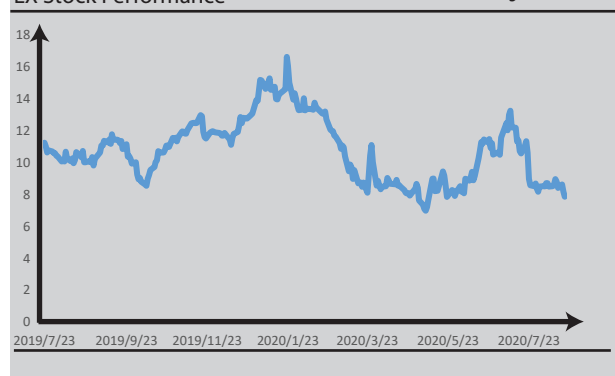


Research report on LexinFintech Holdings Ltd. (NASDAQ: LX)

We Believe LexinFintech Holdings Ltd. (NASDAQ: LX) is a Leverage Time Bomb About to Explode

- LX operates a high-interest rate online consumer lending platform in China. We believe LX's business model is deeply flawed and set to collapse. Our target price is ZERO.
- The structure utilized by LX exposes its shareholders to enormous losses by guaranteeing payment of loans while putting Chinese lenders first. This strikes us as a quintessential "Heads I win, tails you lose" situation for current shareholders.
- LX reports unfathomably low delinquency rates that we simply do not trust. We believe LX is reporting artificially low delinquency rates by essentially giving borrowers who are already in default new funds to make payments. This has led to a rapidly deteriorating credit quality.
- LX has historically charged Chinese consumers enormous interest rates, often above the legal 36% usury rate. New regulation in China will significantly limit how much LX can charge to 15.4%, therefore putting the entire business model at risk.
- LX seems to be still actively engaged in direct peer-to-peer lending, which the company supposedly already halted per regulatory pressure. Other companies that have broken p2p restrictions have mostly been shut down and executives were even jailed. We think LX could face similar regulatory pressure.
- The Corona Virus pandemic added insult to injury and the consequent shut down of the economy has put a massive number of consumers and consumer loans in default or delinquency.
- Several employees run businesses that are not disclosed by LX as related parties. We identified these businesses as service providers or in the same field as LX. The opportunity to maneuver costs and siphon off money unbeknownst to investors and auditors is troublesome to us.
- We also suspect that LX sold one business unbeknownst to investors to the Chairman's relative.
- Giant misstatements in the past and weakness in financial reporting we uncover in this report paint the picture of a company whose financials can simply not be trusted.
- Our review of basic web traffic analysis leads us to question if the purported volume by LX is even real in the first place.
- Despite LX management touting its Tencent background, major shareholders including JD.com are selling off, showing a lack of confidence in LX's future.
- Our valuation prices in the severe risks hidden from investors. Upon adjustments, we believe the company should have seen an equity decrease of RMB 1.85B. Ultimately, we believe the company is not viable under new Chinese regulations.

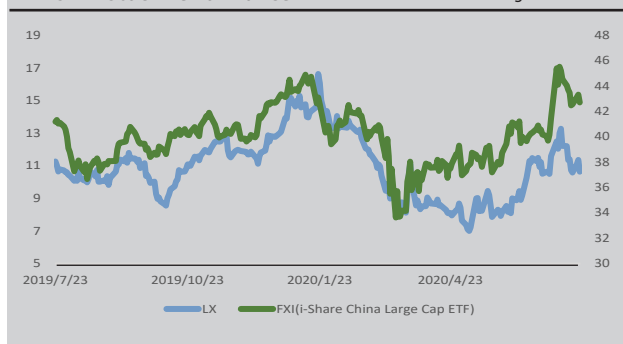
LX Stock Performance As of August 24th 2020



LX Trade Data As of August 24th 2020

Stock Price:	\$8.51
52 Week Low:	\$6.98
52 Week High:	\$16.93
Market Capitalization:	\$1.54B
3 Month Avg. Volume:	2.08M
Weighted Avg. Shares Outstanding:	179.7M

LX vs FXI Stock Performance As of August 24th 2020



Share price performance (%)	3 months	6 month	12 months
Absolute	32%	-36%	-6%
Relative to S&P500	16%	-38%	-15%
Relative to FXI	19%	-35%	-10%

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To the best of our ability and belief, all information contained herein is accurate and reliable, and has been obtained from public sources we believe to be accurate and reliable, and who are not insiders or connected persons of the stock covered herein or who may otherwise owe any fiduciary duty or duty of confidentiality to the issuer. Note that LX LexinFintech Holdings Inc. and insiders, agents, and legal representatives of LexinFintech Holdings and other entities mentioned herein may be in possession of material non-public information that may be relevant to the matters discussed herein. Do not presume that any person or company mentioned herein has reviewed our report prior to its publication.

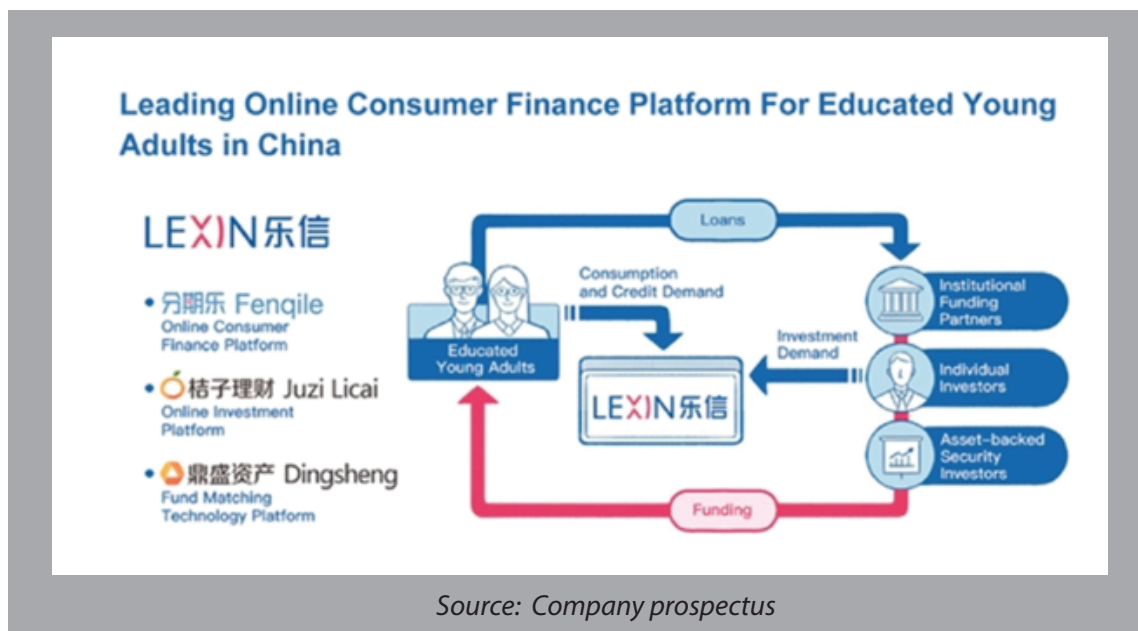
Background

Shenzhen Fenqile Network Technology Co., Ltd. (“Shenzhen Fenqile”), was established in China in August 2013 and began to operate Fenqile, an online consumer finance platform, in October 2013. On Fenqile consumers can borrow money. In October 2013, Beijing Lejiixin Network Technology Co., Ltd. (“Beijing Lejiixin”), was incorporated as an investment holding company in China and established its wholly-owned subsidiary Shenzhen Qianhai Juzi Information Technology Co., Ltd. (“Qianhai Juzi”) in June 2014, which operates the company’s online investment platform Juzi Licai. Juzi Licai is targeted at attracting institutional investors that want to invest in consumer loans.

The company’s online consumer finance platform, Fenqile, offers customers personal installment loans, installment purchase loans, and other loan products. The platform also offers a wide range of products on its e-commerce channel and allows customers to utilize their credit lines to finance their purchases. It matches customer loans with three main funding sources:

- Individual Investors on its Juzi Licai platform
- Institutional Funding Partners through Juzi Licai platform and direct lending program
- Investors of asset-backed securities

At first glance, investors might be impressed by the company’s growth in its loan origination (from 22.2 Billion RMB in 2016 to 126.0 Billion RMB in 2019) and its top and bottom-line growth (revenues grew from 4.3 Billion RMB in 2016 to 10.6 Billion RMB in 2019, with earnings per ADS of loss of 4.03 RMB in 2016 to profit of 12.29 RMB (~US\$1.76) in 2019). However, upon a closer look, it becomes apparent why we believe LX is a ticking time bomb about to explode.



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Research report on LexinFintech Holdings Ltd. (NASDAQ: LX)

Civil Lending/Borrowing Interest Hurdle Rate Reform Means the End of LX's Business Model

On July 22, 2020, China's Supreme People's Court (SPC) and National Development and Reform Commission (NDRC) jointly [issued](#) a guideline on legal protection for the economy. Article 13 talks about the civil lending-borrowing interest rate and the govern-

ment's intention to dramatically decrease the current up-limit interest rate that can be charged by the lenders.

“统筹兼顾利率市场化改革与维护正常金融秩序的关系，对于借贷合同中一方主张的利息、复利、罚息、违约金和其他费用总和超出司法保护上限的，不予支持。……抓紧修改完善关于审理民间借贷案件适用法律问题的司法解释，大幅度降低民间借贷利率的司法保护上限，坚决否定高利转贷行为、违法放贷行为的效力，维护金融市场秩序，服务实体经济发展。”

“Coordinate the relationship between interest rate market reform and normal financial order protection, do not support the counterparty in a lending-borrowing contract whose aggregate interest rate including interest payment, compounding interest, penalty, default fees, and other fees that exceeds the law-protected up-limit interest rate.……Amend the justice explanation of lawsuits involving lending-borrowing civil cases, to dramatically decrease the legal protection of the up-limit of civil lending-borrowing interest rate, decisively denying the high-interest rate loan transfer activity and illegal lending activity, to protect the financial market's order and service the real economy's development.”

The Supreme People's Court set 24% as the legally protected up-limit of the interest rate in the civil lending-borrowing cases, meaning if the agreed interest rate is lower than 24%, the court should support the lender when the lender requests borrower

to pay interest under the contract. It was also reported that the up-limit protected interest rate could be 4 times of the one year LPR (Loan Prime Rate).

“有知情人士向21世纪经济报道记者表示，今年春节前后最高法就在酝酿修改民间借贷的司法解释，相对于之前的24%、36%划分两道“红线”的做法，主流的意见是设定一个民间借贷利率保护上限，这个上限有专家建议参考之前一年期利率的4倍，现在可以参考央行LPR报价的四倍。”

“Certain personnel familiar with this matter told the reporter from 21st Century Business Herald that around this year's Spring Festival the Supreme People's Court has already been under consideration of amending the justice explanation of civil lending-borrowing, in contrast to the previous 24% and 36% two red lines for the interest rate, the mainstream opinion is to set an up-limit protected civil lending-borrowing interest rate, and some expert suggest this up-limit rate should be 4 times of the previous one-year base interest rate, now people can refer the 4 times of Central Bank's LPR pricing.”

