a leading technology-empowered personal service provider in China. The Group developed its business model to bridge the funding gap in the retail credit facilitation (RCF) market and capture substantial opportunities in the wealth management (WM) market. We estimate Lufax's topline revenue would increase at 14.9% CAGR in 2020-23E, with RCF contributing to 67.7% of topline in 2023E. Lufax targets to serve middle class and affluent clients through larger ticket size loans and higher average client assets per investor. ROAE and net margin would reach 17.40% and 28.62% by 2023E.

Cautious increase in credit risk appetite. As of June 2020, 94.2% and 3% of outstanding loans were insured and guaranteed by third parties and funding parties; only 2.8% of the loans were borne by the Group. Upon the mild macro recovery, the Group reduced the proportion insured by third parties to 88.8% in Dec 2020; meanwhile, asset quality was improving, with DPD30+ delinquency rate of secured and unsecured loans lowering to 0.7% and 2.3% as of Dec 2020. The reduced provision pressure drove up net profit by 18.9% YoY in 4Q20. We expect better profitability outlook in 2021 on macro recovery and robust balance sheet growth.

Synergies with Ping An Group (PAG). Lufax receives solid support from PAG , its major shareholder. This includes the access to ~210mn quality financial service customers, in addition to benefiting from the technology know-how and industry experience from PAG. About 36.9% of new loans in 1H20, 35% of active investors and 45% of client assets as of June 2020 were referred by PAG; meanwhile, 91.2% of outstanding loan balance was insured by PA P&C as of June 2020.

Under-regulated business areas. In our opinion, internet finance, subject to governance by multiple regulatory bodies, is a new and evolving industry entailing a high policy risk. These policies may adversely impact the Group's financials, although a highly regulated business environment would benefit market participants in long-run. We believe Lufax are in a better position than most TechFin companies for its sophistication in handling regulatory and compliance changes.

Initiate with BUY. We forecast a 22.3% net profit CAGR over 20-23E; our Gordon Growth Model suggests a TP at US$ 21.45, implying 21E P/B at 3.47x. In our view, the valuation premium over peers and commercial banks can be justified by the Group's strategic market positioning, solid support from PAG, fast growth and high ROAE. Initiate with **BUY**.

Results and Valuation

FY ended Dec 31	2019A	2020A	2021E	2022E	2023E
Revenue (RMB mn)	47,834	52,046	61,043	69,958	78,894
Chg (%,YoY)	18.1	8.8	17.3	14.6	12.8
Net profit* (RMB mn)	13,332	12,354	15,624	19,009	22,578
Chg (%,YoY)	(2.1)	(7.3)	26.5	21.7	18.8
EPS per ADS (RMB)	6.14	5.59	6.41	7.80	9.26
Chg (%,YoY)	(3.0)	(8.9)	14.6	21.7	18.8
BVPS per ADS (RMB)	21.40	33.45	40.23	48.40	58.04
Chg (%,YoY)	35.7	56.3	20.2	20.3	19.9
P/E (x)	18.38	20.17	17.60	14.46	12.18
P/B (x)	5.27	3.37	2.80	2.33	1.94
ROAE (%)	32.14	19.06	17.40	17.60	17.40
ROAA (%)	9.97	6.20	5.78	6.06	6.33
DPS per ADS (RMB)	-	-	-	-	-
Yield (%)	-	-	-	-	-

Note: Company; USD/CNY=6.5
*Net profit =Net profit attributable to shareholders of the Company
Source(s): Bloomberg, ABCI Securities estimates

Contents

A unique business model with strategic focus

A snapshot of Lufax (the Group)

The history of Lufax can be traced back to Aug 2005 although the Group was formally incorporated in Dec 2014. This included the setup of Ping An Group's (PAG) consumer loan business in Shenzhen (SZ) in 2005 and wealth management (WM) business in Shanghai (SH) in Sep 2011. The Group acquired PAG's credit facilitation business as part of the formal incorporation in Dec 2014. Since 2017, Lufax has started its globalization plan with footprint extending to Singapore and HK. On Oct 30, 2020, Lufax completed its US listing with an IPO price of US$ 13.50 per ADS, of which 2 ADSs represent 1 ordinary share.

Lufax is a leading technology-empowered personal financial services platform in China aiming to facilitate retail borrowing and wealth management. It targets to fulfill the gap of underserved customers from traditional FIs and online-only TechFin platforms backed by major internet companies such as Ant Financial, Webank, and Tencent Licaitong. Lufax has 2 core business segments - retail credit facilitation (RCF) and wealth management (WM).

The Group had over 56,000 direct salesforce and over 4,000 personnel in its online telemarketing team, covering more than 270 cities across all provinces in China except Tibet as of June 2020. The balance of retail credit facilitated in its RCF business hit RMB 519.4bn while client assets generated through its WM business platform reached RMB 374.7bn, ranking second and third among non-traditional FSPs in China (such as FinTech companies, online-only TechFin companies, and online lending platforms), according to Oliver Wyman (OW) report as of June 2020.

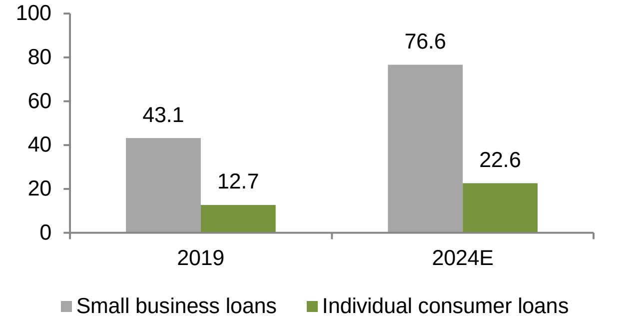
Strategic focus on RCF and WM demand

China has the second largest financial system globally by retail credit lending volume and total amount of investable assets as of 2019, according to the OW report. Total credit provided by China's financial system amounted to RMB 55.9tr in 2019, representing a CAGR of 15.9% over 2014-19. Meanwhile total personal investable assets reached RMB 192tr in 2019, or by a CAGR of 12% over 2014-19. OW estimates China's total personal investable assets to grow at a CAGR of 11% over 2019-24E to RMB 319tr, driven by China's robust organic economic growth, increased importance of small businesses to the economy, and the rise of middle class and affluent population.

The retail credit market in China mainly consists of small business loans and individual consumer loans. According to the OW report, outstanding balance of small business loans in China was RMB 43.1tr in 2019, implying a CAGR of 14.3% in 2014-19. Assuming a 12.2% CAGR over 2019-24, OW forecasts the balance to reach RMB 76.6tr by 2024. Total demand for small business loans in 2019 was estimated at RMB 89.7tr, of which ~52% of demand remained unserved. OW forecasts unserved demand to reach RMB 50tr by 2024.

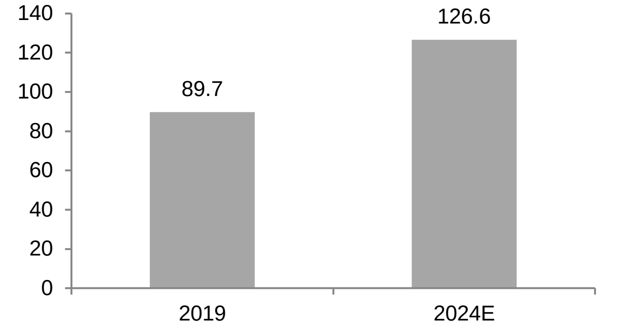
The funding gap reflects difficulties faced by small businesses, which generally do not possess sufficient operating history or collateral assets. These companies find it hard to obtain sufficient credit from traditional lenders at a reasonable interest rate; moreover, the processing time of loan application with traditional FIs is usually long.

Exhibit 1: Projections for China's retail credit outstanding balance (RMB tr)



Source(s): Company, OW report, ABCI Securities

Exhibit 2: Total retail credit demand projections for China (RMB tr)



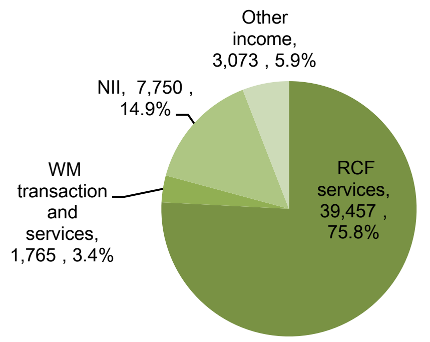
Source(s): Company, OW report, ABCI Securities

Total outstanding consumer loans in China was estimated at RMB 12.7tr in 2019, implying a 22.3% CAGR over 2014-19. OW projects the figure to reach RMB 22.6tr by 2024, implying a CAGR of 12.2% in 2019-24E. This is based on the assumption that China will continue to shift toward a consumption-driven economy. For the WM business in China, total personal investable assets reached RMB 192tr in 2019, the second largest globally, among which only RMB 49tr or 26% has been placed in wealth management products (WMPs).

Lufax formulated its business model with a strategic focus to tap into the huge growth opportunities in these areas, as reflected by the increased topline contribution of credit facilitation fee from 55.1% in 2017 to 75.8% in 2020; meanwhile, WM fees and net interest income (NII) accounted for 3.4% and 14.9% of the topline revenue in 2020.

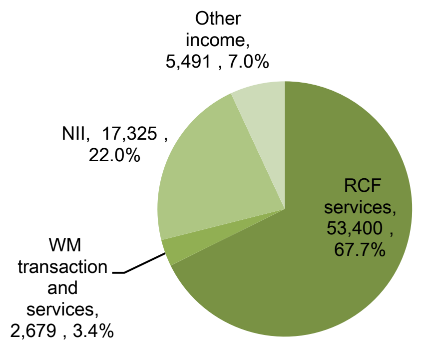
With the organic growth in WM business and increasing credit risk appetite, we forecast Lufax's WM income and NII to grow at 14.9% and 30.8% CAGRs in 2020-23E, faster than the 10.6% revenue CAGR for RCF. Overall Lufax's topline revenue would grow at 14.9% CAGR in 2020-23E. Contribution from RCF income to total income would gradually fall to 67.7% by 2023E; but the segment will remain as the Group's core component and major revenue driver.

Exhibit 3: Lufax's revenue mix (RMB mn, 2020)



Source(s): Company, ABCI Securities

Exhibit 4: Lufax' revenue mix (RMB mn, 2023E)



Source(s): Company, ABCI Securities estimates

Competition landscape

Retail credit facilitation business (RCF)

There are two types of participants in China's retail credit market: 1) traditional financial institutions (FIs) such as banks, finance leasing companies, commercial factoring companies, offline consumer finance companies, and offline small-loan companies; 2) non-traditional FSPs, which includes FinTech companies, online-only TechFin companies, and online lending platforms. In brief, FinTech is the concept where the finance industry starts using technology to offer better customer experience, and TechFin is technology firms entering the finance sector to change consumer behavior.

Major clients of traditional FIs are borrowers with a longer operating history and sufficient collaterals. Without strong technology and data-driven support, the credit application process of traditional FIs is usually long and stringent. Meanwhile, non-traditional FSPs fill the gap with technological aids to capture the market need by resolving the issues that the clients encounter with the traditional FIs.

Exhibit 5: Top 5 non-traditional FSPs in retail credit market (Jun 20)

Ranking	Provider	Estimated o/s balance	Estimated market share	Estimated average ticket size (RMB)
1	A	2,000 - 2,300	46 - 53%	5,000
2	Lufax	519	12%	Unsecured: 146,513 Secured: 422,398
3	B	330 - 380	7 - 9%	9,000
4	C	200 - 250	4 - 6%	3,000
5	D	90 - 120	2 - 3%	3,000

Source(s): OW report, Company, ABCI securities

Non-traditional FSPs differentiate from each other in important ways. Small lending platforms and large online-only TechFin companies usually focus to provide a limited range of products with smaller-sized loans with shorter tenure due to the lack of financial data. In contrast, large FinTech firms usually can leverage its big data to support pricing, risk management functions, and innovative offline-to-online customer acquisition model, optimizing the lending processes to fulfill the untapped demand. Leading FinTech companies can also provide technology enablement and tailor risk-sharing solutions to traditional FIs to increase customer flows.

