

More a Bank or More a Tech Company ——A Case Study of 360 DigiTech

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Abstract:

The research paper discussed the opportunities and challenges that fintech companies may face during the secondary listing process, including the current situation of China concepts stock and the comparison between different choices they may face during the secondary listing listed in Hong Kong. The paper discussed the advantages and disadvantages of 360 DigiTech's choice of conducting secondary listing in the Hong Kong Market to generate insights.

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1. Introduction

On November 29, 360 DigiTech has successfully listed on the Hong Kong Exchanges and Clearing (HKEX), becoming the first listed Credit Technology platform to complete a secondary listing. Priced at HK \$50.03, it opened at HK \$50.6 on its first day of trading and closed at HK \$51.75, up 3.44%.

China Concept Stock is stocks listed in US but conduct actual business and assets in China. After years of development, about 280 China Concept Stock companies have been listed on various exchanges in the United States, including many new economy companies. With the listing of Chinese concept stocks in the United States, there are major uncertainties, and there are many high-quality companies among Chinese concept stock companies, which naturally become the target of competition for various exchanges.

2. Overview of Fintech Shares

1.1 The economic resurgence:

Following the major optimization and adjustment of the epidemic prevention and control policy, the focus of the Chinese government has shifted to stable growth, and various positive factors have boosted the market. The GDP growth is expected to pick up, especially the strong economic recovery momentum in the second half of 2023. The domestic epidemic prevention and control measures ushered in a series of optimization and adjustment.

China's monetary policy is expected to remain loose in 2023, because we believe that the road to economic restart will be gradual and bumpy, while the restrained demand is weak, and the inflation risk is low. Even if inflation rises sharply at the beginning of the re-opening, we also believe that the driving factor behind it will be the supply interruption rather than the strong demand. Before the economy is fully restarted, the People's Bank of China is expected to maintain a loose monetary policy stance and will probably increase the stimulus to cope with the situation of rising infection cases and significantly weakening demand. In view of the limited space for further reduction of reserve requirements and interest rates, the central bank is expected to continue to expand the scale of its balance sheet through the offering of MLF, PSL and refinancing.

1.2 The succeed in serving consumers and small business owners to meet their financing needs. In 2016, 360 Financial Services began to provide small consumer loan products to consumers whose financing needs were not met by traditional financial institutions. At the end of 2020, the company launched loan assistance services for small and micro business owners. The company mainly relies on online channels to gain customers and is also exploring offline channels to expand the loan business of small and micro enterprises. The financing parties of the loans initiated through the 360 Digital Science Platform are mainly financial institutions. By the end of 2020, 360 Digital has reached cooperation with 99 financial institutions, including national and regional banks and consumer finance companies.

1.3 Industry regulatory uncertainty is weakening

Since the second half of 2020, the uncertainty of the regulatory prospects of the Internet finance industry has become a major adverse factor affecting the performance of the industry's share price. We believe that the borrowing costs, capital requirements, consumer protection and credit reporting business of Internet loan companies are the areas that investors pay most attention to.

Long before this round of large-scale tightening of regulation, regulators have begun to tighten the regulation of the Internet finance industry in the field of retail credit. Since November 2020, Chinese regulators have issued a series of regulatory documents; In 2021, some Internet platform leaders involved in financial business carried out business rectification according to regulatory requirements.

At present, the regulatory uncertainty is gradually weakening in the middle of the industry consolidation, which may support the moderate repair of the valuation of the listed Internet loan leader. We believe that the tightening of regulation may lead to a slowdown in the growth of new loans in the industry from 2022 to 2023, but the strict regulation also raises the threshold of the industry, which may squeeze the space of some smaller participants, which is conducive to the long-term sustainable development of compliant large and medium-sized Internet finance companies.

The guidance and stricter supervision of the regulators on the rectification of the Internet finance industry emphasize the financial nature of Internet finance. The financial business of the Internet platform is subject to the same regulatory requirements as traditional financial institutions. The boundary between finance and technology is clearer. At present, the main fields of financial business of the technology platform, including payment, credit and credit

investigation, insurance, banking, and securities/wealth management, have all been incorporated into the financial regulatory framework. We expect that the year-on-year growth rate of social finance stock in 2023 will be around 10.5%, basically the same as that in 2022.