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Research report on LexinFintech Holdings Ltd. (NASDAQ: LX)

Civil Lending/Borrowing Interest Hurdle Rate Reform Means the End of LX's Business Model (Cont'd)

On August 2020, China's Supreme People's Court (SPC) issued a [press release](#) confirming the implementation of the 4x LPR upper limit. According to July 2020 data, this would indicate an upper limit of 15.4%. As of Q2 2020, LX averages 26.5%. SPC further stipulates that fees charged in forms other than interest need also be less than 4x LPR. In

essence, the summation of all fees charged related to a loan will need to conform to the 4x LPR limit. This means LX will not be able to work around this issue by recategorizing interest payments as other forms of fees.

经院审判委员会讨论后决定：以中国人民银行授权全国银行间同业拆借中心每月 20 日发布的一年期贷款市场报价利率（LPR）的 4 倍为标准确定民间借贷利率的司法保护上限，取代原《规定》中“以 24% 和 36% 为基准的两线三区”的规定，大幅度降低民间借贷利率的司法保护上限，促进民间借贷利率逐步与我国经济社会发展的实际水平相适应。以 2020 年 7

The upper limit of judicial protection for private lending rates is determined based on the standard of 4 times the one-year Loan Prime Rate (LPR) issued by the National Interbank Funding Center authorized by the National Interbank Funding Center of the People's Bank of China on the 20th of each month, replacing the original regulations of 24% and 36% two rates and three-zone regulations greatly reduce the upper limit of judicial protection for private lending rates, and promote private lending rates to gradually adapt to the actual level of China's economic and social development.

他费用之和也不得高于民间借贷利率的司法保护上限。即出借人与借款人既约定了逾期利率，又约定了违约金或者其他费用，出借人可以选择主张逾期利息、违约金或者其他费用，也可以一并主张，但总计超过合同成立时一年期贷款市场报价利率四倍的部分，人民法院不予支持。

That is, the lender and the borrower have agreed not only on the overdue interest rate, but also liquidated damages or other costs. The lender can choose to claim overdue interest, liquidated damages or other costs, or both. However, the people's court will not support the portion that exceeds the 4 times LPR limit.

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Civil Lending/Borrowing Interest Hurdle Rate Reform Means the End of LX’s Business Model (Cont’d)

What Does This Mean For LX?

LX currently averages an APR of 26.5%, which is already higher than the previously supported rate. However, new regulations would further decrease the upper limit to 15.4%.

If LX were to apply this 15.4% as its APR, we do not believe LX is viable anymore. According to our model, LX would have negative net income and negative book value of equity.

Therefore, we believe this jointly issued Guideline is an existential risk for consumer lending/P2P platforms such as LX. LX’s business model would simply cease to make sense once the upper-limit interest rate change is implemented. **We therefore give LX a target price of ZERO.**

<i>in RMB Mil</i>	2019 Q4	2020 Normalized
Total Outstanding Principal	60,600	
Original APR	27%	
New Suggested APR	15%	
Credit Spread	-12%	
Reduction in Operating Revenue	-1,757	-7,030
Current Operating Revenue	3,148	12,592
New Operating Revenue	1,391	5,562
Total Operating Costs	1,670	6,680
Gross Profit	-279	-1,118
Total Operating expenses	741	2,964
Net Income Original	518	2,072
Net Income Adjusted	-1,020	-4,082

Source: Grizzly Analysis, Company filings



Link to press release of the Hurdle Rate Reform: <https://tv.chinacourt.org/50474.html>

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Civil Lending/Borrowing Interest Hurdle Rate Reform Means the End of LX's Business Model (Cont'd)

But Sell-Side Said This Could Be Good?

On August 20th, the day when the official decrease of usury rate to 15.4% was announced, headlines and sell-side commentary were quick to conclude that the announcement would actually have positive implications for Chinese Fintech companies and licensed lenders such as LX. We believe these statements to be categorically false and hugely misleading.

First of all, we did not find any indications that fintech platforms are exempt from this regulation. We also believe LX does not fall under the licensed lender category, as those are typically reserved for banks.

"...no impact on major fintech platforms or licensed consumer credit providers, in our view."
--- Jacky Zuo, China Renaissance Securities

Secondly, the goal of the new rule is to lower credit cost for the whole society. Contrary to what Sell-side claims, it is widely acknowledged that following the reduction of unlicensed lenders' interest rates will have a profound effect on the whole credit industry. We have seen this back in 2015 and again today in 2020. An article on Xinhua Net helps explain the full-on effect of the decision.

Although the "Regulations" make it clear that the scope of private lending does not include "financial institutions whose loan business is a business", industry insiders said that taking into account actual operating conditions, this "Regulations" may still have a large impact on financial institutions.

"The general consensus is that licensed financial institutions cannot charge surpass usury rates. Therefore, we see that nominal lending rates for bank credit cards, consumer finance companies, etc. are also set just below the upper limit of judicial protection of private lending rates."

---Chen Wen, director of the Digital Economy Research Center of the School of Finance of the University of Finance and Economics

Thirdly, we compared word by word the 2015 and 2020 rules, and note that the exact same words were used to describe the scope of the effect. The 2015 interest rate changes which set the upper limit to be 36% had a wide effect on all financial institutions. We also see LX complying to the 2015 rules. There is no reason why the 2015 iteration would apply to LX where the 2020 version would not.

In any case, we don't see a scenario where Chinese regulators ignore and allow LX to continue charging predatory lending rates.

法释【2015】18号

2015 Iteration

第一条 本规定所称的民间借贷，是指自然人、法人、其他组织之间及其相互之间进行资金融通的行为。

经金融监管部门批准设立的从事贷款业务的金融机构及其分支机构，因发放贷款等相关金融业务引发的纠纷，不适用本规定。

法释【2020】号

2020 Iteration

第一条 本规定所称的民间借贷，是指自然人、法人和非法人组织之间进行资金融通的行为。

经金融监管部门批准设立的从事贷款业务的金融机构及其分支机构，因发放贷款等相关金融业务引发的纠纷，不适用本规定。

Translation:

These Provisions are not applicable to financial institutions and their branches established with the approval of the financial regulatory authorities to engage in loan business and disputes arising from the issuance of loans and other related financial businesses

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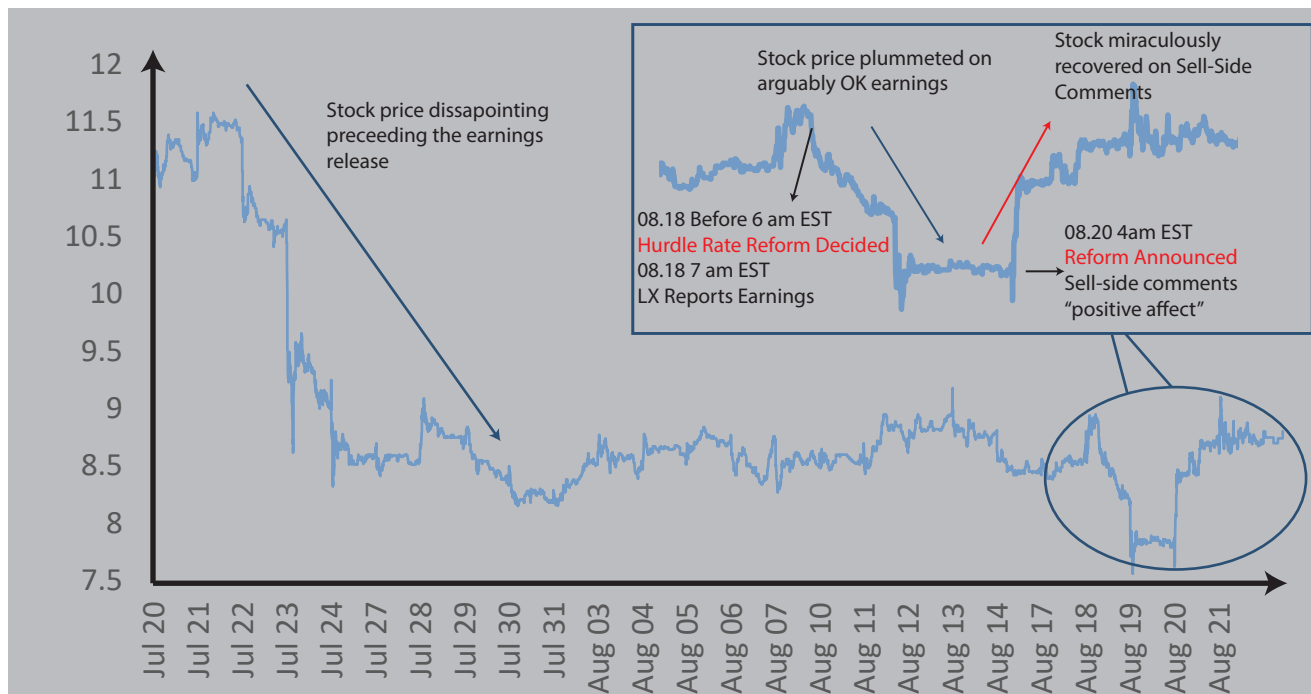


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Civil Lending/Borrowing Interest Hurdle Rate Reform Means the End of LX's Business Model (Cont'd)

Stock Price and Earnings Q&A Signals Negative Effects



The stock price performance on the heels of earnings report was dumbfounding to say the least. With revenue beat and only slight earnings miss, the stock was down almost 15% in the following two days. We suspect people familiar with the hurdle rate reform already began selling-off on rumors of decision being reached. Had the decision been truly beneficial to LX, the opposite likely would have happened.

Contrary to consensus, we believe the decision to reform the hurdle rates was actually reached on August 18th, 2 days before the official announcement. In fact, it is not unreasonable to assume the decision was already reached before LX earnings report.

Translation of Interest Rate Press Conference:

*Hello everyone, thank you all for attending today's press conference. **In accordance with the decision adopted by the Supreme People's Court Judicial Committee on August 18, 2020 at the 1809 meeting of the Supreme People's Court, the decision to amend the regulations on several issues concerning the application of law in the trial of private lending cases was officially released today (August 20, 2020).** The revised Supreme People's Court on Several Issues Concerning the Application of Law in the Trial of Private Loan Cases*

During the earnings call, the management was asked about the "rumors of the interest rate reform". Below are responses from LX.