Exhibit 6: Top 5 non-traditional FSPs in small business loans market (Jun 20)

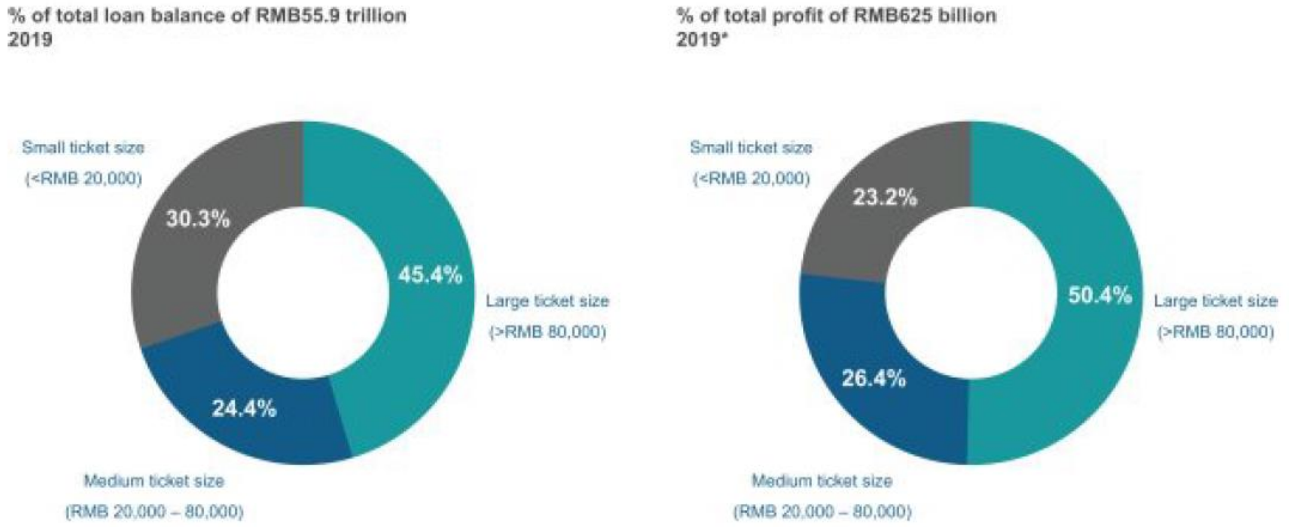
Ranking	Provider	Estimated o/s balance	Estimated market share	Loan product type
1	A	400–500	38–48%	Medium ticket size; unsecured
2	Lufax	331	32%	Large ticket size; secured and unsecured
3	B	40–70	4–7%	Large ticket size; unsecured
4	C	30–40	3–4%	Large ticket size; unsecured
5	D	20–30	2–3%	Large ticket size; unsecured

Source(s): OW report, Company, ABCI securities

That said, key competitive advantage of TechFin companies lies on their well-developed customer base with online behavior, while Fintech companies are experts in product development and risk management supported by valuable data, as well as the ability to transfer offline customers to online ones. The market focus of FinTech and TechFin are not the same.

In view of this, Lufax leverages its business focus on large-ticket secured and unsecured loans. The Group was ranked second in terms of retail credit market outstanding balance and small business loans outstanding balance as of June 2020, according to the OW report. Statistically, large-ticket loans contributed to the largest profit pool in the market, which is served mainly by traditional FIs and large FinTech companies, including Lufax.

Exhibit 7: Distribution of loan volume and profit by ticket size



Source(s): OW report, Company

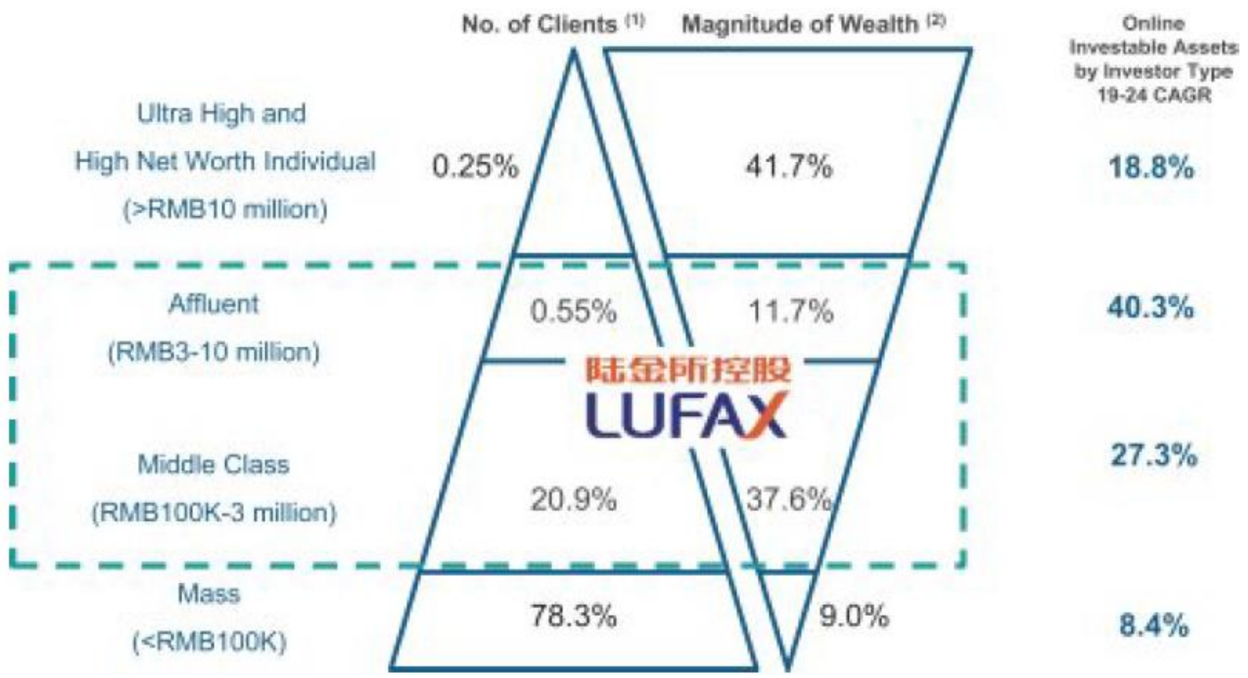
Wealth management (WM) business

In China's WM market, rapid regulatory changes have led to the shift in the product type from guaranteed short-term products to NAV-based long-term products; also, a higher degree of specialization was seen between asset managers and distribution channels. Investors' demand over the suitability of WMPs, both in terms of portfolio diversification and technology support, has increased.

Historically, personal investable assets were managed individually in China. With the increasing number of middle class (with net worth of RMB 100k-3mn) and affluent population (with net worth of 3mn-10mn), however, capacity to provide timely and personalized services to a larger customer population become a major challenge to traditional FIs. According to the OW report, investable assets of middle class and affluent population are expected to grow at 27.3% and 40% CAGRs over 2019-24E; specifically, 21.45% of the population in 2019 will possess 49.3% of total investable assets in 2024E. We believe Lufax's strategic vision to focus on this segment will be fruitful.

Market participants of the WM market include 1) traditional FIs; 2) online non-traditional FSPs; 3) offline non-traditional FSPs. As of June 2020, Lufax was ranked third among non-traditional FSPs in WM market by client assets. Lufax's average WM client assets were three times higher than the weighted average of the client assets of the other top five players, according to the OW report.

Exhibit 8: Personal investable assets by investor types



(1) As percentage of 1.0 billion clients in total as of end of 2019
(2) As percentages of total investable assets of RMB192 trillion as of end of 2019
Source(s): Company

Exhibit 9: Top five non-traditional FSPs in WM market ranked by size of client assets (June 2020)

Ranking	Provider	Client assets (RMB bn)	Market share	Average client assets per investor (RMB)
1	A	4,000–4,200	48–51%	8,000
2	B	1,300–1,500	16–18%	8,000
3	Lufax	375	5%	29,000
4	C	250–300	3–4%	8,000
5	D	180–210	2–3%	11,000,000

Source(s): OW report, Company, ABCI securities

We believe a few factors are crucial to success in the WM business:
1) Effective investor acquisition model covering online and offline channels;
2) Comprehensive suite of products supported by sourcing capabilities;
3) Ability to provide investor-centric, value-added, and personalized services;
4) Strong data analysis ability to provide product insight and cater risk management needs;
5) Ability to swiftly adapt to changes in regulatory environment.

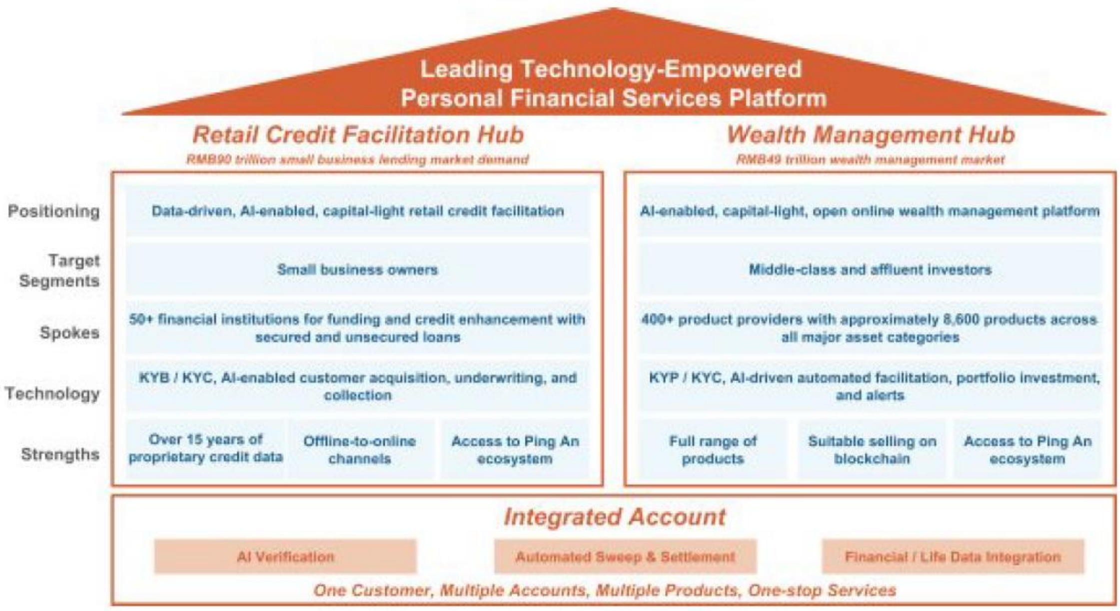
Unique "hub and spoke" business model

In order to capture on the huge market opportunity in RCF and WM, Lufax has developed a unique capital-light business model, namely, the "hub and spoke" model. This business model combines purpose-built technology applications, extensive data, and financial services expertise to match the right product with the right customers. As of June 2020, Lufax's RCF hub has cumulatively connected 13.4mn borrowers with over 50 banks, trusts, and insurers as spokes on its platform. Regarding its WM hub, Lufax connected 8,600 WMPs from 429 institutional product providers to over 12.8mn active customers. The numbers of cumulated borrowers and active WM investors further increased to 14.5mn and 14.9mn as of Dec 2020.

Lufax's capital-light business model achieved an outstanding ROAE of over 30% in 2018 and 2019. Its platform connects hundreds of FIs to facilitate lending and WMPs to retail customers with personalized needs and risk appetites. With over 15 years of data accumulated, Lufax developed its Know Your Product (KYP), Know Your Business (KYB), and Know Your Customer (KYC) capabilities. It leverages extensive data, AI applications, and blockchain solutions to price credit and manage relevant risk.