3. Advantages of H-share Issuing

In recent years, against the background of scarce global listing resources and the continued to intensify of strategic game between China and the US, both the Mainland and Hong Kong began to gradually relax their listing requirements around 2018, appropriately easing the listing restrictions for companies with the same share different rights and red chip structures. Further catalyzed by the U.S. SEC's continued difficulties with Chinese stocks and the Foreign Company Accountability Act, many Chinese companies have chosen to return to A-shares and Hong Kong stock markets.

According to retaining the listing status in the original listing place, there are two ways for Chinese Stock delist from the U.S. markets. The first way is privatization, delisting from the U.S. market, and then finding the opportunity to go public again in A-share or H-share. This method is mainly adapted to the State-owned Enterprise. The second way is to retain the listing status of the original listing place and return to Hong Kong markets in the form of introduction, secondary listing, dual primary listing, etc.

Compared with A-share, H-share's approval time is relatively shorter. For companies with a steady position in their market segment, HKEx is more encouraged. The Enterprise value in H-share is more widely recognized by the investors.

Figure 1: Compare Listing Between A-share and H-share

	HKEX	SZSE/SSE
Popular Industry	Biotech, Retail, 2C Tech, Cloud computing, etc.	Conform to the national strategy
Time to Market	6-8 months	Nearly 12 months
Regulatory Focus	Semi-registration system includes both information disclosure and substantive audit	Information disclosure orientated registration system
Regulatory Procedure	HKEx and SFC	CSRS and Stock Exchange
Business Record	Must have no fewer than three fiscal years of operating records management before and at least 3 fiscal years remain unchanged	Continuing operation for more than 3 years

Source: Public Information, IBSG

Figure 2: Compare of Different Listing Method

Method	Cost of Time	Financial Cost	Regulatory Risk
Secondary Listing			
Secondary Listing in Hong Kong	Low	Low	Low
Listing after Privatization			
Listing in Hong Kong after Privatization	Low	Moderate	Low
Listing in Hong Kong after Privatization and Dismantling the Red-chip Structure	Moderate	High	Low to Moderate
Red-chips List in Mainland after Privatization	High	High	Moderate
Listing in Mainland after Privatization	Moderate to High	Moderate	Moderate
Back-door Listing in Mainland after Privatization	Moderate to High	Moderate to High	Moderate
Dual Listing			
Hong Kong IPO	Low	Moderate	Low
Red-chips Mainland IPO	-	Low to Moderate	High
Mainland IPO	-	Low to Moderate	High

Source: Public Information, IBSG

By comparing the above, it is easy to see that there are not many options for Chinese stocks in the Asian market, especially in specific industries, such as financial technology and education, which are not encouraged by the mainland exchanges. For Chinese stocks looking for another way out, certainty is always the priority, in addition to the cost of time or money to go public. For this reason, secondary listing in the Hong Kong market may be the best solution for fintech companies such as 360 Digital Technology, which can avoid regulatory risks and gain market and investor recognition besides reasonable valuation. Some other examples choosing Hong

Kong market as the secondary listing place are ANT GROUP CO., LTD., Oneconnect and Lufax Holding Ltd (planning stage).

4. Case Study of 360DigiTech

4.1 Background information:

4.1.1 Positioning and value of the business

360 DigiTech. Inc. is a leading credit-tech business in China, founded in 2016 and starting by the name 360 Finance. It is ranked the 3rd largest consumer credit-tech platform in China, behind Ant Group and JD.com. The fact that it is coupled in partnership with 360 group which specializes in cyber security guarantees an advantage in customer acquisition, funding optimization, risk assessment and post-lending management.

Via its Credit-Tech services to financial institutions, the company has devoted itself throughout the years to increasing the personalization and accessibility of credit services for consumers and SMEs. By empowering financial institutions across different stages in the lone lifecycle, including deploying technology to identify diverse needs of individual borrowers and SMEs that can't be satisfied by traditional loans, cross-channel-assessing of borrowers' creditworthiness, and enhancing the effectiveness of debt recollection.