Tony Hung, LexinFintech Holdings Ltd. - Investor Contact [24]

[Interpreted]

So Eddie, we've also seen the reports, obviously, and I think it's fair to say that, ultimately, there is no conclusion, if you will, from any of the government authorities. And then after the article was out, there was certainly a lot of media responses and other things that came out discussing the particular news. And I think a lot of it basically indicated that, well, ultimately, this doesn't really match the situation or the needs in China right now.

Now the goal ultimately is to lower the APR to strengthen the economy that we can certainly understand, and it does make sense by itself. But what it will do and how they will do it in a way that makes sense, obviously, we don't know and no one knows yet.

Now we did do our own analysis on our underlying business as well, which we can share. We can say that businesses where we're making loans over 24% APR, we don't really have that. We're basically focused on an IRR definition of things. And we're much focused on the 24% IRR. Where we can be over in the most recent quarter, we were at around 26%. Well, when we calculated, if we adhere to some of the calculations stringently, then we might have a 10% reduction in our service fees or revenues. And anybody who is over that, we would cut off, unfortunately, as a customer. But in turn, this is going to reduce our overall risk. So in turn, there may be some benefits to it as well.

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Civil Lending/Borrowing Interest Hurdle Rate Reform Means the End of LX's Business Model (Cont'd)

Stock Price and Earnings Q&A Signals Negative Effects

We assume the following two scenarios.

Scenario 1: LX Management Knew the Outcome of the Decision

Assuming management knew the outcome of the decision, their response to the analyst would seem dodgy at best, and pessimistic about its effect on LX's current services. If the ruling were in favor of LX, we believe management would have been much more confident and offered a much stronger response.

Scenario 2: LX Management Unaware of the Outcome of the Decision

Assuming management did not know the outcome of the decision, their response would still indicate that they will suffer as opposed to thrive under the new regulations. Even they acknowledge that they will likely see at least 10% reduction in service fees or revenues. Although we believe the ultimate effect is much more devastating, we side with management in that this is all-together bad news for them.

Therefore, we strongly disagree with the prevailing sell-side commentary and believe that the Hurdle Rate Reform will be a hurdle LX cannot pass.

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Research report on LexinFintech Holdings Ltd. (NASDAQ: LX)

LX Accumulated a Giant Off-Balance Sheet Loan Book that Looks Highly Toxic to Us

Since 2018, LX has been shifting to off-balance sheet loans by facilitating loans between its customers and institutional funding partners. This is the main driver of the company's revenue growth in the past two years.

(in RMB'000, except for number of users)	2016	2017	2018	2019
Outstanding principal balance (in millions)	9,899	19,272	32,397	60,567
<u>Outstanding principal balance by accounting treatment:</u>				
Outstanding principal balance of on-balance sheet loans (in millions)	7,712	12,012	6,808	4,785
Outstanding principal balance of off-balance sheet loans (in millions)	2,187	7,260	25,589	55,782
<u>Outstanding principal balance by type of loan product:</u>				
Outstanding principal balance of installment purchase loans (in millions)	2,106	1,677	1,570	2,365
Outstanding principal balance of personal installment loans (in millions)	7,793	17,595	30,827	58,202

This is due to overall regulatory pressure on peer to peer (p2p) lending. Since 2015, the Chinese government has been adjusting regulations and enforcing more stringent oversight over p2p lending due to the high-risk nature of the business. By the end of 2018 and early 2019, a document called "[Opinions on the correct Classified Disposal and Risk Prevention of Online Lending Institutions](#) 关于做好网贷机构分类处置和风险防范工作的意见", more commonly known as document 175, outlined the general trend of companies exiting the entire p2p industry. We believe LX made the recent structural changes to comply with regulatory changes.

While we applaud the company for taking measures to seem more compliant with relevant regulations, two issues deem scrutiny:

1. Off-balance sheet loans demonstrate high risk profile
2. Despite what the name suggests, equity investors are ultimately liable for the performance of these loans

We believe the increase in the off-balance sheet loans outstanding makes it hard for investors to gauge what kind of risks are associated with these loans. Although the risk profile of the on-balance-sheet loans might not be the same for the off-balance sheet loans, we believe it is a good proxy for investors to get a general idea of how the risk profile has shifted in the last two years.

	2016	2017	2,018	2,019		2016	2017	2,018	2,019
Risk level:									
A	2,575,784	3,078,483	1,544,637	996,524		33.4%	25.6%	22.7%	20.8%
B	1,296,013	2,235,552	1,502,681	1,023,490		16.8%	18.6%	22.1%	21.4%
C	2,455,076	2,890,202	1,447,785	661,688		31.8%	24.1%	21.3%	13.8%
D	892,322	2,714,510	1,359,982	856,633		11.6%	22.6%	20.0%	17.9%
E	206,164	807,290	308,528	625,700		2.7%	6.7%	4.5%	13.1%
F	67,973	170,335	318,276	399,073		0.9%	1.4%	4.7%	8.3%
N and others	218,540	116,078	325,817	221,925		2.8%	1.0%	4.8%	4.6%
Total	7,711,872	12,012,450	6,807,706	4,785,033		100.0%	100.0%	100.0%	100.0%

note: per company's filing, the key factors we consider in determining the credit risk level of each customer include: 1) Geographic location, for example, whether the customer is located in a first-tier, second-tier or third-tier city, and the level of economic development of the relevant city; 2) Education background, i.e., the customer's academic degree and past or current education institutions; 3) Level of income; 4) Outstanding loans from other external sources, such as credit card issuers and other consumer finance platforms; and 5) External credit references. Risk Level A has the highest credit rank.

Above is the table that summarizes the company's net record investment of the financing receivables, by credit quality indicator, from 2016 to 2019.

It is evident that the percentage of loans from risk levels D and below increased dramatically from 2016 to 2019. To put into perspective, the total percentage of loans from risk levels D, E, F and N and others

increased from 18.0% in 2016 to 44.0% in 2019.

Typically, it would make sense for the company to put relatively better loans in terms of risk on its own balance sheet and put the loans that are riskier off its balance sheet. Thus, it is reasonable to assume the risk profile of the loans that are off-balance sheet is as least as bad as what is shown on its balance sheet.

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Research report on LexinFintech Holdings Ltd. (NASDAQ: LX)

LX Accumulated a Giant Off-Balance Sheet Loan Book that Looks Highly Toxic to Us (Cont'd)

Worse Yet, LX Shareholders Are Guaranteeing the Performance of These Toxic Loans.

We believe LX's business model is widely misunderstood. Investors seem to be largely unaware that, even if the majority of the company's loans outstanding are off-balance sheet, it still needs to provide protection for a lot of these loans.

- For the off-balance sheet loans funded by the individual investors on Juzi Licai, **LX provides a risk safeguard scheme** to the individual investors and records the obligations associated with the RSS in accordance with ASC 460, Guarantees.
- For the off-balance sheet loans funded by certain Institutional Funding Partners, **LX provides deposits and replenishes such deposits** from time to time to the institutional funding partners by directly compensating them for principal and interest payment in the event of the borrowers' defaults, which are accounted for as guarantee liabilities under ASC 460, Guarantees, provided that the scope exception under ASC 815-10-15-58 is met.

Accounting Standards Codification (ASC) 460, Guarantees, requires that the fair value of guarantees be recognized as a liability, and establishes the notion that a guarantee actually consists of two distinct components. These two obligations have quite different accounting implications: noncontingent obligation; and contingent obligation. The first of these components is a noncontingent obligation, namely, the obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur. This stand-ready obligation is unconditional and thus is not considered a contingent obligation. The second component, which is a contingent obligation, is the obligation to make future payments if those triggering events or conditions occur.

For a financial guarantee contract to meet the scope exception of ASC 815-10-15-58, the contract must:

1. Provide for payments to be made solely to reimburse the guaranteed party for failure of the debtor to satisfy its required payment obligations
2. Provide payment only if the debtor's obligation is past due
3. Provide payment only if the guaranteed party is exposed to the risk of nonpayment at inception of the guarantee arrangement and throughout its life

Off-Balance Sheet Loans Funded by Individual Investors

Off-balance sheet loans on the Juzi Licai platform went through a structural change in late April 2018. The previous model was referred to as the Old Model. The New Model positions LX as the intermediary between Borrower and Individual Investors. In terms of protection for loans:

Under the New Model, the Group entered into a cooperation agreement with an independent third-party guarantee company (the "Guarantee Company"), to set up a new investor protection program called the Risk Safeguard Scheme ("RSS"). The purpose of the RSS is to provide make-up payments to the Individual Investors on Juzi Licai when the Borrowers default. **The RSS only applies to loans newly funded under the New Model** and requires the Borrowers to contribute to the RSS to protect the Individual Investors. By default, all Borrowers enroll in the RSS when the Underlying Loan Agreements are entered into.

However, the Juzi Licai's old model is not covered by such RSS. Rather they are protected by the quality assurance program that ceased operation in April 2018.

As of fiscal year end of 2019, there are still over RMB 821.4M are still outstanding from the old model. This is disturbing in two aspects:

1. Since the old model halted on April 24th, 2018, why is there such a large balance by the end of 2019?
2. Who offers protection for the default of such loans? They should be largely overdue right? According to company disclosure, loans delinquent for over 90 days are 1.56%, amounting to around 945M. We have reason to believe RMB 821.4M belongs to the old model that is unprotected. **This is a huge red flag**

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LX Accumulated a Giant Off-Balance Sheet Loan Book that Looks Highly Toxic to Us (Cont'd)

Worse Yet, LX Shareholders Are Guaranteeing the Performance of These Toxic Loans.

Off-Balance Sheet Loans Funded by Institutional Funding Partners

LX sources the majority of its funds through institutional funding partners. Wall Street and investors have applauded the company for this structural funding change and have allocated a higher valuation to the company. However, we believe the general perception

of the potential riskiness of the loans is largely misguided. We believe these loans are even riskier than individual investor loans. Per 2019 20F, the company discusses that they have guarantees for institutional funding partners:

Starting from 2019, the Group started to cooperate with third-party insurance companies and guarantee companies that directly provide guarantee services to certain Institutional Funding Partners, and no longer replenished the deposits made to these Institutional Funding Partners. According to relevant financial guarantee arrangements, third-party insurance companies and guarantee companies will provide the principal and interest payment to these Institutional Funding Partners, in case of Borrowers' defaults. However, the Group is required to provide deposits and replenish such deposits from time to time to the bank accounts of these insurance companies and guarantee companies, in the event that such insurance companies and guarantee companies perform their guarantee obligations upon the Borrowers' defaults. ***Effectively, the Group provides back-to-back guarantee to the insurance companies and guarantee companies and takes on all of the credit risk of the Borrowers.***

Effectively, the Group provides back-to-back guarantee to the insurance companies and guarantee companies and takes on all of the credit risk of the Borrowers.