As of June 2020, ~75% (Dec 2020: 75.5%) of client assets invested through the platform had an investment amount of over RMB 300,000; ~88% of its customers used one or more of the integrated account functions. Lufax's integrated account serves as a single interface to connect all borrowers and investors to products, transactions, and services on the platform. This unique business model achieved a 96.8% retention rate among WM customers in 2020, compared to 91.0% in 2018.

Exhibit 10: Lufax's "Hub and Spoke". unique business model



Source(s): Company

According to the OW report, unmet financial demand of small businesses in China amounted to RMB 47tr as of 2019. Small business owners often need larger-ticket loans with longer tenure for both personal and operational needs on short notice. They need highly personalized services and short application time. In addition, salaried workers also require larger and faster loans that are hard to be catered by traditional credit card and loan products offered by banks.

Retail credit facilitation (RCF) hub

RCF segment is Lufax's primary income source, which included loan facilitation and post-origination service fees. In order to minimize capital and credit exposure, Lufax engages with third-party funding partners and credit enhancement partners. Unlike the retail lending model in traditional banks that takes on the entire credit risk, Lufax redirects such risk to its third-party funding sources. In 1H20, 99.3% of new loans facilitated were financed by third-party partners; Lufax only funded 0.7% of the amount through its microloan and consumer finance companies.

Major competitors

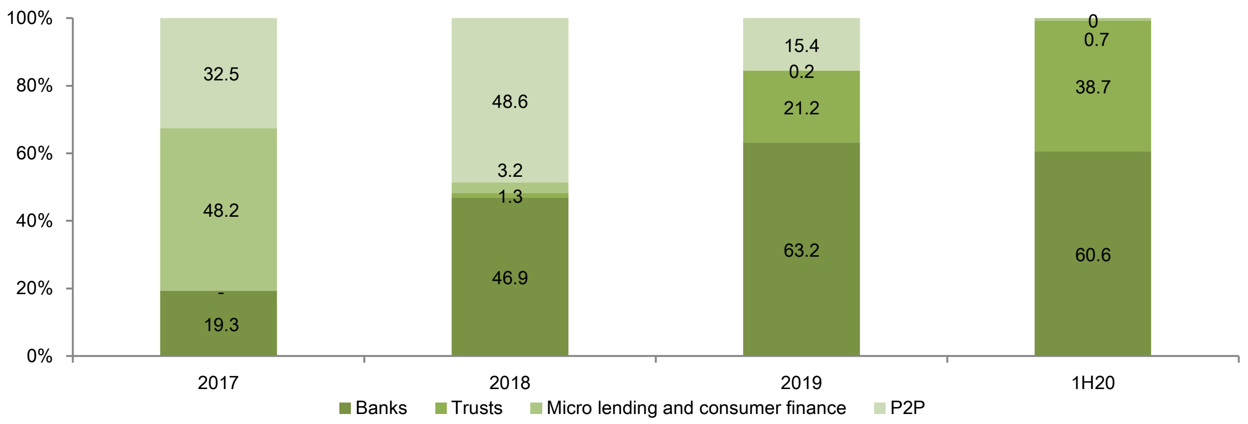
Key competitors in the RCF business include Ant Financial, 360 Finance, Lexin, JD Digits, and Webank. We consider Ant Financial as the market leader by the no. of customers. Meanwhile, Lufax differentiates itself from its competitors by offering larger loan sizes and longer tenures; also, it has a relatively high asset quality among peers.

Exhibit 11: RCF business major competitor comparison

	Lufax	Ant Financial (蚂蚁金服)	360 Finance	Lexin (乐信)	JD Digits (京东数科)	Webank (微众银行)
Key products	Lujindai	Huabei Jiebei	360 Penny Loan 360 Finance E-commerce platform	Fen Qi Le Le Card	Baitiao Jintiao	WeiLiDai WeiYeDai
Customers	44.7mn (registered) 13.4mn (accumulated borrowers)	500mn (consumer credit) 20mn (MSE credit)	149mn (registered) 27.7mn (with credit lines)	95.3mn (registered) 22.7mn (with credit lines)	>55mn (Baitiao) >22mn (Jintiao & MSE)	>200mn (retail customers) 900k (MSE)
Loan size (RMB)	146k(unsecured) 422k (secured)	3.5k (consumer credit) 21mn (MSE credit)	na	Average: ~7.8k	na	8k (WeiLiDai)
Loan duration (mths)	35.1 (unsecured) 36 (secured)	3-12	8.5 (2Q20)	11.4 (2Q20)	1-24	na
Asset quality (DPD 90+)	2.1% (unsecured) 0.9% (secured)	2.15% (consumer credit) 2.05% (MSE credit)	2.82%	2.99%	1.65% (consumer credit) 0.38% (MSE credit)	NPL ratio: 1.24% (2019)

Note: data as of 1H20 unless otherwise stated
Source(s): Companies, ABCI Securities

Exhibit 12: New loans facilitated by funding sources (%)



Source(s): Company

Timely adjustment to market changes

Lufax's RCF business started in 2005. Regulators have increased surveillance on the P2P business since 2017, and Lufax officially ceased using individual investor funding on the P2P platform in Aug 2019. Currently, all third-party funding comes from FIs, such as banks and trust plans. After the strategy shift in Dec 2017, the Group also reduced the proportion of self-funded lending, which is now primarily used to test out new products. In 1H20, 60.6% and 38.7% of Lufax' new loans facilitated were funded by banks and trusts.

Eyes on high-quality borrowers

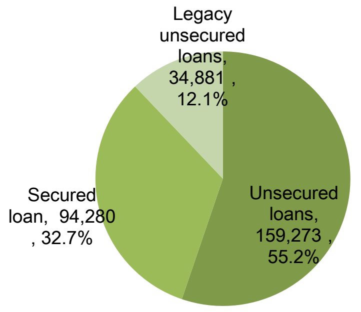
Lufax targets at high-quality borrowers (G1-G3 of its risk classification system) requiring larger-ticket loans. These borrowers, who usually have financial assets, real estate, or some access to commercial bank credit, are underserved by online-only TechFin companies and traditional FIs in China. Among the borrowers served in 1H20, ~92% of them have credit cards, more than 57% own residential real estate, and 57% of them do not have an outstanding unsecured bank loans. The no. of cumulative borrowers increased from 7.5mn in 2017 to 13.4mn in June 2020 and 14.5mn in Dec 2020.

These customers usually need larger loans. Lufax's average loan size was RMB 146,513 for general unsecured loans and RMB 422,398 for secured loans, compared to an average ticket size of ~RMB 5,000 for the other top five lenders among non-traditional FSPs, according to the OW report. Lufax is a leader in the small business owner lending space, which has high entry barriers, and enjoys a high profitability with limited direct competition.

Shift in loan mix

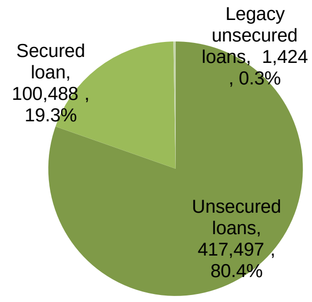
Lufax's has shifted its loan mix over the past years. The proportion of unsecured loans to total loans increased from 67.3% in 2017 to 80.4% as of June 2020. About 12.1% of total loans in 2017 were related to legacy unsecured loans, which have been largely cleared in past years upon maturity. As of June 2020, the legacy unsecured loans only accounted for 0.3% of total outstanding balance, which indicates a clean loan portfolio uncumbered by legacy.

Exhibit 13: Outstanding balance by loan type (RMB mn, 2017)



Source(s): Company, ABCI Securities

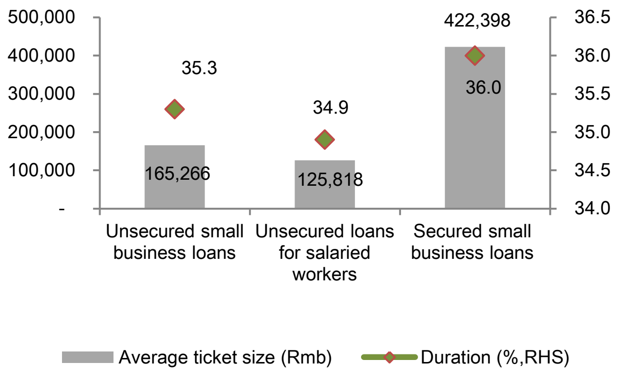
Exhibit 14: Outstanding balance by loan type (RMB mn, June 2020)



Source(s): Company, ABCI Securities

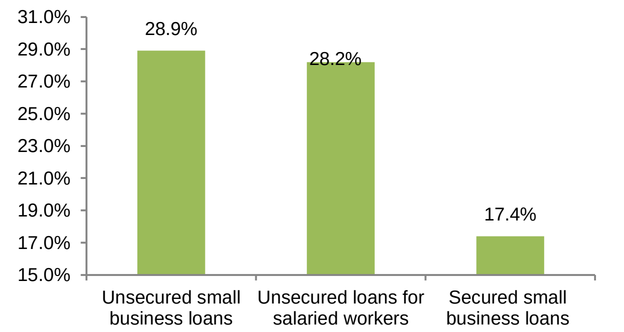
As of June 2020, secured small business loans has an average ticket size of RMB 422k, compared to RMB 125k-165k for unsecured personal and small business loans. APR of secured small business loans was also lower at 17.4%, compared to 28.2%-28.9% for unsecured personal and small business loans. In order to comply with the latest regulatory development, APR of new loans applied after Sep 4, 2020, were below 24%, driving down the Group's RCF average take rate in 2H20.

Exhibit 15: Loan product mix (facilitated in 1H20)



Source(s): Company, ABCI Securities

Exhibit 16: APR by loan type (facilitated in 1H20)



Source(s): Company, ABCI Securities

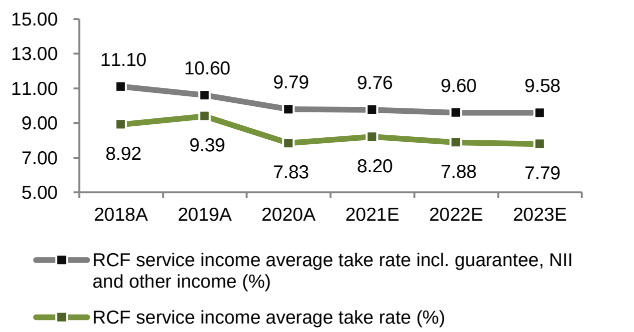
Expect mild drop in RCF take rate

In addition, we believe rapid growth in RCF market size would attract competitors in the RCF platform business, which may result in price competition and regulatory control on take rates. Customers on these platforms with advanced technology are highly price-sensitive - fund flow among different platforms would be fast.

Competition is likely to come from both tech companies and traditional FIs in China with robust financial support from core business. We project a mild reduction in Lufax's RCF service income take rate (total RCF service fees/average outstanding balance of loan facilitated). In our base case scenario, the RCF service income average take rate, which includes/excludes guarantee, NII and other income would edge down from 10.6%/9.39% in 2019 to 9.58%/7.79% in 2023E.

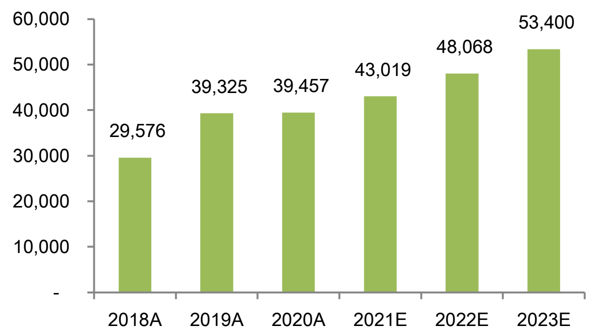
Taking into account Lufax's early-entrant advantage and a leading market share, we believe robust business growth could partially offset the negative impacts of price competition. We project its RCF income to grow at a 10.6% CAGR over 2020E-23E, backed by the 14.5% and 19.3% CAGRs in outstanding balance of loans facilitated and new loans facilitated over 2020-23E.