The targets of their service are mainly Financial Institutions, consumers, and SMEs.

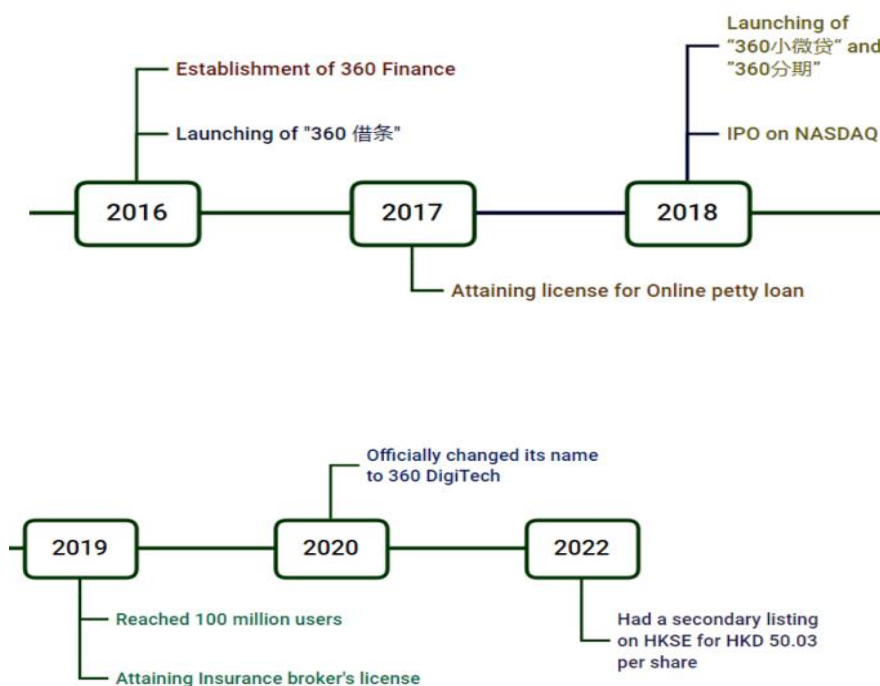
Figure 3: Targets of 360 DigiTech's services

	Characteristics	Services
Financial Institutions	National And Regional Banks Consumer Finance Companies	Real-Time Automatic Borrower Acquisition
		Enhanced Credit Screening
		Post-Facilitation Services
Consumers	With Promising Growth Potentials and Has Great User Lifetime Values	Identifying Borrowers with Low Delinquency Risks
		Credit Profiling
SMEs	Relatively Small in Size	Data Analytics and Credit Profiling
	Short Loan History	Designing Tailored Products Flexible, Collateral-Free and Satisfactory to The SMEs
	Insufficient Tangibles and Collaterals	

Source: 360 DigiTech Company website

4.1.2 History of development

Figure 4: History of 360 DigiTech



Source: 360 DigiTech Company website, Public Information

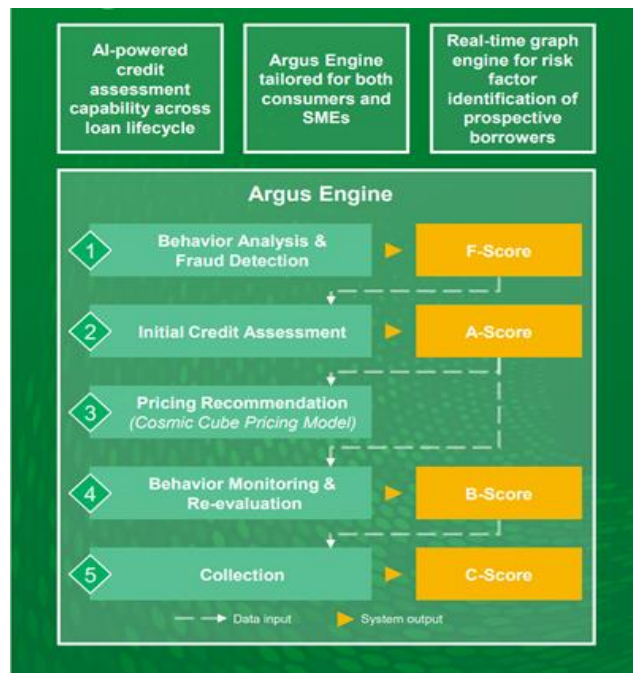
It is worth to note that, changing the name to 360 DigiTech is in line with the earlier trend in which the financial technology arm of JD changed its name to JD Digits and Ant Financial also emphasized “Technology” in its name. Behind this move, financial technology companies are shifting their strategic position from “finance” to “technology”, to distinguish themselves from common traditional online loan platforms. In the case of 360 DigiTech, it has a competitive advantage in technical services, while it accounts for growing shares of its total operating revenues. Name-changing also has a positive influence in its stock performance, while stock prices increased for more than 4.5%, focusing more on the technology side is also beneficial to its valuation. Traditional online-loan business typically has a low P/E ratio and is competing with superior customer-acquisition ability, the survival of these companies depends on outstanding risk-control, which then reflect the strength of technology.