Sophisticated verbiage aside, their RSS program is a limited liability account that only pays out investors the maximum amount in the RSS program, whereas guarantees for institutional investors take on all credit risks of borrowers. Essentially, under mass default, all company assets and shareholder equity are fair game as repayment measures. As of December 2019, the company has close to \$8 billion in outstanding principal from off-balance sheet loans. However, the company only holds \$179 million in deposits to insurance companies and guarantee companies, which is merely 2.2% of the total outstanding balance. This is even insufficient to cover the ~3% default rate disclosed by the company, not to mention the undisclosed, or hidden portion of the defaults.

In essence, LX is under-reserving for a liability that they are 100% responsible for.

To give you an idea how fragile LX's balance sheet is, consider the restatement that occurred in Q1 2020. The FASB issued amended guidance related to impairment of financial instruments as part of ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which became effective January 1, 2020. The implementation of this new accounting guidance wiped out 0.3B RMB, or 5% of LX's shareholder equity on its balance sheet. Shareholder equity is a common metric to value subprime lenders, and we are surprised the significant development has gone seemingly unnoticed.

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LX Accumulated a Giant Off-Balance Sheet Loan Book that Looks Highly Toxic to Us (Cont'd)

Timeliness: Why we believe the Scheme is about to Fall Apart

We believe that LX's structure has exposed shareholders to giant off-balance sheet liabilities while protecting Chinese institutional investors. While in good times big leverage might work in your favor, it also exposes you to greater risk when the going gets rough. We believe the time has come for LX's scheme to unfold and it is only a question of time until the company must restructure or wipe out shareholders. Our belief is based on four key insights:

1. Recent guidelines issued by SPC and NDRC put significant downward pressure on the future usury hurdle. Under the newly proposed interest rate, LX's business will see a significant decrease in profits, if not a complete wipeout of business.
2. LX is essentially targeting low credit quality consumers in China. Even under current interest hurdle rates, LX's consumer lending platform seems to be predatory. There are countless complaints about usurious interest rates (36% apr is usury hurdle in China) and predatory collection practices. These consumers are likely unable to obtain credit from traditional financing methods.
3. The Corona Virus has forced many Chinese borrowers into delinquency. We believe the recent delinquency rates LX reports seem way too low and are utterly untrustworthy. This effect should disproportionately affect low-quality borrowers who are willing to pay the excessive interest rates LX charges.
- 4. We observed that LX seems to extend and restructure loans to give the appearance of performance and current-ness of old loans where the borrower is actually delinquent or in default.**

Additionally, we have evidence that makes us strongly doubt the integrity of the financial statements in general and the legality of certain business practices in particular:

- LX seems to be still facilitating direct peer to peer lending, which is generally outlawed as illegal in China.
- Several employees of LX operate companies in the similar business as LX. We suspect these undisclosed related parties are used to inflate financials and conduct borderline illegal activities such as direct peer-to-peer lending and aggressive debt collections.
- Big restatements of past financials cast doubt on the integrity of financial statements.
- Insiders are selling shares, and pocketing unordinary high compensations.

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LX Continues to Sell P2P Products Despite Publicly Stating Otherwise

“Given the increasingly tightening trend of restrictions on online consumer financing, we have gradually shifted our business model away from individual funding and further diversified our funding sources in 2019 in line with regulatory guidance. We have ceased facilitating new loans with funding from individual investors on Juzi Licai platform since November 2019.” --- LX 20F

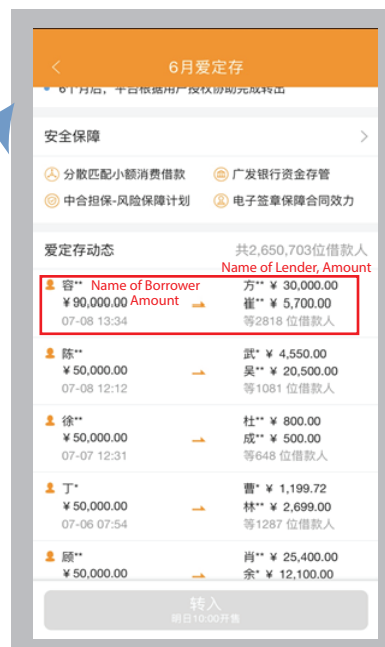
Despite what the company claimed, we discovered that LX is blatantly lying to the government and investors, and are continuing to offer P2P products on its Juzi Licai app (LX's P2P Mobile App). We are also quite amazed at how auditors neglected a red flag that was so easy to identify. All they had to do was to download the application and look at the product offerings. As of the date of this report, LX's Juzi Licai is still offering 8 products with interests ranging from 5% to over 10%. The products are sold daily at 10am every day.

Each product has a detailed breakdown of the related transaction personnel involved, including whose loan was matched with whose money.

For example, in this case, on July 8th, a person Surnamed Rong borrowed RMB 90,000 and received loans from over 2818 lenders.



A variety of products are offered everyday at 10:00 Beijing Time.



Even as of today, we still see cases where peer loans are matched with peer lenders on the Juzi Licai platform, in the typical P2P finance fashion.

It is mind-boggling that LX continues to sell P2P products under the current stringent regulatory environment. We believe this could cause a big backlash once the regulator determines to take action on this activity.

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LX Continues to Sell P2P Products Despite Publicly Stating Otherwise (Cont'd)

It seems LX is in clear violation of the current regulation from the city of Shenzhen, Guangdong Province. According to a [media report](#), on December 7, 2018, the Shenzhen Internet Finance Association (a

self-regulating body backed by the local government) issued a notice that put additional strict rules on the P2P sector.

及本协会提前报备, 并书面承诺积极配合相关工作。P2P 网贷机构在中国境内运营中收集和产生的用户信息和重要数据应当在境内存储。

四、P2P 网贷机构待偿余额不得增加。

五、P2P 网贷机构出借人人数不得增加, 并应有序减少出借人人数。

六、P2P 网贷机构不得新增违规业务, 存量违规业务必须持续下降, 直至结清。

七、P2P 网贷机构不得新增分支机构, 线下门店数量必须持续压缩, 且线下门店功能限于信用信息采集、核实、贷后跟踪、抵(质)押管理等风险管理及网络借贷有关监管规定明确的部分必要经营环节。

八、凡是已出现兑付风险或拟良性退出的 P2P 网贷机构, 不得新增出借人(受让存量债权的除外), 不得开展新

4. P2P companies should not increase balance of loans outstanding [they handle as intermediaries]

5. P2P companies should not increase the number of individual investors [on their platforms] and gradually decrease the number of individual investors

It was reported that as of January 2020 already 203 P2P platforms have phased out of this peer-to-peer lending business. It seems the trend is continuing. As recently as April and May, two big-scale P2P platforms have announced a gradual phase-out of the P2P business. These two companies located in the city of Shenzhen, where LX's P2P platform Juzi Licai is also headquartered.

In the past few years, countless P2P platforms have been busted which resulted in management arrest/civil lawsuits/regulatory shut-down. LX is danger of facing the same fate.

- In Feb 2019, the Chinese government [confirmed](#) it had frozen \$1.5 billion in assets from unscrupulous P2P lenders and around 100 executives are under investigation. Thousands of platforms have gone bust or just disappeared over the past two years.
- In April 2020, a P2P platform called Suishouji (随手记) issued a [notice](#) stating that it will gradually conduct business closure and get out of the P2P business. It is reported that the balance of outstanding loans on its platform was RMB 2.6 Billion as of March 31, 2020, with 80,793 individual lenders.
- In May 2020, a P2P platform called Xiaoniuzai (小牛在线), one of the biggest P2P platforms in Guangdong Province, announced the gradual phase-out of the P2P business. According to its [website](#), the balance of outstanding loans on its platform was RMB 10.4 Billion with 115,790 individual investors.

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Fenqile Lending Platform Seems Highly Predatory

We looked into Fenqile and found that it targets very low credit consumers and often charges interest rates over the legal usury rate in China, which is 36% p.a. Additionally, the company seems to bully lenders on the platform with harassing phone calls, and sudden increases in principal. These practices are more reminiscent of loan sharks than a credible lending operation.

There are many complaints online that allege Fenqile's APR is over 36%. For example, on one of the main consumer complaining site, <https://ts.21cn.com/> (聚投诉), numerous complaints are alleging Fenqile has been charging higher than 36% on the loans the company lends out.

Example 1: <https://ts.21cn.com/tousu/show/id/2305472>

“……而欠款额度到达三万多的时候是2018年到2020年期间，就算这两年借满三万五，一年利息按24%算，一年7200，两年也才14400，加上2018年以前的年利息算6000，总的也才两万左右利息啊，现在还要我还出四万五，也就是这几年的本金还清了，借款三万多，这两年的利息就是四万五，其利息高出法律红线，是高利贷中的高利贷，期间多次跟分期乐客服沟通，都说后期联系我，但是一直没联系，现在也逾期了，如果本人征信受到影响，必将拿起法律逾期保护自身权益……”

“The borrowing amount reached RMB 30,000 plus between 2018 and 2020, and even if [I] borrowed RMB 35,000, and based on an annual interest rate of 24%, 1 year [I will have to pay] RMB 7,200, and it will be RMB 14,400 for two years. Adding the total annual interest payable of RMB 6,000 before 2018, the total interest [for me to pay] should only be about RMB 20,000. Now [Fenqile] is asking me to pay RMB 45,000, which means even if the principal of RMB 30,000 plus is paid off during these years, but the interest [on this principle] is RMB 45,000. **This interest rate is much higher than the law-allowed red line, and it is usury of the usuries.** During this period [I have] communicated with Fenqile's customer service and then they told me they would contact me, but they didn't. Now I am in delinquency, and if my credit is negatively affected, I will rely on the law to protect my rights...”

In this case, the person complained that he/she is receiving over 60% annualized interest rate on his/her principal.

Example 2: <https://ts.21cn.com/tousu/show/id/2306531>

“……16年中旬亲戚用我的名义借款30000元，实际到账30000元，期间亲戚承诺还款，但一直分期或者最低还款，现还款金额达到15000元，期间催收电话进行通讯爆破，本人才得知真相，直至今日需还款单涨到50000元，我认为分期乐属于高利贷，以分期手续费名义进行乱收费，利滚利，现本人需要和分期乐协商退还手续费，重新规划债务……”

“In the middle of 2016, one relative used my name to borrow RMB 30,000, and the actual borrowing [from Fenqile] is RMB 30,000. During this period my relative promised to pay it back, but he/she only paid in installments or minimum payback, and until now the total payback reached RMB 15,000. During this period, the debt collection parties phoned many of the contacts on my phone, and then I realized that the current balance payable increased to RMB 50,000. **I believe Fenqile belongs to usury, and it collects fees and uses the interest to grow interest under the name of installment fees.** Now I need to negotiate with Fenqile to give me back the fees and reorganize the debt.”

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Fenqile Lending Platform Seems Highly Predatory (Cont'd)

Additionally, we also saw countless complaints regarding the collection policy. These malpractices are borderline reckless, harassments, and illegal. Many of these malpractices include contacting the borrower's friends and family to pressure repayment. Note that in China it is illegal to disclose personal loan information to third party without consent of the debtor.