Exhibit 17: Lufax's average RCF take rate (%)



Source(s): Company, ABCI Securities estimates

Exhibit 18: Lufax's RCF revenue (RMB mn)



Source(s): Company, ABCI Securities estimates

Comprehensive risk management

Thanks to a well-structured business model and big data accumulated, Lufax, had a day past due (DPD) 30+ delinquency rate at 2.3% for unsecured loans and 0.7% for secured loans as of Dec 2020. DPD 90+ delinquency rate was 1.3% and 0.4% for unsecured and secured loans, and overall DPD 30+ and 90+ delinquency rates were marked at 2.0% and 1.2% as of Dec 2020. The low delinquency rates were achieved despite a high loan CAGR of 26.6% in 2017-19 and the impact of COVID-19.

The system NPL ratio of commercial banks was 1.96% as of Sep 20, according to the CBIRC. In our opinion, Lufax's asset quality is guarded by its comprehensive risk management mechanism with the KYP, KYB, and KYC systems.

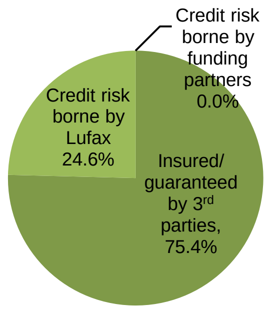
Lufax's loan application is entirely online and paperless. Since 2019, all loan application was made through Lufax's mobile application with supporting documents being uploaded digitally. For new customers, the Group will perform a preliminary credit assessment with their database and analytical insight once the borrower's identification is verified through facial recognition and device fingerprint.

Borrowers can provide additional information to justify credit profile and increase credit limit. These documents included but not limited to insurance policies, automobile registration, residential mortgage, deeds and tax bills. With the uploaded documents, the Group applies automatic speech recognition and optical character recognition to expedite document scrutinizing function.

In addition, borrowers will need to take an AI credit assessment interview on anti-fraud and further credit assessment before loan approval. Analyses are done with both financial and behavioral data. An average credit approval time is about 30mins for unsecured loans and two hours for secured loans in 1H20.

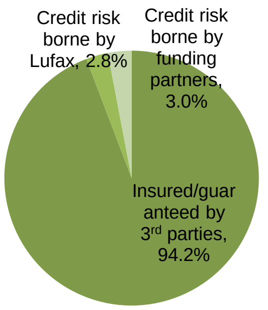
Lufax's credit assessment is built on its proprietary and third-party database under proper authorization and legal procedures. These include the use of Credit Reference Center of the PBOC, data publicly available from other government institutions, and a variety of consumption, social, and behavioral data for blacklisted and negative records. In relation to small business borrowers, corporate credit rating, CAT, POS, UnionPay records, utility bills, insurance, and industry organization membership will also be taken into account.

Exhibit 19: Outstanding loan guarantee status (2017)



Source(s): Company, ABCI Securities

Exhibit 20: Outstanding loan guarantee status (Jun 20)

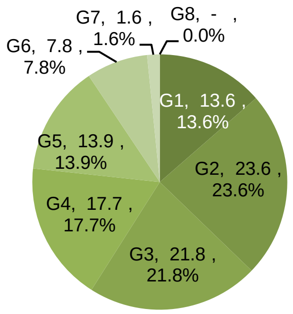


Source(s): Company, ABCI Securities

Cautiously raising the credit risk level

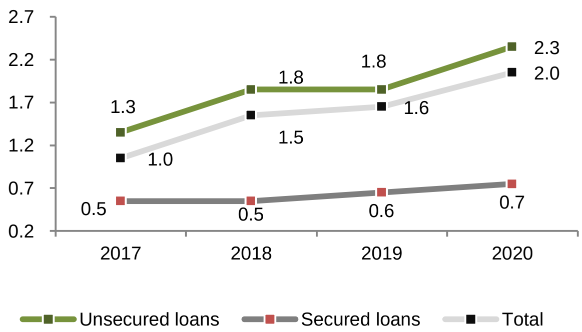
Lufax avoids taking up credit risk from the loan facilitation business except during the initial stage of business. As of June 2020, 94.2% of outstanding loans were properly insured and guaranteed by third parties (vs. 75.4% in 2017); risk borne by Lufax only accounted for 2.8% of total outstanding balance (vs. 24.6% in 2017). Lufax has adjusted its business model to take up more credit risk in loans originated by consolidated trust plans since 2019. As of Dec 2020, 88.8% of outstanding loans insured by third parties.

Exhibit 21: Risk level distribution (June 2020)



Source(s): Company, ABCI Securities

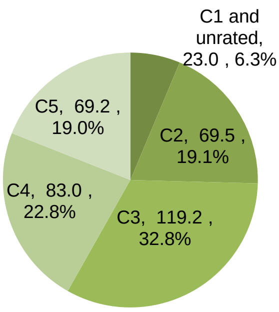
Exhibit 22: DPD 30+ delinquency rate (%)



Source(s): Company, ABCI Securities

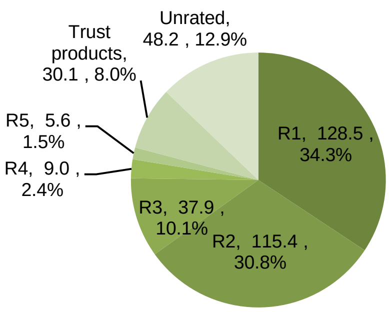
With the credit assessment mechanism, Lufax classified its customers into eight classes, of which G1 has the lowest risk level and G8 the highest. Specifically, the Group considered G1-G3 as high-quality borrowers. As of June 20, high-quality borrowers accounted for 59% of Lufax's outstanding credits; 70.7% of new loans facilitated in 4Q20 were granted to these borrowers.

Exhibit 23: KYC rating by client assets (RMB bn, June 2020)



Source(s): Company, ABCI Securities

Exhibit 24: KYP rating by clients assets (RMB bn, June 2020)



Source(s): Company, ABCI Securities

Wealth management (WM) hub

WM business generates income through WM transaction and services fees. The Group facilitates the distribution of third-party financial products without taking up any product risks or obligations. Investors' risk tolerance and product portfolio is monitored closely with Lufax's KYC and KYP systems during the matching process. Lufax has a KYC rating on client tolerance level from C1 to C5, with C1 as the most risk-averse and C5 the least. KYP rating ranges from R1 to R5 based on product risk, with R1 as the least and R5 the most. Lufax's WM business has been operating since 2011. Due to regulatory development, the Group ceased offering B2C products in 2H17 and P2P products in Aug 2019. In Sep 2017, Lufax expanded its business to Singapore and in Sep 2019 to Hong Kong to tap into the large pool of investable funds controlled by overseas Chinese.

Major competitors

Ant Financial and Licaitong of Tencent are the major competitors of Lufax's WM business. Once again, Ant Financial is the market leader in terms of the no. of customers and total AUM. Unlike RCF business, Lufax's WM business is relative small compared to major peers; nonetheless, the Group's AUM per customer was higher at RMB 29,000.

Exhibit 25: WM business major competitor comparison

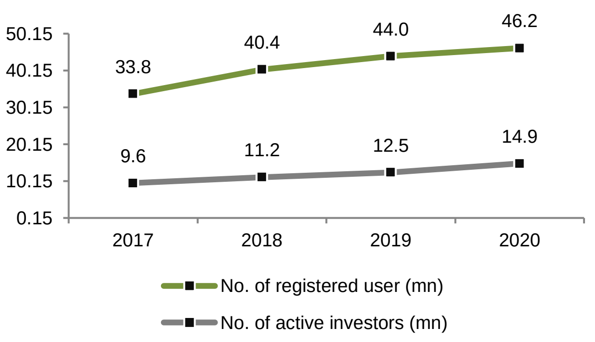
	Lufax	Ant Financial	Licaitong (Tencent)
Key products	na	Yu'ebao Yulibao	na
Customers	44.7mn (registered) 12.8mn (active)	500mn	~200mn (2019)
AUM (RMB bn)	375	4,099	1,000 (2019)
AUM per customers (RMB)	29k	8,198	5,000

Note: data as of 1H20 unless otherwise stated
Source(s): Company, ABCI Securities

Focus on middle class and affluent market

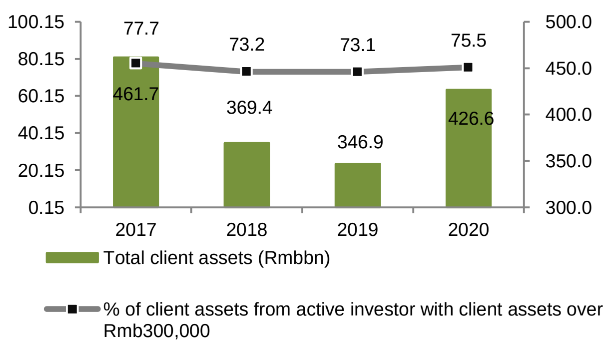
The Group selectively avoids direct competition in the mass market and tactically focuses on wealthier clients. Driven by fast growth and high savings rate of the middle class and affluent population in China, demand in personalized investment and WM is on the rise. Yet, the population segment is underserved by private banking services in traditional banks.

Exhibit 26: No. of Lufax's WM customers



Source(s): Company, ABCI Securities

Exhbit 27: Lufax's total client assets



Source(s): Company, ABCI Securities

Assets under management for the WM market in China reached RMB 49tr in 2019. OW estimates the figure to reach RMB 118tr by 2024E, or at a CAGR of 19% in 2019-24E. Recent introduction of the New Asset Management Guideline suggests a stronger orientation to customer needs. We believe technology and big data will be the keys to provide more personalized services.

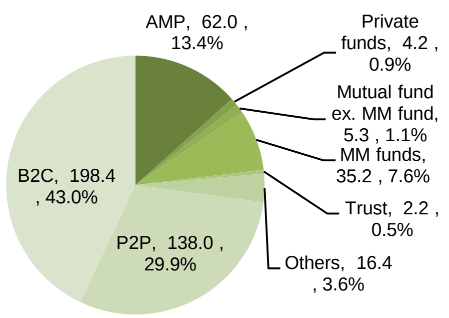
The Group sources WM investors through the ecosystem of Ping An Group (PAG), direct online marketing, and member referral channels. As of Dec 2020, Lufax served 46.2mn of registered users and 14.9mn of active investors. About 75.5% of its total client assets were from higher-value investors with client assets at above RMB 300,000, in which indicates a differentiation from Ant Financial and Licaitong.

On the supply side, Lufax is connected with 429 institutional financial investment product providers, including 40 banks, 123 mutual funds, 103 private investment funds, 100 asset management companies, and 38 other entities, such as securities companies and insurers, as of June 2020. To note, Lufax does not assume any product risks or obligations to meet any implicit guarantee expectations in sourcing and facilitating third-party WMP distribution. The Group dedicates to match the right products to the right investors at the right time through its proprietary LuFlex system. Operating efficiency has been enhanced over time through the increasing no. of customers, more data, and economies of scale.

