[YRD] - Yirendai Ltd., Q2 2017 Earnings Conference Call
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CORPORATE PARTICIPANTS

Mr. Matthew Li; *Director, IR*
Ms. Yihan Fang; *CEO*
Mr. Dennis Cong; *CFO*
Ms. Joanne Liu, VP Finance

CONFERENCE CALL PARTICIPANTS

Richard Xu; *Morgan Stanley*
Ella Ji; *China Renaissance*
Erik Wen; *Blue Lotus*
Ryan Roberts, *MCM Partners*
Pu Han; *CICC*

PRESENTATION

Operator: Good day, and welcome to the Yirendai Limited, second quarter 2017 earnings conference call. (Operator Instructions)

Please note this event is being recorded.

I would now like to turn the conference over to Mr. Matthew Li, Director of Investor Relations. Please go ahead, sir.

Matthew Li- IR Director

Thank you, Operator. And welcome to Yirendai's second quarter 2017 earnings conference call. Today's call features presentations by our CEO Ms. Yihan Fang, and our CFO Mr. Dennis Cong. Mr. Cao Yang, our COO and CTO, and Ms. Joanne Liu, our VP of Finance, will join the presenters in the Q&A session.

Before beginning, we would like to remind you that discussions during this call contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Such statements are subject to risks, uncertainties and factors that may cause actual results to differ materially from those contained in any such statements. Further information regarding potential risks, uncertainties or factors is included in Yirendai's filings with the U.S. Securities and Exchange Commission. Yirendai does not undertake any obligation to update any forward-looking statement, except as required under applicable law.

During this call, we will be referring to several non-GAAP financial measures as supplemental measures to review and assess our operating performance. These non-GAAP financial measures are not intended to be considered in isolation or as substitute for the financial information prepared and presented in accordance with U.S. GAAP. For information about these non-GAAP measures and reconciliation to GAAP measures, please refer to our earnings press release.

With that, I will turn the call over to our CEO. Yihan, please begin.

Yihan Fang- CEO

Ms. Yihan Fang: Thanks, Matthew. And thank you all for joining the call today.

We are pleased to deliver another strong quarter with loan originations growing by 80% from the same quarter of prior year to RMB 8.2 billion. This brings our cumulative loan origination volume as of June 30th, 2017 to RMB 47 billion and outstanding loan balance to RMB 28 billion.

In Q2 2017, we facilitated loans to 139,000 qualified borrowers. 71% of these borrowers were acquired from online channels, representing 51.2% of our loan volume. Online volume growth this quarter is 129% year-over-year. Nearly 100% of the online loan volume was facilitated through mobile. As of the end of Q2, we had cumulatively served 744,000 qualified borrowers, with cumulative registered borrowers of 33.5 million.

The strong growth from online channels was mainly driven by our continuous focus on technological innovation in areas including programmatic online marketing, customer acquisition and conversion efficiency, data quality and automatic anti-fraud system.

Despite the continued growth of loan volume, the risk performance of our loan portfolio has remained very stable. This quarter, we launched a new risk grid based on our proprietary credit scoring system, the Yiren Score, in aims of delivering more precise and accurate characterization of our borrower's credit profile. We have and will continue to invest heavily in our technology, data and AI to drive our operational efficiency and risk management capabilities.

We continue to focus on product innovation. In Q2 2017, about 5% of our borrowers were repeating borrowers from the top-up loan products. In addition, based on initial testing results, our insurance policy based products have shown very stable performance. We expect to open this product to all our customers in the near future.

In addition, our housing provident fund-based product has been widely received in the market and has helped us acquire many customers with high credit quality. This product has recently reached the RMB 100 million origination monthly milestone.

In the second half of the year, we plan to launch new products that are based on China's social security data. Our commitment to continuous product innovation has helped us improve customer satisfaction as well as maintaining our leading position in the online lending industry in China.

Moving onto wealth management, we served close to 200,000 investors during the quarter. All these investors invested through our online channel, and 90% of them used our Yiren Wealth mobile app.

As of the end of Q2 2017, we had cumulatively served about 1.1 million customers and registered users is about 5.6 million.

In Q2, average investment term for our Yidingying product remained healthy at 10 months, with an average annualized return of 7.9%. In addition, AUM per investor continued to increase to RMB 103,000 in Q2.

Mobile DAU in March 2017 was approximately 318,000.

We aim to build Yiren Wealth into a leading online wealth management platform in China that serves the growing mass affluent population with investable assets of RMB over 600,000.