Example 3: <https://ts.21cn.com/tousu/show/id/2339816>

“……外包催收直接打爆通讯录，打到公司，导致我现在被公司准备辞退，协商分期付款，不同意，一直不停的爆通讯录。……”

“The outsourced loan collection company called many people in my contact list, even to my company. I have now been laid off due to this. **I tried to negotiate an installment but they didn't agree and continued to aggressively call everyone on my contact list....**”

Example 4: <https://ts.21cn.com/tousu/show/id/2305293>

“分期乐平台再4月24日给我发送一封律师函件，当时我加了联系人微信。告知对方款项已经还清，并且我征信报告和支付宝上面也没有记录。对方让我登陆分期乐账户，但是我登陆不了。由于上班原因要晚上8点才下班。客服电话我也联系不了。在这期间联系家人告知有欠款事情，老母亲已经马上60岁了，身体一直不好，听其消息整个人由于雷劈，身体受到严重伤害。其父亲也一同受到伤害，并且打的是我父亲新的手机号码，不知道对方在何地用何种方法窃取到的。现要求分期乐致电家人道歉并提供录音，对家人造成的影响做出赔偿”

“Fenqile sent me a lawyer letter on April 24th, I immediately added their WeChat account. I told them I repaid the money already. In addition, my credit report and Alipay account both do not have a record of loans outstanding. The other party asked me to log into Fenqile, but I couldn't. Due to work, I couldn't get off until 8 pm and couldn't reach out to customer service as well. **During this period, they contacted my family and told them about the loan issue.** My mother is almost 60 years old and has always been in poor health. Upon hearing the news, she was shocked and suffered health injuries. My father was injured as well. They also managed to call my father's new number. I don't know how they got that in the first place. I now demand Fenqile record an apology to my family and compensate my family accordingly. ”

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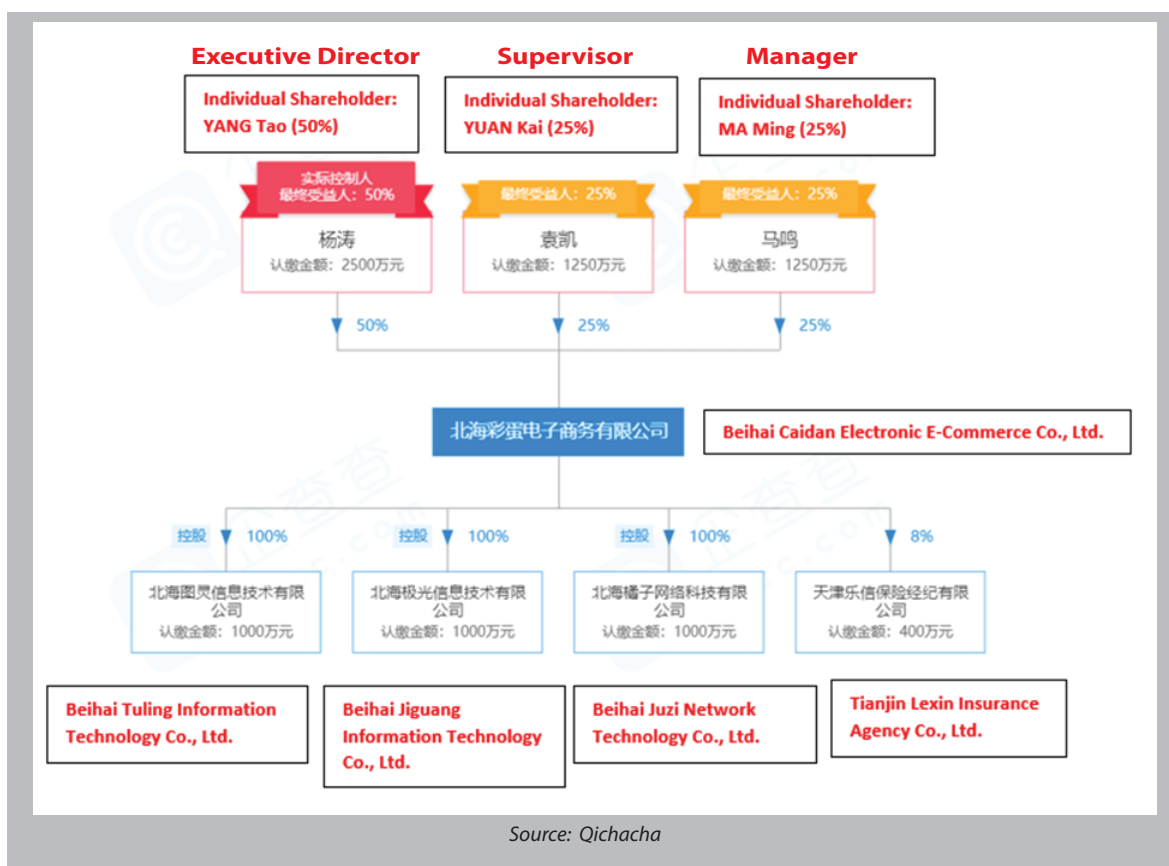


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Related Party Issues - Undisclosed Entities are not a good look

Employees of LX Has Been Holding Equity Interest in Companies that Are Undisclosed by LX as Subsidiaries



During the research, we identified at least five companies that are owned by individuals who we believe are related to LX.

We obtained SAIC filing on the above companies and discovered that only Beihai Jiguang had meaningful financials. The company generated 52m RMB in revenue in 2018, of which close to 20M RMB were from loan collection services provided most likely to LX. (Note that there were no costs associated with the additional 20M revenue.) It's as if the company gave this money to Beihai Jiguang for free.

The parent company Beihai Caidan lists www.mycaidan.com as their official website. The website is no longer functional as of the date of this report. However, wayback archive suggests that the website previously hosted MMM Finance (MMM 互助金融平台). In 2016, [Chinese Central Bank warned](#) investors to not participate in MMM Finance. Due to the website's previous involvement in MMM Finance, we do not believe this related party to be a credible company. We suspect this is one of the reasons why the company was not disclosed as a related party.



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Research report on LexinFintech Holdings Ltd. (NASDAQ: LX)

Related Party Issues - Undisclosed Entities Cast Doubt on Integrity of Financial Statements

Three individuals own Beihai Caidan E-Commerce Co., Ltd (“Beihai Caidan”), which has another 4 subsidiaries. Those individuals are YANG Tao (50%), YUAN Kai (25%), and Ma Ming (25%). YANG Tao is also the legal representative of Beihai Caidan.

On LX’s official [website](#), YANG Tao was listed as the company’s Vice President.



杨涛
副总裁

杨涛于2014年2月加入乐信前身分期乐，参与组建公司线下营销团队。2014-2015年，任职分期乐华中大区总经理；2016年起，任职普惠营销部总经理。杨涛拥有15年营销管理经验，加入乐信之前，曾在IT、互联网领域从事产品销售及管理工作，并有自主创业经历。杨涛具有极强的系统管理能力，善于带领团队拓展新业务，帮助公司和员工实现业绩提升，是资深的营销负责人。

Source: LX Website

Yuan is the legal representative for numerous branch offices of Shenzhen Fenqile, which is one of LX’s main subsidiaries.



序号	企业名称	法定代表人	注册资本	地区	持股比例	职位
1	沃根建材 广州沃根建材有限公司	陈志宏	200万元人民币	广东省	49%	监事
2	彩蛋电子 北海彩蛋电子商务有限公司	杨涛	5000万元人民币	广西壮族自治区	25%	监事
3	分期乐 深圳分期乐信息技术服务有限公司重庆分公司 Branch office of Shenzhen Fenqile -Chongqing	袁凯 YUAN Kai	-	重庆市	-	-
4	分期乐 深圳分期乐信息技术服务有限公司河南分公司 Branch office of Shenzhen Fenqile -Henan	袁凯 YUAN Kai	-	河南省	-	-
5	分期乐 深圳分期乐信息技术服务有限公司云南分公司 Branch office of Shenzhen Fenqile -Yunnan	袁凯 YUAN Kai	-	云南省	-	-

Source: Qichacha

With the employee being legal representative and combined 75% equity interest of Beihai Caidan (along with its 4 subsidiaries) owned by its employees, we believe it is reasonable to say that LX has the ultimate control over Beihai Caidan. According to the introduction on Beihai Caidan’s business per SAIC filings, it includes:

Commerce information consulting services, e-commerce information consulting services, electronic and network electronic product development, technological consulting, technological services, technological promotion and transfer. Enterprise information consulting service, etc.

These business descriptions share similarities to LX’s consumer financing lending business and we highly suspect there are undisclosed related party transactions between these two parties.

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Related Party Issues - Family Matters

We Suspect LX Sold a Business Unbeknownst to Investors to the Chairman's Relative

According to the SAIC information, Ji'an Microcredit was established on December 2, 2016, and it was 100% owned by one of LX's subsidiaries until May 8, 2019, when a company called Jiangxi Leyu Technology Co., Ltd. (江西乐誉融科技有限公司, "Jiangxi Leyu") became a 34% shareholder. There is limited information on Jiangxi Leyu, but we also found that there is another company called 吉安奥聚讯信息咨询服务有限公司 (Ji'an Aojuxun Information Consulting Services Co., Ltd. "Ji'an Aojuxun"), which shares the same phone number (15079604902), email address (1913425305@qq.com), and both of the companies are on the 7th floor of the same building.

Ji'an Aojuxun is 80% owned by an individual named XIAO Wenjuan, whose name is very similar to LX's Chairman and CEO, XIAO Wenjie. We strongly suspect this individual to be in fact the chairman's sister, and act as a proxy on his behalf.

If true, this constitutes a clear violation of SEC disclosure guideline.

We suspect the reason why XIAO Wenjuan (related to XIAO Wenjie) wants to control Ji'an Microcredit is that the microcredit lending business has a much lower regulatory risk. In November 2019, the National Fintech Risk Regulators [issued](#) a notice that guides P2P companies to transform to become microcredit lending companies. That means microcredit lending business, in regulator's views, is a lower risk sector than the P2P sector, and it appears to us that XIAO Wenjuan's move in May 2019 is to take advantage of this regulatory trend in advance.

We question why the management failed to disclose this transaction at the time. Was it due to favorable prices? Was it due to the family connection? We suspect both!

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Research report on LexinFintech Holdings Ltd. (NASDAQ: LX)

Terrible Macro Trends: The Chinese Low Credit Consumer has had a Tough Period During The Quarantine

The overall banking sector in China has taken a heavy blow due to COVID, and the vast economic effects continue to show.

Multiple media outlets have touched upon the massive headwind to the credit industry in China during the coronavirus.