Rapid changes in business mix

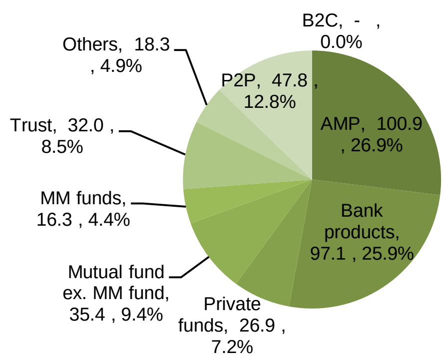
Significant changes have been seen in the underlying products of Lufax's WM business over the past years. Back in 2017, legacy products from its startup stage, such as P2P and B2C products, accounted for 29.9% and 43.0% of total client assets. However, with rapid development in related regulations, the balances in these products dropped significantly. As of June 2020, only 12.8% of Lufax's client assets were related to these legacy P2P products. Assuming the Group will not facilitate these products again in the future, we expect the remaining balance to be fully absorbed by 2022E.

Exhibit 28: Client assets by product category (RMB bn 2017)



Source(s): Company, ABCI Securities

Exhibit 29: Client assets by product category (RMB bn Jun 20)

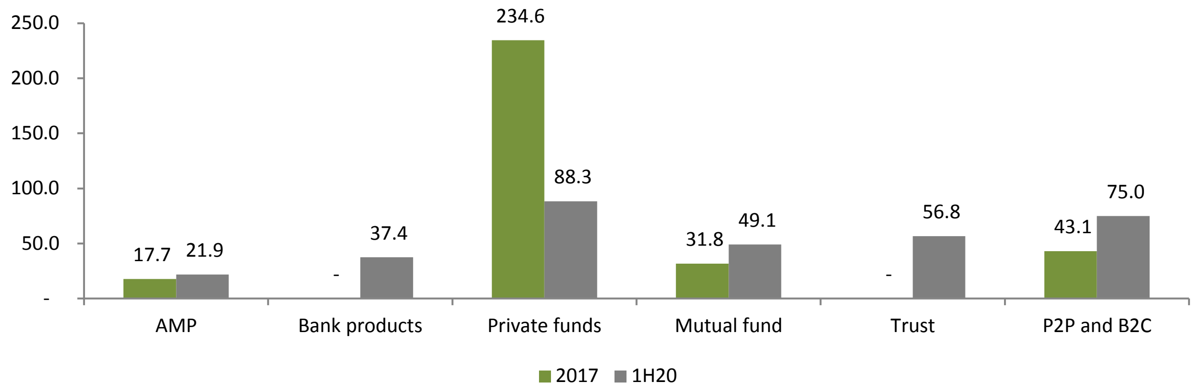


Source(s): Company, ABCI Securities

Lufax generates fees based on client asset balance. In 1H20, 31% of service fees were collected from investors, while 69% were collected from asset providers. The average take rate was calculated by dividing the total fee collected by the average client assets generated through Lufax's WM platform. The average take rates in most of the product categories have improved since 2017.

In particular, private investment funds was the only category recording decline in the average take rate. For the private investment funds, 83.3% of total client assets held as of June 2020 were securities investment funds, while the remaining 16.6% of total client assets were invested in private equity and venture capital funds, as compared to the distribution of 69% and 31% in 2017. We believe the change in client asset mix is the reason behind the lower average take rate.

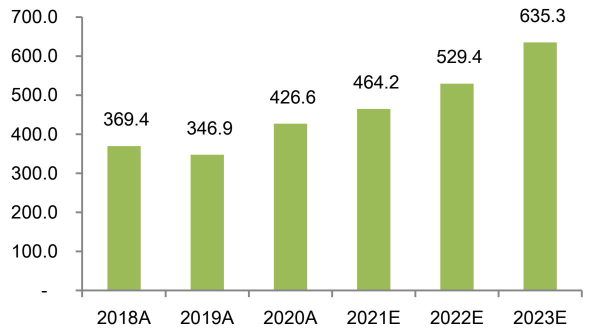
Exhibit 30: Average take rate of WMP facilitated by Lufax (bps)



Source(s): Company, ABCI Securities

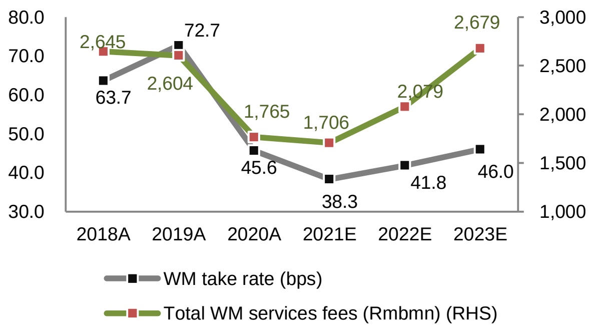
In our base case scenario, we project Lufax's total client assets to grow by 14.2% CAGR in 2020-23E, of which balance of the legacy products will be gradually absorbed while current products would grow at a 16.0% CAGR over 2020-23E. Since legacy products in P2P and B2C have a higher average take rate, we forecast Lufax's WM average take rate to normalize in the range of 38.3bps-46.0bps for 2021E-23E. These factors would drive WM service fee income to increase at 14.9% CAGR over 2020-23E.

Exhibit 31: Lufax's total client assets (RMB bn)



Source(s): Company, ABCI Securities estimates

Exhibit 32: Lufax's WM income and average take rate



Source(s): Company, ABCI Securities estimates

Competitive advantage from synergies with Ping An Group (PAG)

Relationship with major shareholders

After completion of Lufax's US listing, we estimate PAG's direct shareholding is ~39%. Meanwhile, certain senior management in PAG and its subsidiaries hold the full interest in Tongjun Investment Company Limited, which owns 41% of Tun Kung Company Limited. With the ~39.4% post-IPO stake of Lufax owned by Tun Kung Company Limited, these senior management ultimately controls 16.15% of Lufax. With the ~55% direct and indirect stake by PAG and its senior management, PAG has a significant influence over Lufax.

Exhibit 33: Shareholding structure (%)

	Pre-IPO	Post-IPO
Tun Kung Company Limited	42.7	39.4
Ping An Group	42.3	39.0
Eddie Siu Wah Law	3.4	3.1
Others	11.6	18.5
Total	**100.0**	**100.0**

Source(s): Company, ABCI Securities estimates

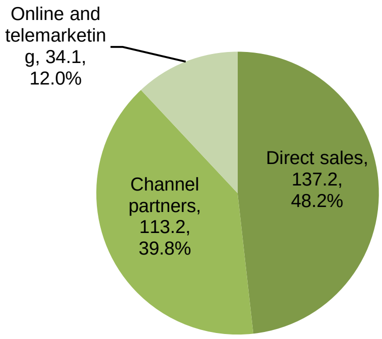
The PAG ecosystem

One of the key differentiating factors of Lufax is the concrete support it receives from the financial conglomerate, PAG. The Group has potential access to ~210mn financial services customers through PAG. These customers are small business owners, middle class, and affluent investors. Referral business from the PAG ecosystem, which entails a high flexibility, would be least impacted by regulatory changes. Moreover, the ecosystem also shares its technology know-how and industry experience with the Group, leaving the door open for product development in the future.

In brief, 36.9% of new loans in 1H20, 35% of active investors and 45% of client assets as of June 2020 were referred by the PAG ecosystem; 91.2% of outstanding loans facilitated were insured by PA's P&C insurance. In particular, new loans facilitated by the PAG ecosystem increased from RMB 65.1bn in 2017 to RMB 105.1bn in 1H20. Total client assets in current products acquired from the ecosystem increased from RMB 40.1bn in 2017 to RMB 142.3bn in 1H20. On the technology front, many of Lufax's advanced technologies, such as facial and voice recognition, AI and machine learning algorithms, and blockchain technology, are licensed from PAG.

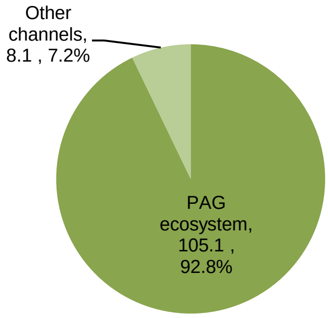
Multiple synergies with PAG were crucial in the startup stage of Lufax – it helps build a solid foundation required for long-term success. The cooperation between PAG and Lufax is mutually beneficial as customer loyalty for all parties could be strengthened through the one-stop integrated financial service platform.

Exhibit 34: Volume of new loans facilitated (RMB bn, 1H20)



Source(s): Company, ABCI Securities

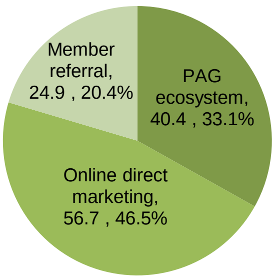
Exhibit 35: Volume of new loans facilitated by channel partners (RMB bn, 1H20)



Source(s): Company, ABCI Securities

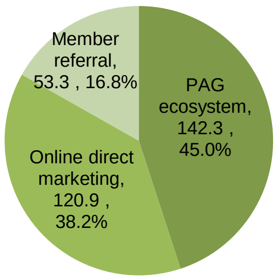
In 1H20, new loans facilitated by direct sale, channel partners, and online & telemarketing accounted for 48.2%, 39.8%, and 12% of total volume, respectively. Of the facilitated loans by channel partners, 92.8% in 1H20 came from the PAG ecosystem, implying that 36.9% of total new loans facilitated in 1H20 were from the PAG ecosystem, as compared to 23.3% in 2017.

Exhibit 36: Client assets ex. legacy products by channel (RMB bn, 2017)



Source(s): Company, ABCI Securities

Exhibit 37: Client assets ex. legacy products by channel (RMB bn, June 2020)



Source(s): Company, ABCI Securities

Of the total client assets of current products in WM business, 45% were acquired through the PAG ecosystem (vs. 33.1% in 2017). Total client assets rose from RMB 122.1bn in 2017 to RMB 316.5bn in June 2020. In addition, clients attained through the PAG ecosystem are of quality - the average client assets per active investor stood at RMB 32,228 as of June 2020, higher than RMB 30,387 for online direct marketing and RMB 12,658 for member referral.

Although we regard concrete support from PAG as Lufax's core competitive edge, increasing reliance on PAG, however, may expose Lufax's to potential risk. If PAG reduces its support in the future, the Group's core business lines could be materially affected. In addition, 91.2% of the outstanding loan balance in Lufax was insured by PA P&C as of June 2020. Should PAG reduce the insured level, Lufax will need to take up more credit risk.

High policy risk for under-regulated internet finance business

The current regulatory framework for the internet finance industry is still rudimentary since it is a relatively new business in the market. However, rapid growth in market size and increasing complexity in products and business environment has expedited changes, exposing industry participants to a higher policy risk. For instance, Lufax's RCF and WM business lines have been affected by regulatory changes in micro-lending, financing guarantee, fund products, internet finance, and advertising, among others.

Lufax is simultaneously monitored by multiple regulators, which include but not limited to the central and provincial governments, NDRC, SAFE, MoF, PBOC, CBIRC, CSRC, MIIT, etc. Key policies affecting the fields of RCF, WM business, FinTech are listed below.