Since its establishment, 360 DigiTech has gone through a series of reforms in services and products. As an increasing number of Fintech companies were gradually weighting finance over technology in the earlier years, 360 DigiTech together with several other large players are “Definancing” and becoming more “technology-driven” to avoid being limited by the strict regulation in the financial sector. It is moving from a pipeline company to platform company, without participating in the creation of the final value to consumers, it plays the role of linking the financial institutions and users. To be specific, the company is promoting better producibility and after-sale services. It promotes digitalization and automation in operation of traditional financial institutions, reducing cost and enhancing efficiency. Meanwhile, accessing a wider range of high-quality clients through targeting, modeling, and pre-screening, improving the risk control and help penetrate the sinking market.

4.1.3 Products and services

Argus intelligent risk control engine and Cosmic Cube pricing engine are tools developed in-house to promote the efficiency by automation in credit evaluation process and automatically monitors and adjusts interest rate pricing based on algorithms and continuously iterates the pricing model.

Figure 5: Function of the Argus Engine



Source: 360 DigiTech Company Website, Public Information

Figure 6: Three major products of the company

	Target User	Services	Advantages
360 借条	Consumer	<p>Presents personal credit status through cloud computing, machine learning, 360 Big Data and other technologies</p> <p>Dynamic credit application limit is set based on consumption habit and credit risk</p>	<p>Easy user interface, dynamic credit limit</p> <p>Integrating data from multiple channels and build social network profile to better assess credit risk</p>
360 分期	Consumer	Related to 360 借条, cooperating with third party e-commerce platforms and offer installment purchasing	Wide range of high-quality products with reliable after-sale services, large and highly active user base
360 小微贷	SMEs with unfilled credit demand, short verifiable credit history, high credit risk	Offers online application of real-time loan with moderate risk under relative higher interest rate	Supported by in house developed credit evaluation tools, it has high risk control ability

Source: 360 DigiTech Company website

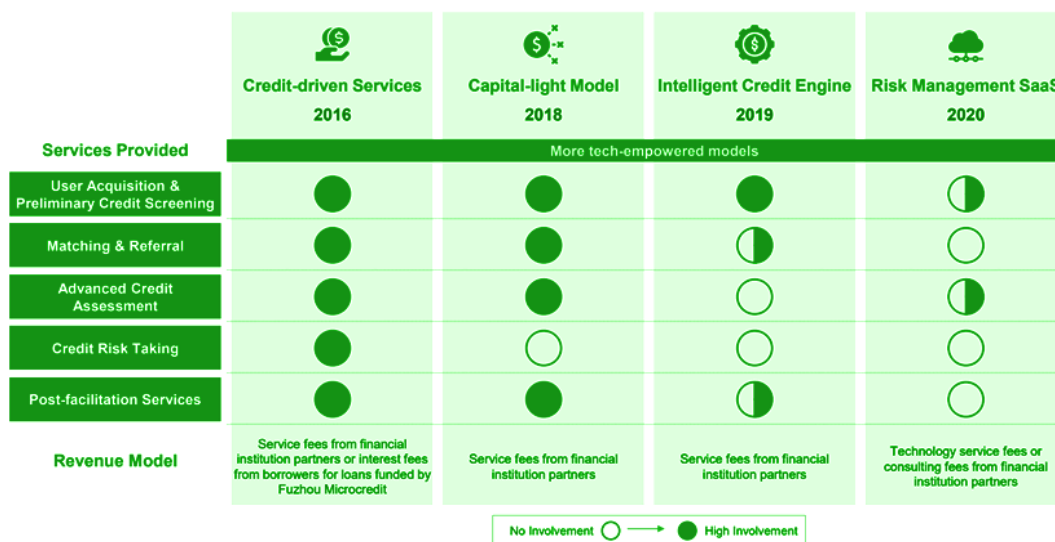
4.1.4 operation under the combination of light-asset as well as heavy-asset model:

360 DigiTech started off with mainly consumer loans and later expanded into SME loans. Under the Light-asset model, platforms like 360 DigiTech do not bear the risk, like the SAAS model in online finance, it earns major profit from sharing the revenue on a preset term with the financial institutions. While the industry average is around 30%, 360 DigiTech typically receives a larger share due to its outstanding risk control ability.

On the other hand, under the heavy-asset model, 360 bears risk as an intermediary. It provides a predetermined amount of margin to be placed at the bank, and deducts the relevant confirmed default risk loans, revenue is the part of interest income after deducting the capital cost and bad debt loss of the bank.

To reduce the risk it bears and lower the capital barrier, the company has been actively working to shift from Heavy-Asset to Light-Asset, with the latter accounting for more than 60% in 2021. The revenue for the company is stable at the 4 billion RMB for four consecutive quarters tracing back from Q3 2022, with YoY and QoQ growth of loan facilitated amount of about 13%.

Figure 7: Evolution from credit-driven platform to SAAS



Source: 360 DigiTech Company website

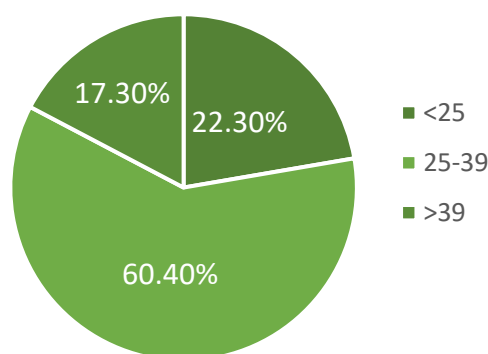
4.1.5 Focusing on Consumer loan and SME loans

360 DigiTech started off with mainly consumer loans and later expanded into SME loans. It is also cooperating with 3rd parties to promote embedded finance aiming to provide application scenarios.

Consumer loan is typically risky for traditional banks, due to the low amount for single loan (on average about 7700 RMB in Q3 2022), as well as the disbursed borrowers making it hard to verify their credit history, while the interest rate are typically higher, there is a large chance of delinquency. With the help of Fintech companies, multiple channels are expanded to evaluate the risk of default comprehensively, even automatically under certain algorithms, certainly enlarging the market for consumer loans. One large group of target users is young people frequently engaged in e-commerce, who are more likely to be subjected to positive feedback of marketing strategies, including celebrity advertisements on social platforms and official accounts, as well as recommendations within the community, loyalty programs in the Apps, and successful acquisition from 3rd party websites.

Meanwhile, under the supportive policy for SMEs, the loan market is also growing. The amount can be larger, on average about 23 thousand RMB in Q3 2022, with payback period of about 2-3 years, under the pandemic and economic downturns which struck many startups, posing extreme hardship for their survival, risk-control is of more significance, where advantage of 360 DigiTech is shown.

Figure 8: Age breakdown by users with approved credit lines as of June 30, 2022



Source: 360 DigiTech Company website

4.2. Risks and Challenges

4.2.1 Operational risks

Eroding “traffic dividend”

Though total users on 360 DigiTech platforms has reached 200 million in September 2022, the user growth is slowing down, with only 8 million increases for Q3, because of tightened regulation on digital finance and remaining public concerns. Consumer acquisition is always a competitive advantage under the Light-Asset model. Relying on the continuous optimization

of channel structure and delivery model, the identification rate of 360 DigiTech is as high as 90%, while the scale of customer delivery ranks first in the industry.