"Consumer default rates at some banks have already increased to as high as 4% from about 1% before the outbreak, according to Zhao Jian, head of Atlantis Financial Research, who cited a survey of lenders. An executive at one major Chinese bank said his firm is taking steps to **tighten credit card loans or even drop some clients after seeing a rapid increase in overdue payments."**

---[The Economic Times](#)

"Meanwhile, multiple local banks told the FT their **overdue personal loan ratio had surged by as much as 60 percent from January,** when the disease broke out....China Merchants Bank Co., paused on its credit-card business in March after a significant increase in past-due loans." ---[Financial Times](#)

"The lending campaign, however, has raised concerns about credit risks because defaults have also taken off. Zhou Lifeng, chief risk officer at Hangzhou-based Sunyard Fintech, a consultancy that advises banks on risk management, said **his clients had seen an increase of between 20 percent and 50 percent in non-performing consumer loans since the disease emerged."** ---[Financial Times](#)

The situation unfortunately prolonged even when Covid in China was steadily put under control. The borrowers are still fundamentally in a bad place.

"As of June 2020, Chinese bank's delinquent loan rate is 2.1%, even higher than during the first quarter. **Regulators are even more worried that the current numbers do not fully reflect the underlying risks** due to a number of policies put out such as extending loans, borrowing new ones to repay old etc." ---[Sina Finance](#)

Similarly, in the online financing sector, which is typically considered to be targeting subprime borrowers who could not secure financing from lower interest rate channels such as banks and other traditional financial institution, the situation has been consistently dire.

Qudian Inc., (NYSE: QD) has seen its delinquency ratio jump to 20% in February from 13% at the end of last year.

Notice that borrowers and users under LX are typically considered sub-prime and high-risk borrowers by any traditional bank standards. Most probably turned to LX services after failing to acquire the desired loan from a bank. If the situation banks present is this dire, we worry the risks LX is facing is even a lot worse.

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We Believe the Company is Masquerading Deteriorating Credit Quality

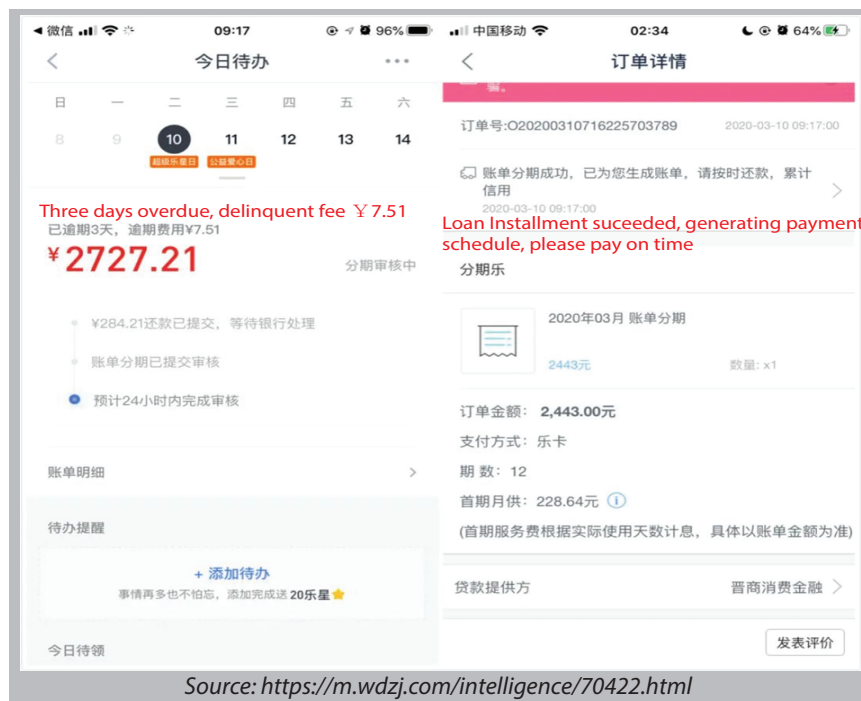
We believe LX has artificially deflated its default and delinquency ratio to give the appearance of a more healthy financial position.

We believe the LX has been artificially increasing the maturity of the loans upon default through a feature called “再分期”, installment on installment and “最低还款服务”, minimum payment. To put this into perspective, this is equivalent to when your minimum credit card payment comes due this

month, the company gives another extension to your minimum payment and treat it as a new credit loan. According to LX users, LX has recently been extending the maturity of their loans on the second day after they become delinquent. We believe the company has been secretly doing so for a long time.

One user applied for this extension on the third day of becoming delinquent. His loan balance suddenly spread out over 12 months.

We spoke to numerous sell-side analysts who also casted doubt on how LX was able to maintain such low default and delinquency data. They suspected loan extensions but weren't able to obtain evidence. We now provide proof that delinquent loans were in fact extended/renewed.



Source: <https://m.wdzj.com/intelligence/70422.html>

This feature has been implemented by LX since 2016. However, it was only used on loans that weren't delinquent. **Now, most likely due to effects of COVID-19, the company has deployed this tactic on delinquent loans to generate a seemingly healthy loan portfolio.** The users don't have to pay back the amount immediately and the company no longer has to book delinquencies.

In reality, we believe what is happening under the black box that no investors, no lenders can see is the following.

Suppose \$1M of loans issued in Jan 2019 becomes due 12 months later on Jan 2020 and only very few borrowers are able to make payment. Instead of

directly charging the entire balance of 1M+ delinquent loans, LX “vets” its borrowers and chooses to either offer them “installment on installment” or “minimum payment”. Those who do not receive such services are accounted for as delinquent borrowers, but the company wants to keep this number to a minimum. However, those who receive such options, their delinquent loans are essentially packaged into another product that is sold to lenders (investors). The proceeds are then used by the borrowers to pay back delinquent loans, thus reducing delinquency rates. We believe the black box is so elaborately set up that even institutional investors and insurance companies are not fully aware. As long as the company can solicit more funding from investors the Ponzi scheme keeps rolling.

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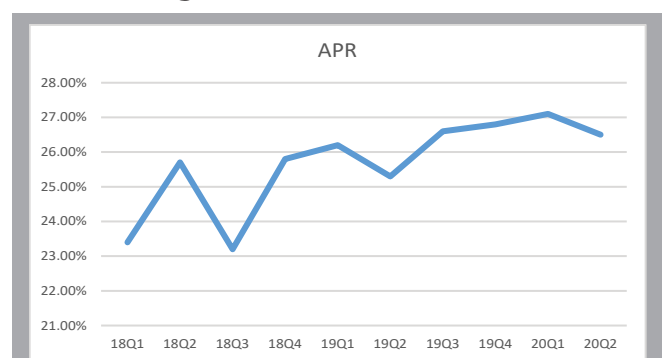
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We Believe the Company is Masquerading Deteriorating Credit Quality (Cont'd)

However, there are some symptoms we can expect from this scheme.

Overall High APR



Source: Company filings

We can expect an overall increase in APR due to higher interest expenses charged on supposedly delinquent loans

Note that in China, the legal upper limit of interest rate is separated into two tranches, 24% and 36%. For borrowers who have not repaid interest, the lender must not ask for an APR higher than 24%. The amount exceeding 24% will not be protected by law. For borrowers who have already paid interest, borrowers can request the amount of interest exceeding APR of 36% to be returned.

LX's APR has been consistently over 24% in 2018Q4 and will likely continue to rise due lower asset credit qualities and the installment on installment scheme. This has been above the legal interest rate. Borrowers can refuse to pay such amounts. In other words, the increase of APR cannot go on.

Furthermore, the recent regulation in China will likely further limit the company's ability to charge excessive APR.

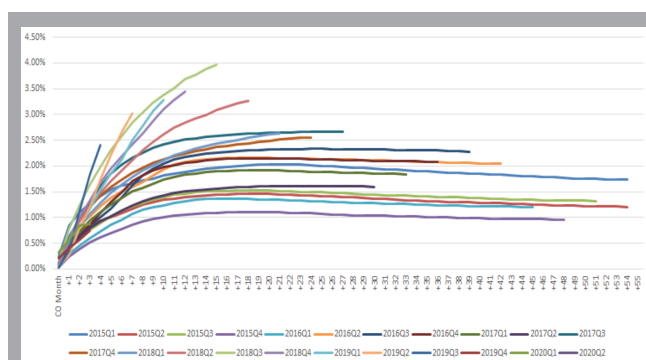
Deteriorating Credit Performance

Another symptom we can expect is the deterioration of credit performance measured by many factors, including vintage rate, charge-off rate, delinquency rate, and default rates. While some are more reliable than others, in the case of LX, we see deterioration in all metrics.

Vintage Rate

Vintage rate is defined as the amount of net delinquent loans during a period (vintage) to the total amount of loans originated during that same period. The metric is more reliable than the delinquency rate since delinquency rates can easily be manipulated by growth.

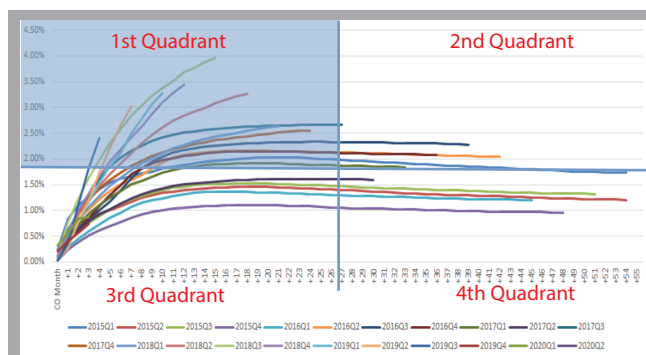
Below is the chart of LX's vintage rate up to Q2 2020. As we can see, the lines that are to the upper-left tend to be shorter than those to the lower left. The length of the line corresponds to the period of origination. Shorter lines indicate that less time has passed, thus corresponds to more recent periods, and longer lines correspond to more distant periods. We see that newer vintages are having higher delinquency rates, indicating lower credit quality.



Source: Company filings

Vintage Rate Curve of LX from 2015Q1 to 2020Q2.

We see a taller vintage curve due to lower quality loans being packaged together into newer loans. As discussed below, a tall vintage curve indicates a recent deterioration of asset quality. We believe as LX repackages delinquent loans and selling them to investors, they are postponing the inevitable delinquency into later periods. This can already be seen in the changes in the vintage curve. We believe this trend will continue and that LX's loans will become even riskier.