Exhibit 38: Regulations highlight for RCF business

Date	Policy	Key contents
May 2008	Guiding Opinions on the Pilot Operation of Microloan Companies (PBOC, CBIRC)	- Specified business scope of microloan companies - Single borrower's loan balance <5% of net capital - Interest rate ceiling cannot exceed ceiling prescribed by the judicatory authority - Interest rate floor at 0.9 times of PBOC benchmark rates
Aug 2008	Interim Measures for the Administration of Pilot Operation of Chongqing Microloan Companies	- Principal laws governing Chongqing microloan companies
Jun 2009	Promotion of Pilot Operation of Microloan Companies (Hunan Municipality)	- sets forth requirements for setting up a microloan company, and stipulates that microloan companies shall not absorb public deposits or illegally raise funds
Aug 2009	Measures for Supervision and Management of Microloan Companies in Hunan Province (Trial)(Hunan Municipality)	- Balance of loans to the same borrower shall not exceed 5% of the net capital - Single loan granted to the same borrower by the microloan company shall not exceed 1% of its net capital
Feb 2010	The Interim Measures for the Administration of Private Loans (CBRC)	- Lenders shall not issue private loans without specified purposes - Lenders shall only entrust certain part of loan investigation to qualified third-party companies and shall not entrust the whole process of loan investigation to third-party companies
Mar 2010	Tentative Measures for the Administration of Financing Guarantee Companies (CBRC, NDRC, MIIT, MoF, Ministry of Commerce, PBOC, and the State Administration for Market Regulation)	- Stipulated the registered capital, business scope, operating rules, risk control and supervision of financing guarantee companies - Outstanding balance of financing guarantee liabilities of the financing guarantee company <10 times of its net assets
Sep 2011	Administrative Rules of Shenzhen Microloan Companies (Trial) (Shenzhen Government)	- Microloan companies are encouraged to focus on providing credit services to SMEs, individual industrial and commercial households, and individual entrepreneurs - Loans to the same borrower shall not exceed 5% of the net capital - Upper limit of the balance for the same borrower is RMB 5mn - Upper limit of the loan interest rate shall not exceed the upper limit prescribed by national policies and relevant regulations - Lower limit is 0.9 times the benchmark interest rate PBOC
June 2012	Interim Measures for the Financing Supervision of Chongqing Microloan Companies (Chongqing Municipal Finance Office)	- Financing balance of a microloan company in Chongqing <230% of its net capital
2013	Measures for the Pilot Management of Consumer Finance Companies (CBRC)	- Stipulate the conditions for the investor of the consumer finance company, its business scope, and operating rules
Feb 2014	Notice on Shenzhen Microloan Companies Launching Innovation Business (Shenzhen Government)	- Total proportion of funds incorporated through external compliant channels <200% of the company's net assets in the previous year
Feb 2014	Pilot of the Financing Innovation of Shenzhen Microloan Companies (Shenzhen Government)	- Microloan companies could finance from banks, Qianhai equity trading exchange, Qianhai financial assets exchange and other approved platforms - Total funds financed through the external compliance channels into the proportion of <200% of the company's annual net assets - Lending capital through interbank placements <30% of the net assets of the previous year

Source(s): ABCI Securities

Exhibit 39: Regulations highlight for WM business

Date	Policy	Key contents
Aug 2014	Interim Measures for the Supervision and Administration of Private Investment Funds (CSRC)	- Define private investment funds as investment funds raising capitals from qualified investors in a non-public channel - Specified qualified investor system
Apr 2015	The Securities Investment Fund Law of PRC (NPC Standing Committee)	- Governs the administration and supervision of securities investment funds, which includes private investment funds
Feb 2016	Administrative Measures on Supervision of Money Market Funds (CSRC, PBOC)	- Define money market fund as a fund invested in money market instruments and authorized to subscribe for and redeem fund shares on each trading day - Limit fund sales promotion, share offering, subscription, redemption or other related activities to carry out only with qualifications granted by CSRC
July 2016	Administration Measures for the Fund Raising of Private Investment Funds (AMAC)	- Only two kinds of institutions are qualified to conduct fund raising for private investment funds: (a) private fund managers registered with the AMAC ; and (b) fund distributors with a fund distribution license who are AMAC members
Apr 2018	Guideline on Asset Management Business of Financial Institutions (PBOC, CSRC, CBIRC, SAFE)	- FIs shall independently manage an asset management product - Proposes the definition and classification of the asset management and asset management products - Divides the investors of asset management products into non-specific social public and qualified investors
Jan 2020	Notice on Further Regulating Financial Marketing and Publicity Activities (PBOC, CSRC, CBIRC, SAFE)	- Stipulate that entities without relevant financial business license shall not carry out marketing and publicity activities in relation to that business
Aug 2020	The Supervisory and Administrative Measures on Sales Agencies of Open-ended Securities Investment Funds (CSRC)	- Sales agencies share of the fund management companies' management fee for retail investors <50%; for corporate investors <30%

Source(s): ABCI Securities

Exhibit 40: Regulations highlight for internet finance and other areas

Date	Policy	Key contents
Jul 2015	Guidelines on Promoting the Sound Development of Internet Finance (PBOC, MIIT, CBRC)	- Defines the internet finance as a new financial business model whereby traditional FIs and internet enterprises use internet technology and information and communications technology to provide loans, payments, investments and information intermediary services
Feb 2016	Administrative Measures on Supervision of Money Market Funds (CSRC, PBOC)	- No person may engage in the fund sales promotion, share offering, subscription, redemption or other related activities without relevant fund sales business qualifications granted by CSRC
Apr 2016	Promulgation of Implementation Plan for the Special Rectification regarding Internet Insurance Risks (PBOC, CIRC, CSRC and other authorities)	- Any internet company conducting asset management business shall be ordered by the competent authority to rectify
Jun 2017	Notice on the Clean-up and Reorganization of Illegal Business in Cooperation with Internet Platforms and Various Trading Venues (Internet Finance Office)	- Supervision of the internet platform and trading venues shall order internet platforms within the jurisdiction to stop illegal business before July 15, 2017 and properly resolve any illegal stock business
Mar 2018	Notice on Increasing the Strengthening of the Asset Management Business Remediation and the Acceptance Work via the Internet (Office of the Leading Group of Special Rectification of Internet Financial Risks)	- Non-FIs are not allowed to issue or sell asset management products
Jun 2018	Further Regulating the Internet Sales and Redemption of Money Market Funds (CSRC, PBOC)	- Unlicensed institutions are prohibited from retaining investor fund sales information
Feb 2019	Administrative Regulations on Blockchain Information Services (State Internet Information Office)	- Regulates information services provided to the public through internet sites, applications and other means based on blockchain technology or systems
Feb 2021	Administrative Measures for Credit Investigation (Draft for comments) (PBOC)	- Licensing of personal credit investigation activities

Source(s): ABCI Securities

Following the acceleration of financial reform in China over the past decades, the central government, the local governments, and the regulators have rolled out numerous rules and regulations. These policies, usually prescribed with a reasonably sufficient transitionary period, are formulated to manage issues in the following aspects : 1) definition of a business or product, 2) qualification and administration in each business or product, 3) risk control through setting regulatory requirements in interest/fee rates, competition, key operation ratios, the degree of business concentration and funding channels for the business.

With Lufax's expanding business scope, product range, and increased product complexity, relevant policy risk would rise. The timing of these regulatory changes, which can potentially have significant impacts on Lufax's business model and financial performance, are highly unpredictable. Nevertheless, with PAG's sophistication in rules and compliance and Lufax's practice of maintaining a close communication with regulators, the Group will be in a better position than other TechFin players in tackling with policy changes.

Potential policy risks of Lufax are listed below.

1) Given the lending in RCF and transaction fees in WM, the regulatory environment of internet finance companies, including Lufax, may be getting more similar to that of the commercial banks, meaning that they will be subject to capital, liquidity, and asset quality requirements.

2) Downward risk in take rates, fee rates, and interest rates for small lenders is increasing. Given the policy direction to reduce social financing cost, APR cap of small lenders may fall from the 24% at present, which could materially affect Lufax's core income.

3) Similarly, according to the management guideline on mutual fund sales effective Oct 1, 2020, client maintenance fee charged by the distribution platform cannot be higher than 50% of the management fee. Further control on management fee rate and the share rate of distribution platform could affect Lufax's income from its core sources.

4) As of 2020, only 78.3% of Lufax's new loan facilitated was off-balance sheet (off-B/S). Together with the off-B/S WMP facilitation, regulations on shadow banks could indirectly affect Lufax's current business model and accounting method in use.

5) The unpredictable development of Sino-US dispute could hamper Lufax's listing status in the US.

Financial forecasts

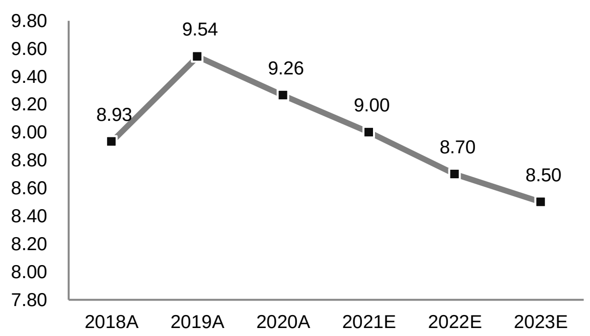
Significant growth and sound profitability

Lufax's financials in 2017-19 was marked by solid growth and profitability. Total loans facilitated grew at a 26.6% CAGR over the period; total WM client assets, excluding legacy products, grew at a 39.4% CAGR. Meanwhile, total income and net profit grew at 31.1% and 49.5% CAGRs over 2017-19. Net margin also rose from 21.7% in 2017 to 27.8% in 2019, driven by the expanded business scale and improving efficiency.

In our base case scenario, we project topline revenue to grow at a 14.9% CAGR over 2020-23E on increases in loan facilitation scale and client AUM. By revenue component, technology platform-based income (RCF and WM fees) would grow by 10.8% CAGR; specifically, WM fees would rise at 14.9% CAGR compared to 10.6% CAGR for RCF fees during the period.

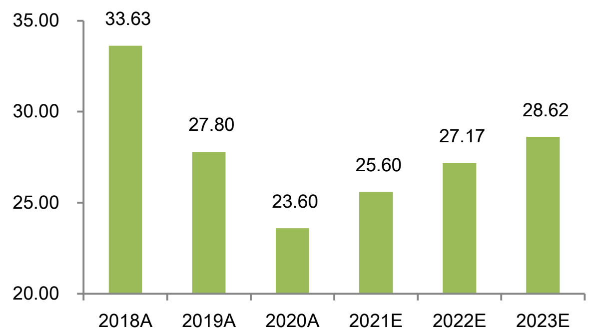
Given the cash-rich position after the IPO, we project loan balance to expand at a 21.8% CAGR 2020-23E. This would support a 30.8% CAGR in NII over the same period. NII mainly reflects its interest income from loans to consolidated trust plans and micro-lending. On the back of interest rate down cycle in China and policy direction to lower social financing cost, we expect blend average loan yield to lower by 20bps-30bps each in 2021E-23E to 8.5% by 2022E.

Exhibit 41: Lufax's blended average loan yield (%)



Source(s): Company, ABCI Securities estimates

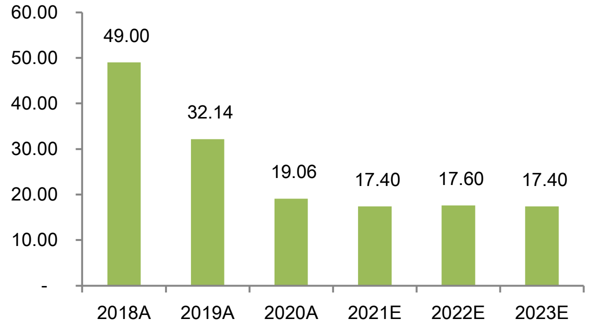
Exhibit 42: Lufax's net margin (%)



Source(s): Company, ABCI Securities estimates

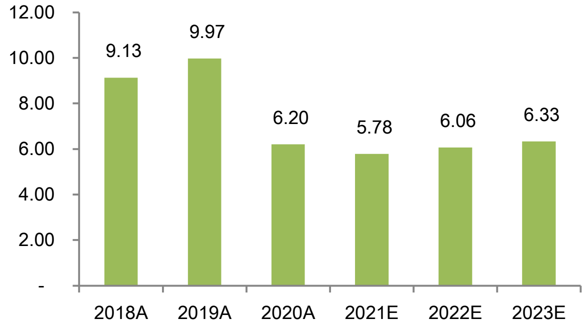
With a topline CAGR at 14.9% and the total expenses CAGR at 10.2%, Lufax' net margin would bottom at 23.6% in 2020 as a result of large provision made for the year due to COVID-19. As the economy recovers and operation efficiency improves, net margin would gradually rise to 28.62% by 2023E, supporting a net profit CAGR of 22.3% over 2020-23E. In fact, signs of rebound have started to show since 4Q20 when net profit grew by 18.9% YoY on the back on lower credit impairment and tax expenses. With the steady recovery of the economy in China, we expect profitability to rise further on better momentum in core businesses in 1Q21. Nonetheless, our assumptions are valid on the scenario that there will be no substantial changes in the regulatory environment.