Due to the lack of application scenarios on its own platforms, 360 DigiTech operates under embedded finance which acquires most of its users from third parties. The consumer acquisition cost has dropped from the pre-pandemic rate of more than 200 RMB to around 130 RMB, but this number re-bounced to more than 350 RMB as the situation recovers. This poses a great challenge of promoting consumer loyalty as well as conversion rate to enjoy a prolonged and sustainable growth as “traffic dividend” is gradually disappearing.

To be specific, comparing 360 DigiTech with similar NASDAQ listed Chinese Fintech companies operating in Consumer loan sectors Lexin Fintech Holdings and FinVolution Group. Newly registered users’ growth rate of 360 DigiTech has plummeted to 3.5% by the end of 2021 comparing to its all-time high of 20.4% starting 2019, already surpassed by its rival Lexin who has reached 7.1%.

Pandemic and economic downturns lower solvency

As the pandemic situation worsened in early 2022 and ensuing lockdowns in China hindered economic growth, daily operations of small business were struck hard, therefore, solvency for loans for especially SMEs decreased. Meanwhile, the lack of a stable source of income for households also decreases the intention of large consumption spending, especially on margin. Therefore, both SME business and Consumer loans for 360 DigiTech are negatively influenced, as the algorithms used to evaluate credit risk met macro-level distortion, resulting in unexpected soar in delinquency rate, 30+ days overdue has reached 4.4% compared to 2.2% in 2019. However, as a common case across the industry, 360 DigiTech still has the lowest default rate among its rivals.

Intense competition

Though consumer loan and SME loan markets both have large growth potential, fierce competition exists between major players to acquire high-quality consumers, for example JD which has advantage in big brand name and self-owned application scenarios that helps to reach a wider range of consumers.

Compared with traditional banks, Online loans have a wider customer coverage. The asset disadvantage under the capital-intensive model is gradually weakened through the transformation, while the comprehensive rate is also declining, resulting in a large growth potential. There are many players in the industry, and 25% of the market share of Internet

micro-credit is still occupied by Ant Financial. While 360 DigiTech accounted for only 2.4% of Online Consumer loan sector in 2021.

Under the traditional Joint lending and ABS mode, relying on the consumption scenarios provided by the parent company Alibaba compounded onto the traffic dividends from Alipay as a mobile payment portal, Ant Financial has a great advantage. The joint lending market has formed an oligopoly, with CR3 exceeding 90%. JD Digital and Baidu Finance only share 10% of the market share, while 360 Digital lacks competitive advantage. However, under the transformation to the Light-Asset Loan-Aid model, with the markets of 2B SME loan and 2C Consumer loans is growing rapidly at CAGR 20.8% and 20.4% respectively, 360DigiTech with the advantages of algorithm and risk- control gains an upper hand.

4.2.2 Market risks

Macroeconomic uncertainty

As a company whose operation mainly focuses on China, uncertainty of future inflation as well as exchange rate between RMB and US Dollars may affect the consumption behaviors as well as the value of ADS investments.

Tightening regulation on Internet finance industry

A series of regulations are enforced to regulate the Fintech industry, including eliminating P2P lending, requiring reforms for those Internet finance companies over-involved in financial sector etc. Many including 360 DigiTech have been appointed by related authorities and 360Jie has been shortly suspended due to illegal collection and misuse of personal information.

These tightened measures stimulated Fintech companies to shift focus on the technology side and march towards light-model operation, however, there are still concerns about safety issues of online loans, especially after earlier scandals.

4.2.3 Risks from the stock market

Uncertainty about future suppression on Chinese stocks in U.S. stock market

The decision of 360 DigiTech's secondary listing In HKSE was during the mass delisting of Chinese stocks, with the surface reason being the disagreement between revision on working papers of Chinese companies listed in U.S. stock exchange, and 360 DigiTech is one of them. This, combined with the US-China trade war, has caused significant stock price plummets for Chinese stocks.