Source: Grizzly Analysis, Company filings

The lines will start to pile into the first quadrant indicated by the red rectangle. This is an indication of deteriorating credit quality

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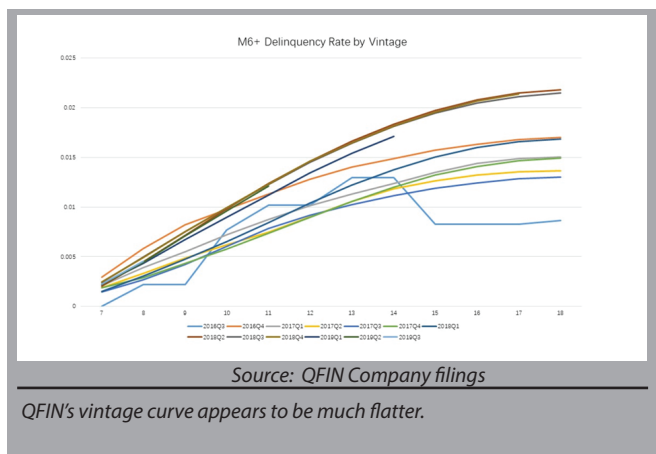
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We Believe the Company is Masquerading Deteriorating Credit Quality (Cont'd)

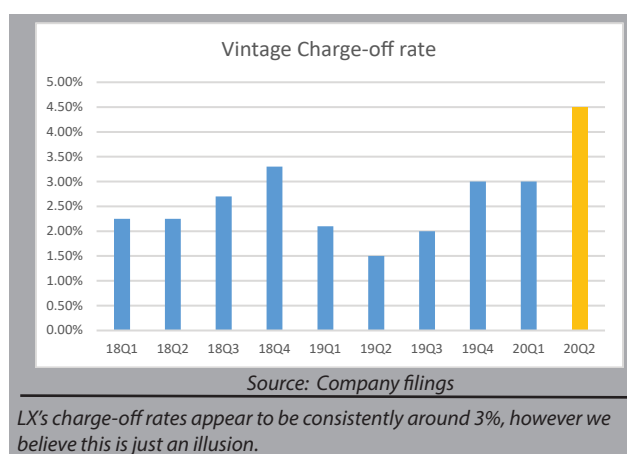
In comparison, LX's competitor QFIN demonstrates higher stability in their products' creditworthiness.



Vintage Charge-off Rate

Vintage Charge-off rate, more commonly known as default rate is the amount of loan that was charged-off (due to default) during a specific period (vintage) to the total loan amount originated during the same period.

We see that apart from the latest quarter Q2 2020, charge-off rates have been consistently around 3%. However, as we've previously shown, this datapoint is not to be relied upon.



Delinquency Rate

Delinquency rates can be fairly misleading. It is defined by the delinquent amount over the total outstanding loan balance of a given period. It can be easily manipulated to portray a better risk profile by simply issuing more loans.

RMB in Bil	18Q1	18Q2	18Q3	18Q4	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2
Total outstanding principal balance	21.3	24.7	25.8	32.4	35	40.6	51.5	60.6	58.5	61.9
<i>growth y/y</i>					64%	64%	100%	87%	67%	52%
30 Days + Delinquency Ratio	3.00%	2.60%	2.80%	2.60%	2.90%	3.00%	2.70%	3.45%	6.02%	5.55%
<i>growth y/y</i>					-3%	15%	-4%	33%	108%	85%
30 Days + Delinquency Amount	0.64	0.64	0.72	0.84	1.02	1.22	1.39	2.09	3.52	3.44
<i>growth y/y</i>					59%	90%	92%	148%	247%	182%
90 Days + Delinquency Ratio	1.44%	1.39%	1.39%	1.41%	1.42%	1.49%	1.40%	1.56%	2.57%	2.99%
<i>growth y/y</i>					-1%	7%	1%	11%	81%	101%
90 Days + Delinquency Amount	0.31	0.34	0.36	0.46	0.50	0.60	0.72	0.95	1.50	1.85
<i>growth y/y</i>					62%	76%	101%	107%	203%	206%


As we can see, each decrease in delinquency rate was accompanied by much higher growth in outstanding principal relative to delinquent amount. By expanding the denominator at a faster speed, LX can artificially keep their delinquency rate lower and portray healthy loan performance.

When we consider the total effect of charge-offs (default) and the highly uncollectable M3+ Delinquent loans, we see that as of Q1 2020, total potential downfall can be between 6.1% to 7.1%. This is equivalent to around 4.4B RMB, or roughly \$630M.

According to the latest 20-F, LX has an allowance for credit loss for financial receivables of RMB 374 million, way short of covering the potential risks.

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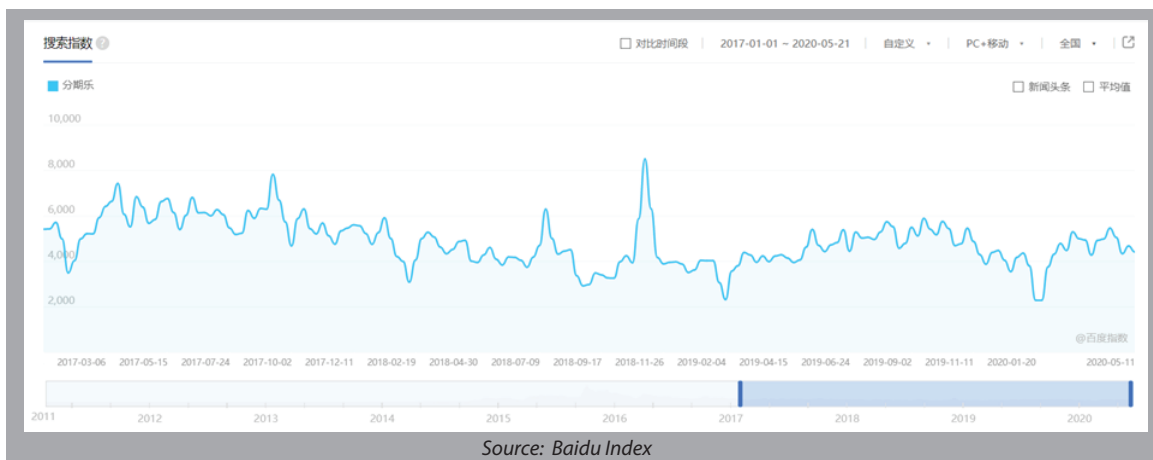
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Web Traffic Analysis Casts Doubt on Purported Volume

Below is the Baidu index for LX's key consumer lending product Fenqile (分期乐) from the beginning of 2017 to May 21, 2020. One can easily see that in the past couple of years the index has rather flat. This does not make sense given that the LX's registered users increased from 20.2M at IPO

to 84.2M as of March 2020, or approximately 300% in total.

We dare to ask: How does a company manage to grow by 3x when the website traffic on its main platform appears to be flat or even declining?



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Valuation

We believe there are severe risks that have not been correctly modeled into the current valuation, including the hidden portion of delinquency and default risks and the existential risk incurred by the recent policies regarding civil-lending hurdle interest rates. We further consider hidden liabilities brought by the old P2P model and the real effect of back-to-back guarantees.

According to our model the income statement is affected by one-time charges of RMB 372M due to delinquency and default risk adjustments, and an annual decrease of RMB 4.082B in 2020 due to hurdle interest rate changes. As a result, shareholder equity is decreased to RMB 1.85B in 2020Q1, and to negative value by the third quarter of 2020. We believe the company is essentially insolvent.

Effect of Hidden Portion of Delinquency and Default Risks

Denominated in RMB			
Delinquency Data			
	2019 Q1	2020 Q1	YoY Multiple
QFIN [1]	0.94%	2.17%	2.31
FINV [1]	3.80%	7.25%	1.91
YRD [2]	4.50%	8.90%	1.98
QD [3]	7%	20%	2.86
		Average	2.26
LX	2019 Q1 Reported	2020 Q1 Reported	2020 Q1 Implied
	1.42%	2.57%	3.21%
		Delta%	25.03%
		Effect on Operating Costs M	95.00
Default Data			
	YoY Multiple	QoQ Multiple	
QFIN [4]	1.80	1.37	
YRD [5]	Nil	1.68	
	Average	1.53	
LX	2019 Q1 Reported	2019 Q4 Reported	2020 Q1 Reported
Default Rate	2.00%	3.00%	3.00%
		2020 Q1 Implied YoY	2020 Q1 Implied YoY
		3.59%	4.58%
		Average	4.09%
		Delta	1.09%
		Loan Originated in Q3 2019 M	37,000.00
		Effect on other costs M	401.46
		LX Risk Management Discount	25%
		Total Under-reported Costs M	372.35

Notes:

[1] Multiples for QFIN and FINV is based on 90 Days Delinquency Rates.

[2] Multiples for YRD is based on Cumulative Delinquency Rates due to lack of comparable metrics.

[3] Multiples for QD is based on D1 Delinquency Rates due to lack of comparable metrics.

[4] Multiple for QFIN's Default Data is based on Provision for financial assets receivable to Loan Origination during respective vintage periods. For instance, 1.8 is derived by (93.7/55965)/(25.1/26925)

[5] Multiple for YRD's Default Data is based on QoQ Vintage Charge-Off Rates

Source: Grizzly Analysis, Company filings

We compared delinquency data and default data of many publicly traded peers with LX to project the estimated potential effect on its income statement. The effect from delinquency data amounts to RMB 95M in one-time charges. The effect from defaults on costs amounts to over RMB 400M in one-time charges. We give the company the benefit of the doubt by applying a 25% discount to default charges due to LX's superior "Eagle Eye" risk management

system. The cumulative dollar effect amounts to RMB 372.35M.

As of Q1 2020, LX incurred RMB 678M in losses. To be fair, over RMB 1B in costs was due to provision for credit losses of contingent liabilities of guarantees due to the adoption of CECL. Nonetheless, even when we remove CECL effects, LX would still be unable to break-even in our model.

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Valuation

Effect of Existential Risk due to Hurdle Interest Rate Changes

<i>in RMB Mil</i>	2019 Q4	2020 Normalized
Total Outstanding Principal	60,600	
Original APR	27%	
New Suggested APR	15%	
Credit Spread	-12%	
Reduction in Operating Revenue	-1,757	-7,030
Current Operating Revenue	3,148	12,592
New Operating Revenue	1,391	5,562
Total Operating Costs	1,670	6,680
Gross Profit	-279	-1,118
Total Operating expenses	741	2,964
Net Income Original	518	2,072
Net Income Adjusted	-1,020	-4,082

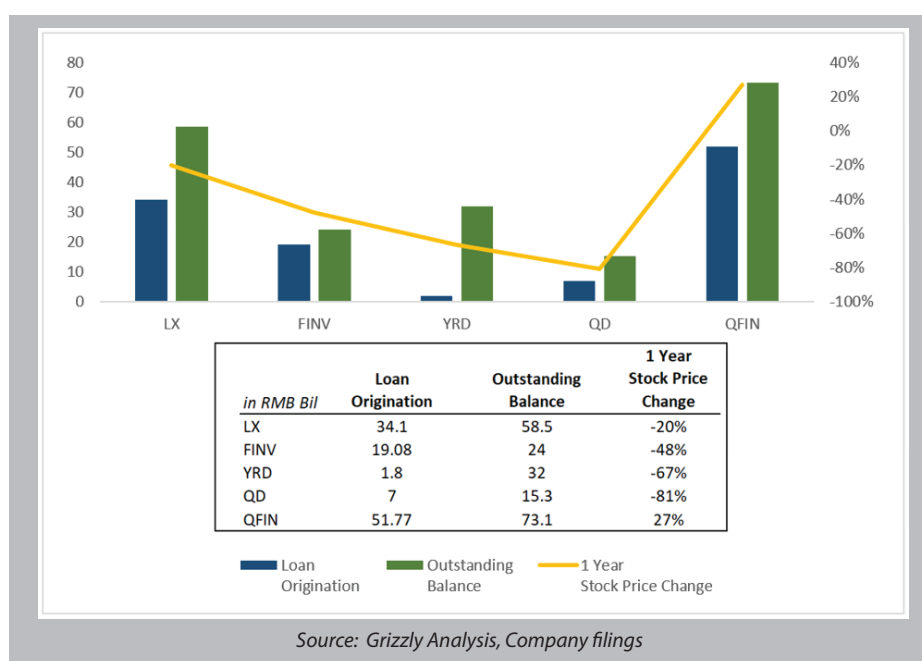
Source: Grizzly Analysis, Company filings

The effect of the hurdle interest rate changes is devastating. Simply put, if the new policies came into effect LX’s business model would be rendered uneconomical.