Exhibit 43: Lufax's ROAE (%)



Source(s): Company, ABCI Securities estimates

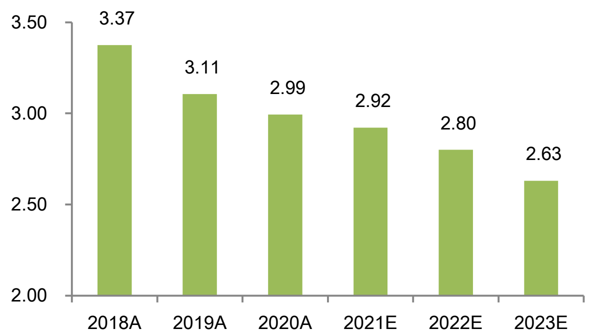
Exhibit44: Lufax's ROAA (%)



Source(s): Company, ABCI Securities estimates

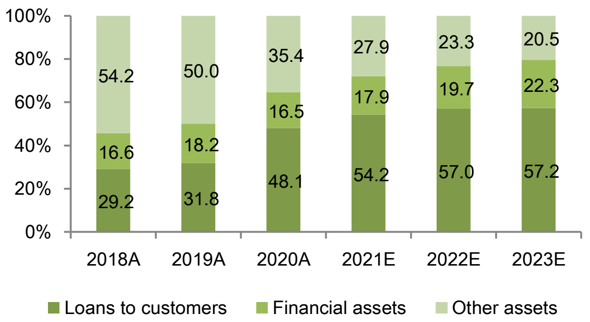
With a capital-light business mode, Lufax had a much higher profitability compared to traditional commercial banks whose system ROAE and ROAA were 10.05% and 0.8% in 3Q20, according to the CBIRC data. The Group achieved a ROAE of 49.0% and 32.1% in 2018 and 2019, and a ROAA at 9.1% and 10.0% in 2018 and 2019. With the expanded capital base post-IPO, we forecast ROAE and ROAA to be in the range of 17.4%-17.6% and 5.78%-6.33% over 2021E-23E. Lufax's asset-to-equity ratio would be in the range of 2.63x-2.92x over 2021E-23E, reflecting a low leverage level in general.

Exhibit 45: Lufax's asset-to-equity ratio (x)



Source(s): Company, ABCI Securities estimates

Exhibit 46: Lufax's asset mix (%)



Source(s): Company, ABCI Securities estimates

On the balance sheet, we forecast total assets and total liabilities to expand at 14.9% and 12.2% CAGRs in 2020-23E. Although Lufax's exposure to credit risk from the loans and WMP facilitated is low, but it takes on the credit risk from loans to trust plans and investments. As of Dec 2020, loans to customers and financial assets accounted for 48.1% and 16.5% of total assets, indicating a certain level of credit and investment risks.

Valuation

Initiate with BUY; TP at US$21.45 per ADS

Although a large proportion of Lufax's business came from transaction-based income sources, we regard its operation as balance sheet-based given its lending-plus-fee income nature. We use the Gordon Growth Model (GGM) as a primary valuation method for the Group.

We derive our TP at US$21.45 per ADS, and initiate with a **BUY** rating. Our TP implies 3.47x 2021E P/B, or 21.75x 2021E P/E, justified by Lufax's strategic market positioning, competitive edge with PAG's support, fast growth and its higher ROAE than traditional commercial banks. Nonetheless, we are cautious of the high policy risk in the sector.

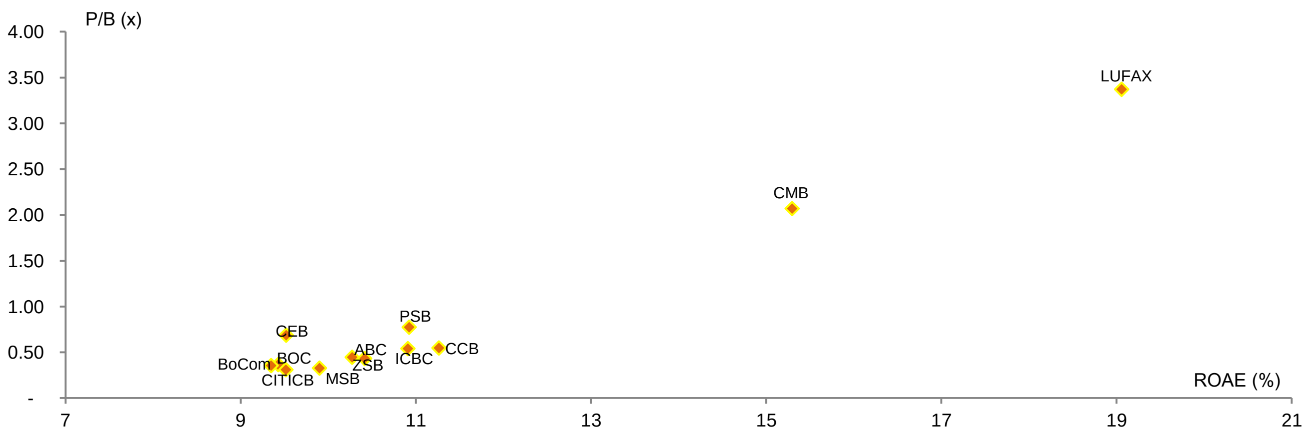
Based on our estimates, net profit would grow at 22.3% CAGR over 2020-23E. Topline revenue would increase by 14.9% CAGR over the same period while net margin would improve to 28.62% by 2023E. ROAA and ROAE would be in the ranges of 5.78%-6.33% and 17.4%-17.6% for 2021E-23E. We assume Lufax will not declare dividend in 21E-23E.

GGM assumptions

Our base case calculation assumes:

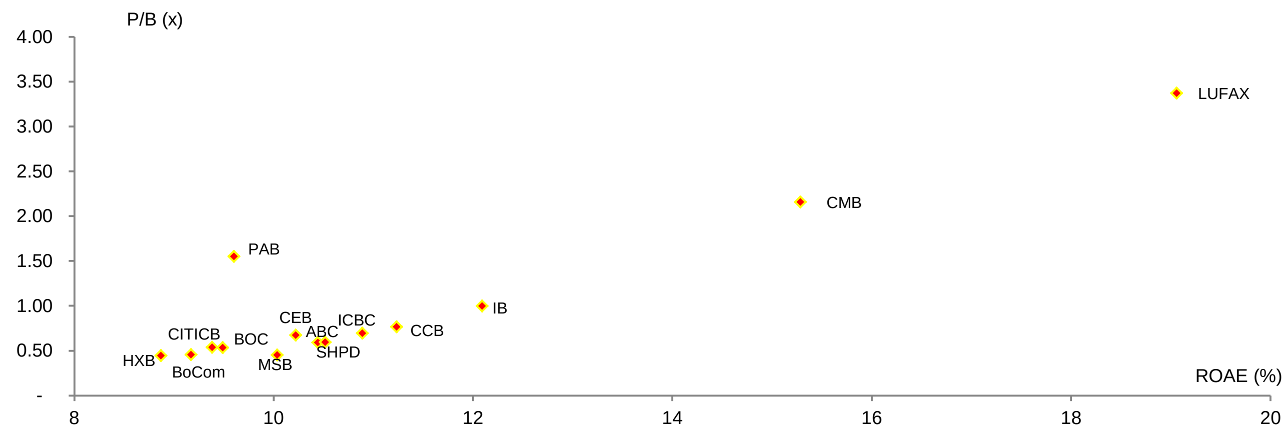
1. A sustainable ROAE of 16.9% (assume 1% below simple average of Lufax's ROAE from 2020 in our model);
2. A cost of equity (COE) of 10.2%;
3. A risk-free rate 3.15% (10-year Chinese government bond);
4. An equity beta of 0.82 (reference to US listed comparable);
5. An equity risk premium of 8.6% (reference to Bloomberg);
6. A long-term growth of 7.5% (assuming higher growth than that of China's nominal GDP).

Exhibit 47: 2020 P/B vs. ROAE with H-share banks



Source(s): Bloomberg, ABCI Securities

Exhibit 48: 2020 P/B vs. ROAE with A-share banks



Source(s): Bloomberg, ABCI Securities

Based on the P/B vs. ROAE analysis that compares Lufax with traditional commercial banks in the A/H share markets (based on Bloomberg consensus data), the Group has a higher P/B than the A&H share banks –this is well justified by its outstanding ROAE. Similar to CMB (3968 HK/600036 CH), which has the highest P/B among A/H share banks, also attains the highest ROAE among the bank peers.

Internet finance and WM companies comparable to Lufax in the US market include 360 Digitech (QFIN US), Lexin (LX US), and Noah (NOAH US). Although Lufax's ROAE is not the highest among this group, we believe its valuation premium over peers is supported by its integrated business platform covering both RCF and WM businesses, solid support from PAG, and the larger balance sheet (2019 total assets: RMB 149,534mn vs. the peer range of RMB 9,803mn-20,356mn).

Sector valuation summary (Data as of Feb 5, 2021)

Company	Ticker	Rating	Price (US$)	TP (US$)	Upside (%)	FY20E P/B(x)	FY21E P/B (x)	FY20E P/E (x)	FY21E P/E (x)	FY20E ROAE (%)	FY21E ROAE (%)
Lufax	LU US	BUY	17.35	21.45	23.63	3.37	2.80	20.17	17.60	19.06	17.40
360 Digitech	QFIN US	NR	19.91	na	na	2.02	1.48	5.74	4.94	38.81	33.47
Lexin	LX US	NR	9.99	na	na	1.80	1.36	16.83	5.67	11.28	28.94
Noah	NOAH US	NR	50.05	na	na	2.36	2.13	19.56	17.44	12.69	12.37

* USD/CNY = 6.5 throughout this report unless otherwise stated
Source(s): Bloomberg, ABCI Securities estimates

Risk factors

Operation risk

The retail credit and WM industries in China are rapidly changing. There is no proven business model given the rapidly evolving internet finance sector with a limited no. of market participants. Changes in competition direction and landscape could affect Lufax's future financial performance.

Meanwhile, Lufax's business model from business generation, credit assessment, collection, and risk management rely heavily on the Group's internal system, technology, big data, and AI. System interruption and ineffective data analysis could adversely affect the Group's daily operation and elevate business risk.

Policy risk

We believe the internet finance sector entails a high policy risk. Regulatory framework governing retail credit and WM industries are expected to be expedited, yet the rollout of relevant policies, in terms so timing and directions, are highly unpredictable. Therefore, Lufax's ability to adjust its business model promptly and apply for relevant license required by regulators would be essential to survival. Nevertheless, a tightly regulated business environment would benefit all market participants in the long run. (Please also refer to pg.21 of this report: Potential policy risk of Lufax).

Asset quality risk

Lufax's business model is closely connected with the credit cycle in China, both in growing pace and asset quality. Changes in credit cycles associated with volatility in the economy will affect the Group's business in both credit facilitation and WM. As of Dec 2020, Lufax had a DPD+30 delinquency rate of 2.3% and 0.7% for unsecured loans and secured loans, compared to an average NPL ratio of 1.96% for commercial banks. Also, we perceive the Group has a low direct asset quality risk as only 0.7% of new loans in 1H20 were funded by Lufax.