Though the delisting wave was temporarily resolved with the settlement of audit supervision measures, future conflict of interest between the two countries may still result in imposed suppression on Chinese stocks and causing price turbulence.

Undervalue of Fintech companies

Fintech companies listed in the US have long been undervalued under a model closer assemblies traditional banks instead of technology firms, typically with a lower P/E ratio. Which was once as low as 2.2x and is now around 5.8x, because of the regulation pressure and liquidation concerns, as well as the market fear of the potential suppression on US listed Chinese stocks.

4.3 The Opportunities of 360 Digitech for Secondary Listing

4.3.1 Operational Opportunities

Services provided by 360 Digitech can be classified into credit-driven services and platform services. Platform services also include comprehensive loan assistance and post-loan services under the light capital model, intelligent marketing services, referral services and risk management SaaS for financial institution partners under the Intelligent Credit Engine (ICE) model.

From 2019 to 2021, the company's net income increased from 9.22 billion to 16.64 billion, with a CAGR of about 34.3%, mainly driven by the growth in the scale of platform-matched loans. The scale increased from 199.1 billion in 2019 to 357.1 billion in 2021. The average compound growth rate is 33.9%. From 2019 to 2021, the company's net profit increased from 2.50 billion to 5.77 billion, with an average annual compound growth rate of 51.8%, the net profit margin increased from 27.1% to 34.6%, and the adjusted net profit increased from 2.75 billion to 6.02 billion, with an average annual compound growth rate 48.0%. From the perspective of the use of raised funds, the company will use 50% of the raised funds for research and development to enhance the company's technology and credit evaluation capabilities and develop more diversified technical solutions, and 40% will be used to further penetrate the credit technology industry and expand users Group, 10% for general corporate purposes and working capital needs.

4.3.2 Market Opportunities

360 Digital is one of the pioneers in the industry to launch a light capital model. Under the light capital model, the company empowers financial partners throughout the entire loan life cycle

through technology. As of June 30, 2022, a total of 56 financial institutions have cooperated with the company in a capital-light model. Since under the light capital model, financial institutions need to bear credit risk by themselves, so financial institutions put forward higher requirements for the risk control ability and customer acquisition quality of credit technology platforms. To meet the credit needs of small and micro enterprises, 360 Shuke launched 360 Small and Micro Loans under the brand of 360 IOU at the end of 2020. The product portfolio of 360 Small and Micro Loans includes three products, e-commerce loans, enterprise loans and invoice loans, to meet the credit needs of small and micro enterprises in different business environments and at different stages of business development.

4.3.3 Stock market wise

For Chinese stock companies listed in the United States, the process of returning to the Hong Kong capital market is relatively simpler than returning to A shares.

Therefore, for red-chip stocks listed in the United States, if the place of incorporation of the listing entity is a jurisdiction accepted by the Stock Exchange and it chooses to apply for listing in Hong Kong, it does not need to make special adjustments to its shareholding structure (such as the red-chip structure).

Due to the high cost of privatization and delisting, and the re-listing after delisting will face certain uncertainties, in addition to choosing to apply for listing in Hong Kong after delisting in the United States, companies that are still allowed to list in the United States can also consider listing in the United States and Hong Kong. Dual listing in Hong Kong. If a company that has been listed overseas wants to be listed in Hong Kong at the same time, there are two options: primary listing in Hong Kong (that is, dual primary listing), or secondary listing in Hong Kong only.

If the company only conducts secondary listing in Hong Kong, the Exchange expects that the company's securities will mainly be traded on overseas exchanges and will be subject to the supervision of the regulatory authorities of the main listing place. The review standards, and there are several exemptions and preferential treatment policies. Therefore, the operability of the secondary listing is strong.

If the applicant for listing is a "qualifying issuer" (that is, an applicant listing on a "qualifying exchange", "qualifying exchange" includes the New York Stock Exchange, NASDAQ stock market or The London Stock Exchange's main market (and falls within the FCA's 'Advanced

Listing' classification)) and is an 'innovative industry company' which would normally be considered suitable for a secondary listing under Chapter 19C.