Currently, LX averages an overall 27% APR and spends around 8.1% on funding costs. Were the hurdle rate to decrease to 4x LPR rate, which currently stabilizes around 15.4%, LX should see an immediate decrease of 12% in credit spread. Note that funding costs are unlikely to decrease due to institutional investors demanding a risk premium when investing money in risky assets on LX’s platform.

We removed any effect of the adoption of CECL. However, despite our courtesy, after considering the effect of hurdle rate changes, LX’s still looks like it is facing a fundamentally broken business model. We forecast a whopping RMB 4B decrease in 2020’s Net Income or approximately RMB 1B per quarter.

To be fair, we do believe this is an industry-wide headwind and will likely cause a similar impact on other companies. However, we believe LX will be hit harder than most, due to its higher loan origination volume and higher total outstanding loan balance.



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Valuation

Effect of Legacy P2P Model Liabilities

As previously noted, Juzi Licai’s old model is not covered by the newly implemented RSS. Rather they are protected by a quality assurance program that ceased operation in April 2018. Currently, there are still RMB 821.4M liabilities outstanding. We believe this is a direct impact on shareholder equity.

Valuation Summary

<i>in RMB Mil except share price</i>	2020-Q1	2020-Q2	2020-Q3	2020-Q4	FY2020
Beginning BV of Original Shareholder Equity	4,059	1,845	824	-196	4,059
One Time Decrease in NI due to Hidden Delinquency and Default Rates	-372	-	-	-	-372
New Net Income due to Changes in Hurdle Rate	-1,021	-1,021	-1,021	-1,021	-4,082
One Time Effect of Legacy P2P Model Liabilities	-821	-	-	-	-821
Ending BV of Original Shareholder Equity	1,845	824	-196	-1,217	-1,217
P/B Ratio of LX	2				
Shares Outstanding (in Mil)	352				
Share Price in \$USD	1	1	-0	NA	NA

Source: Grizzly Analysis, Company filings

After considering the full effect of all adjustments, we believe LX’s share price will only continue to trend down. We conclude that LX will soon be worthless.

Some industry analysts consider LX a better player in an overall bad subprime lending industry, but we think LX is among the worst companies because:

- Under-reported delinquency rate and default rate, in our opinion, exaggerated the company’s net income and shareholder equity to a large extent
- The company is still in the loan origination expansion mode, and also has a larger outstanding loan balance, which puts it in greater risk under the new hurdle rate policy. The issues are only exacerbated by the borderline fraudulent practices of LX masking its deteriorating loan quality
- Stock performed relatively well compared to competitors in the past year, yet but still faces the existential risk that the proposed new hurdle rate policy might just put every company in this sector out of business, which means LX might have further downside from here
- Weakness in corporate governance that make us question the integrity of LX’s financials such as undisclosed related parties and large financial restatements in the past

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Outrageous Financial Restatement in Q1 2019

The reason why LX entered into our radar was the outrageous Q1 2019 restatement that happened in the company's Q2 2019 earnings release. This restatement also serves as a red flag that investors should have recognized.

What really caught our eye is the big restatement of its previously reported Q1 2019 results. The table below illustrates the magnitude of the restatement.

US\$'000	As Reported	As Restated	in \$	in %
Interest and financial services income and other revenues	56,508	45,021	(11,487)	-20.3%
Loan facilitation and servicing fees	135,678	114,470	(21,208)	-15.6%
Financial services income	192,186	159,491	(32,695)	-17.0%
Net income	86,866	61,811	(25,055)	-28.8%
Adjusted net income	92,738	67,551	(25,187)	-27.2%
Non-GAAP EBIT	110,617	80,369	(30,248)	-27.3%
Earnings per ADS	\$0.48	\$0.34	(\$0.14)	-29.2%
Adjusted Earnings per ADS	\$0.51	\$0.37	(\$0.14)	-27.2%
Retained earnings	324,067	293,694	(30,373)	-9.4%

The reason for the restatement given by the company was mainly due to the "error" that was identified about the revenue from financial services income. The revenue from financial services income for the first quarter of 2019 was overstated by RMB 129 million, due to "certain discounts and interests waived were not appropriately recorded due to unintentional use of incorrect system reports in connection with the preparation of the financial statement adjustments for such discounts and waived interest." In addition, the company also recorded an out-of-period

adjustment of RMB 66.1 million to financial services income for the first quarter of 2019 "to correct the cumulative effect of errors in recording discounts and interests waived in the periods prior to December 31, 2018. The out-of-period adjustment primarily resulted in a decrease of RMB63.6 million of interest and financial services income and other revenues, and financing receivables, respectively."

The fact that LX overstated results and had to adjust previously reported financials does not give the impression of great internal controls.

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Other Red Flags

Audit Fees

LX's auditor has been PricewaterhouseCoopers Zhong Tian LLP since 2016. One thing we like to check is the audit fees trend along with the

reported business development. Below is the table that summarizes the overall audit fees and operating metrics from 2016 to 2019.

	2016	2017	2018	2019	% change from 2017 to 2019
Audit fees (US\$)	\$691,637	\$2,462,867	\$2,268,926	\$2,528,082	
Audit-related fees (US\$)	—	—	\$407,243	—	
Audit fees & Audit-related fees	\$691,637	\$2,462,867	\$2,676,169	\$2,528,082	2.6%
Annual Operating Revenue	\$667	\$858	\$1,105	\$1,523	77.5%
Outstanding Principal Balance of Loans (US\$ M)	\$1,521	\$2,962	\$4,712	\$8,700	193.7%
Loan Originations (US\$ M)	\$3,412	\$7,332	\$9,612	\$18,093	146.8%

LX went public in 2017, which might be the reason for the audit fee jump from 2016 to 2017. However, from 2017 to 2019, the annual total audit fees and audit-related fees together only increased from \$2.46 million to \$2.53 million, a 2.6% increase, yet the company's reported revenue increased 77.5%, the outstanding principal balance of loans increased 193.7% and loan

originations increased 146.8%, respectively. We are not saying that audit fees should increase at the same rate as compared to these operating metrics' rate, however, the fact that the audit fees, in general, remained almost flat with the soared business development is something investors should pay attention to. In our opinion, this could be a red flag for weak auditing/supervision process and warrants investors' caution.

Management Compensation

Year	2016	2017	2018	2019
Mgmt Comp (RMB Mil)	4.6	6.2	15.5	28.1
Rev (RMB Bil)	4.3	5.6	7.6	10.6

We are also cautious when it comes to management overpaying themselves, especially when growth in management compensation outpaces revenue growth by a large margin. In the case of

LX, while revenue has only doubled, management compensation has 6 folded. We see this as another red flag.

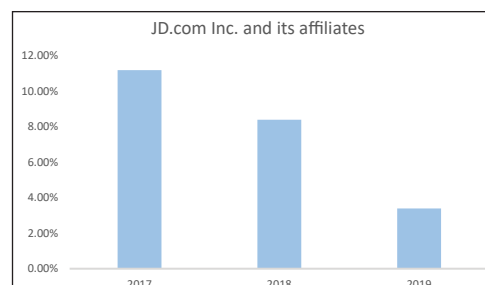
Insider Selling

What's perhaps more disturbing is the magnitude to which insiders have sold off their shares in the firm. Insider selling, typically regarded as a negative signal, is not an uncommon phenomenon. However, insider selling of this degree is clear sign

of lack of confidence in the company in our opinion.

We see that over the course of three years, insider position has decreased by half from 81.7% to just under 40%.

	Percentage of total Ordinary Shares		
	2017	2018	2019
Installment Payment Investment Inc	33.4	30.5	27.2
K2 Partners entities	14.2	13.3	11.9
Matrix Partners China III Hong Kong Limited	11	10.3	*
JD.com Inc. and its affiliates	11.2	8.4	3.4
Magic Peak Investment Limited	6	5.1	*
Apoletto entities	5.9	*	*
Total	81.7	67.6	39.1



JD.com's involvement has long been considered an confirmation for LX's value and future. However, in the past three years, JD has been consistently decreasing its position.

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Conclusion

We have laid out in detail in this report why we are troubled by almost all aspects of LX. The company's fundamental set up is a "Heads I win, tails you lose" situation. US investors are essentially guaranteeing payment of what we believe to be predatory consumer loans. Beyond that, we believe LX is making a conscious effort to misrepresent the viability of its business and the credit quality of its platforms.

Recent reform on upper limit of interest rate essentially renders LX's business model non-feasible. According to our valuation model, LX's will be unable to be profitable. Moreover, we believe the income statement is affected by one-time charges of RMB 372M due to delinquency and default risk adjustments, and an annual decrease of RMB 4.082B in 2020 due to hurdle interest rate changes. As a result, shareholder equity is decreased to RMB 1.85B in 2020Q1, and to negative value by the third quarter of 2020. We believe the company is essentially insolvent.

The Coronavirus crisis and related quarantine measures have certainly had a profound impact on the global economy and China in particular. LX had run a low quality and potentially fraudulent credit business


in China, and we believe the crisis has had a profound impact. Currently, LX is trying to stay alive by artificially extending extra credit to delinquent borrowers, but the Ponzi type nature of this activity will soon come to light. Make no mistake about it: We believe the Corona crisis has already put LX in a position where the public company is on the hook for a lot more liabilities than it purports— LX is just trying to masquerade that fact.

Management seems to agree with our negative assessment of the company: Insiders and early investors sold shares aggressively and management resorts to pocketing big cash compensations. The China hustle continues.

In conclusion, we give LX a target price of ZERO.

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