Meanwhile, the Group bears the credit risk on loans for trust plans and hold investment position. As of Dec 2020, on-B/S loans and financial assets accounted for 48.1% and 16.5% of the Group's total assets. These balances are subject to relevant market risk and default risk; the occurrence of impairments could substantially affect the Group's earnings.

Risk related to COVID-19

Lufax's resilience and fundamental strengths were proven during COVID-19. DPD 30+ delinquency rate of unsecured loans increased from 1.8% in 2019 to 3.3% in June 2020 before going down to 2.3% by Dec 20; DPD 30+ delinquency rate for secured loans increased from 0.6% in 2019 to 1.4% in June 2020 before falling to 0.7% by Dec 2020. Also, remote work, AI collection technology and AI underwriting robots were deployed during the lockdown of China in end-Jan 2020 to minimize operational disruptions.

High reliance on major shareholder

The Group has an extensive history and a close business relationship with PAG. Strategic partnership between the two has been greatly enhanced over the past years. Deterioration of its relationship with PAG or major changes in cooperation structure between the two could adversely affect Lufax's business and growth outlook

Foreign exchange risk

As Lufax's major overseas entities are holding USD as a functional currency, the Group is exposed to forex risk. Nevertheless, as the majority of the Group's business remains onshore, we estimate its exposure to forex risk is manageable. However, if the level of globalization accelerates, forex risk would increase.

Exhibit 49: Sensitivity of profit before tax to changes in exchange rate

RMB mn	2017	2018	2019
RMB +5%	1	13	15
RMB -5%	(1)	(13)	(15)

Source(s): Company

Interest rate risk

As Lufax has a balance sheet-based business model, the Group is exposed to interest rate risk for its loans to customers and financial assets on the asset side, in addition to borrowings, debt and interest-bearing instruments issued.

Exhibit 50: Sensitivity of profit before tax to changes in interest rate

RMB mn	2017	2018	2019
-100 bps	42	(231)	(318)
+100 bps	(42)	231	318

Source(s): Company

Financial statements

Consolidated income statement

FY Ended Dec 31 (RMB mn)	2019A	2020A	2021E	2022E	2023E
RCF services	39,325	39,457	43,019	48,068	53,400
WM transaction and services	2,604	1,765	1,706	2,079	2,679
Total technology platform based income	**41,929**	**41,222**	**44,726**	**50,147**	**56,079**
NII	3,909	7,750	12,510	15,206	17,325
Guarantee income	465	602	752	925	1,129
Other income	879	1,517	1,911	2,332	2,798
Investment income	579	940	1,128	1,331	1,544
Share of NP of equity accounting investments	73	15	16	18	20
Total income	**47,834**	**52,046**	**61,043**	**69,958**	**78,894**
Sales and marketing	(14,931)	(17,814)	(20,486)	(23,149)	(25,695)
G&A	(2,853)	(2,976)	(3,095)	(3,187)	(3,251)
Operating and servicing	(5,471)	(6,031)	(6,484)	(6,937)	(7,354)
Technology and analytics	(1,952)	(1,792)	(1,702)	(1,617)	(1,536)
Credit impairment	(1,863)	(3,035)	(3,490)	(3,944)	(4,339)
Asset impairment	(135)	(7)	(9)	(10)	(12)
Finance cost	(1,520)	(2,866)	(3,296)	(3,757)	(4,208)
Others	325	384	480	586	691
Total expenses	**(28,400)**	**(34,136)**	**(38,081)**	**(42,016)**	**(45,703)**
PBT	**19,434**	**17,910**	**22,963**	**27,942**	**33,191**
Tax	(6,117)	(5,633)	(7,233)	(8,802)	(10,455)
Net profit	**13,317**	**12,276**	**15,730**	**19,141**	**22,736**
MI	(15)	(78)	(105)	(131)	(158)
Net profit attributed to shareholders	**13,332**	**12,354**	**15,624**	**19,009**	**22,578**
Growth (%)					
RCF services	33.0	0.3	9.0	11.7	11.1
WM transaction and services	(1.6)	(32.2)	(3.3)	21.8	28.9
Total technology platform based income	**30.1**	**(1.7)**	**8.5**	**12.1**	**11.8**
NII	(33.7)	98.3	61.4	21.6	13.9
Guarantee income	(42.9)	29.4	25.0	23.0	22.0
Other income	73.0	72.6	26.0	22.0	20.0
Investment income	(43.1)	62.3	20.0	18.0	16.0
Share of NP of equity accounting investments	58.7	(79.7)	10.0	10.0	10.0
Total income	**18.1**	**8.8**	**17.3**	**14.6**	**12.8**
Sales and marketing	38.7	19.3	15.0	13.0	11.0
G&A	2.0	4.3	4.0	3.0	2.0
Operating and servicing	25.3	10.2	7.5	7.0	6.0
Technology and analytics	17.7	(8.2)	(5.0)	(5.0)	(5.0)
Credit impairment	99.3	62.9	15.0	13.0	10.0
Asset impairment	1,828.6	(94.7)	20.0	17.0	15.0
Finance cost	68.9	88.5	15.0	14.0	12.0
Others	(177.5)	18.2	25.0	22.0	18.0
Total expenses	**30.0**	**20.2**	**11.6**	**10.3**	**8.8**
PBT	**4.2**	**(7.8)**	**28.2**	**21.7**	**18.8**
Tax	20.6	(7.9)	28.4	21.7	18.8
Net profit	**(1.9)**	**(7.8)**	**28.1**	**21.7**	**18.8**
MI	(65.3)	409.4	35.0	25.0	20.0
Net profit attributed to shareholders	**(2.1)**	**(7.3)**	**26.5**	**21.7**	**18.8**

Notes: Individual items may not sum to total due to rounding difference and may not equal to financial statements due to reclassification
Source(s): Company, ABCI Securities estimates

Consolidated balance sheet

As of Dec 31 (RMB mn)	2019A	2020A	2021E	2022E	2023E
Cash at bank	7,352	24,259	18,194	14,555	12,372
Restricted cash	24,603	23,030	24,181	25,632	27,426
Financial assets at FVTPL	18,583	34,424	46,472	61,343	79,746
Financial assets at amortized cost	8,623	6,564	5,579	4,910	4,419
Repo assets	-	700	910	1,138	1,365
Accounts, other receivables and contract assets	26,296	23,326	20,993	19,314	18,155
Loans to customers	47,499	119,826	158,170	191,386	216,266
Other assets	16,578	16,762	17,098	17,525	18,051
Total assets	**149,534**	**248,890**	**291,598**	**335,803**	**377,800**
Payable to platform investors	15,344	9,115	10,026	11,230	12,802
Borrowings	2,990	10,315	11,863	13,642	15,689
Account, other payables and contract liabilities	4,826	5,484	6,142	6,817	7,499
Payable to investors of consolidated structured entities	47,243	110,368	132,441	153,632	172,068
Financial guarantee liabilities	243	749	1,086	1,466	1,905
Convertible promissory note payable	10,014	10,117	10,218	10,321	10,424
Convertible redeemable preferred shares	10,259	-	-	-	-
Optionally convertible promissory notes	-	7,531	7,681	7,835	7,991
Other liabilities	10,469	12,061	12,315	10,937	5,806
Total liabilities	**101,388**	**165,739**	**191,773**	**215,879**	**234,184**
Share capital and share premium	**14,113**	**33,214**	**33,214**	**33,214**	**33,214**
Treasury shares	(0)	(0)	(0)	(0)	(0)
Other reserve	4,582	7,419	8,309	9,223	10,145
Retained earnings	29,346	40,928	56,552	75,561	98,140
Total equity (excl MI)	**48,042**	**81,560**	**98,074**	**117,998**	**141,498**
MI	104	1,592	1,751	1,926	2,118
Total equity	**48,145**	**83,151**	**99,825**	**119,923**	**143,617**
Growth (%)					
Cash at bank	(60.4)	230.0	(25.0)	(20.0)	(15.0)
Restricted cash	210.0	(6.4)	5.0	6.0	7.0
Financial assets at FVTPL	13.0	85.2	35.0	32.0	30.0
Financial assets at amortized cost	177.4	(23.9)	(15.0)	(12.0)	(10.0)
Repo assets	na	na	30.0	25.0	20.0
Accounts, other receivables and contract assets	30.9	(11.3)	(10.0)	(8.0)	(6.0)
Loans to customers	38.0	152.3	32.0	21.0	13.0
Other assets	(4.3)	1.1	2.0	2.5	3.0
Total assets	**26.8**	**66.4**	**17.2**	**15.2**	**12.5**
Payable to platform investors	56.3	(40.6)	10.0	12.0	14.0
Borrowings	(38.9)	245.0	15.0	15.0	15.0
Account, other payables and contract liabilities	(22.7)	13.6	12.0	11.0	10.0
Payable to investors of consolidated structured entities	48.5	133.6	20.0	16.0	12.0
Financial guarantee liabilities	(11.4)	208.4	45.0	35.0	30.0
Convertible promissory note payable	9.6	1.0	1.0	1.0	1.0
Convertible redeemable preferred shares	14.8	(100.0)	-	-	-
Optionally convertible promissory notes	na	na	2.0	2.0	2.0
Other liabilities	(9.5)	15.2	2.1	(11.2)	(46.9)
Total liabilities	**22.2**	**63.5**	**15.7**	**12.6**	**8.5**
Share capital and share premium	**0.0**	**135.3**	**-**	**-**	**-**
Treasury shares	100.0	-	-	-	-
Other reserve	0.1	61.9	12.0	11.0	10.0
Retained earnings	80.7	39.5	38.2	33.6	29.9
Total equity (excl MI)	**37.5**	**69.8**	**20.2**	**20.3**	**19.9**
MI	454.3	1,433.3	10.0	10.0	10.0
Total equity	**37.8**	**72.7**	**20.1**	**20.1**	**19.8**

Notes: Individual items may not sum to total due to rounding difference and may not equal to financial statements due to reclassification
Source(s): Company, ABCI Securities estimates

Other financial data (2018A-2022E)

FY Ended Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Key ratios (%)					
ROAA	9.97	6.20	5.78	6.06	6.33
ROAE	32.14	19.06	17.40	17.60	17.40
CIR	59.37	65.59	62.38	60.06	57.93
Net margin	27.80	23.60	25.60	27.17	28.62
Asset/equity	3.11	2.99	2.92	2.80	2.63
DPD 30+ delinquency rate	1.60	2.00	1.90	1.80	1.70
DPD 90+ delinquency rate	0.80	1.20	1.10	0.90	0.80
Effective tax rate	31.48	31.45	31.50	31.50	31.50
Dividend payout ratio	-	-	-	-	-
Per share (RMB)					
Basic EPS	12.27	11.19	12.82	15.59	18.52
BVPS	42.80	66.91	80.45	96.80	116.08
DPS	-	-	-	-	-
Per ADS (RMB)					
Basic EPS	6.14	5.59	6.41	7.80	9.26
BVPS	21.40	33.45	40.23	48.40	58.04
DPS	-	-	-	-	-
Growth (%)					
Per share (RMB)					
Basic EPS	(3.0)	(8.8)	14.5	21.7	18.8
BVPS	35.7	56.3	20.2	20.3	19.9
DPS	-	-	-	-	-
Per ADS (RMB)					
Basic EPS	(3.0)	(8.9)	14.6	21.7	18.8
BVPS	35.7	56.3	20.2	20.3	19.9
DPS	-	-	-	-	-

Notes: Individual items may not equal to financial statements due to reclassification
Source(s): Company, ABCI Securities estimates

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Definition of equity rating

Rating	Definition
Buy	Stock return rate≥ Market return rate (~10%)
Hold	- Market return rate (~-10%) ≤ Stock return rate < Market return rate (~+10%)
Sell	Stock return < - Market return (~-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2008 (For reference: HSI total return index 2008-20 CAGR at 9.2%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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