To increase customer stickiness on our platform, we are constantly reviewing our product mix as well as our app's features and tools to ensure we can suit our investors' varying demands.

In the future, we plan to provide asset allocation services to our customers through implementing KYC measures and leveraging CreditEase broad wealth management product portfolio.

Our new platform business, which is conducted through the Yirendai Enabling Platform, or YEP, that we launched in March of this year, has shown steady yet accelerating growth. We have established close partnerships with several industry stakeholders on data collection, anti-fraud and customer acquisition, and have already seen outstanding results.

We'll continue to work with qualified partner companies to help grow our platform business, and at the same time optimize industry's efficiency and the customer experience.

For the rest of the year, we will execute our key strategies as discussed above. Furthermore, we will also continue to work closely with regulators to ensure our full compliance status with online lending industry guidelines.

I'm very pleased with the progress we have achieved to date. We have been ranked number one three months in a row by wangdaizhijia.com in their online lending platform development index, which further solidifies our leading position in the fintech landscape in China.

I'll now hand the call over to our CFO, Dennis, to discuss our Q2 2017 financial results.

Dennis Cong- CFO

Mr. Dennis Cong: Thanks, Yihan. Hello, everyone. I will first go over our second quarter 2017 financial results, followed by our guidance for next quarter and our updated guidance for fiscal year 2017.

We again delivered solid results for the past quarter, with strong loan origination volume and top-line growth.

Q2 2017 total net revenue beat our guidance by approximately 10%, increasing 61% from previous year to RMB 1.2 billion, with a corresponding revenue take rate of 14.4%. The strong revenue growth was mainly due to growth of loan origination volume, especially from online channels as well as increased service fees billed to investors and monthly fees billed to borrowers as our remaining loan balance continued to expand. It was partially offset by the impact of deferring revenue recognition nature of the loans facilitated from online channels and monthly fee collection loans, which has a fee collection schedule with monthly payments in addition to a portion paid up front.

Driven mainly by loan volume and investor AUM growth, we billed fees of RMB 1.9 billion to borrowers and investors in Q2 2017, an increase of 68% from previous year. Our take rate of fees billed, was 23% in Q2 2017, similar to the previous quarter and compared to 24% in Q2 2016.

Turning to operating expenses, sales and marketing expenses were RMB 618 million for the quarter or 7.5% of loan facilitation volume, compared to a seasonally low 6.8% in the previous quarter and 7.8% in the prior year. The decrease in sales and marketing expense as a percentage of loan volume on a year-over-year basis was mainly due to the improvement of borrower acquisition efficiency from online channels.

Origination and servicing costs were RMB 93.1 million for the quarter or 1.1% of loan volume, increased from 0.8% in the previous quarter. Origination and servicing costs increased due to our enhanced efforts in loan collection activity this quarter.

Our G&A expense were RMB 99 million for the quarter or 8.3% of total net revenue, compared to 9.8% in the previous quarter. The decrease in G&A expenses as percentage of total net revenue was primarily attributable to the improved operational efficiency and leverage, despite our increased level of investment in technology development, artificial intelligence and machine learning capabilities.

In terms of profitability, we achieved an adjusted EBITDA margin of 32%, compared to 39% in the previous quarter and 36% in the same period of 2016.

Net income in Q2 2017 was RMB 269 million, an increase of 3% from the same period last year. Excluding the one-time withholding tax for special cash dividend, the adjusted net income in Q2 2017 was RMD 329 million, an increase of 26% from the same period of last year.

On the risk management front, we continued to maintain solid anti-fraud and credit underwriting process and closely monitor risk performance of our loan portfolio. As 2015 and 2016 vintage loans continue to mature, the risk performance of our loans is consistent with our expectations, as demonstrated by the stable delinquency rates and consistent vintage charge-off performance of our loan portfolio. The current total charge-offs of our 2015 vintage loans with reducing balance, are standing at 8.3%, a good indication of our asset quality as well as loan performance.

As a leading fintech company in China, we strive to uphold industry best practice for all aspects of our business. We are pleased to see the continuous progress made in refining our credit scoring model to deliver more precise and accurate credit assessments of loan applicants. Under the new Yiren Score credit scoring system starting May 1st, 2017 we will adopt an upgraded risk grid system with five segments to more accurately characterize the risk profile of our borrower base.

Similar to FICO score, the new system has a score range from 300 to 900 that corresponds to the credit quality of a borrower. Through our benchmark testing, our Yiren Score has a good correlation to FICO score in terms of expected net charge-off rate and actual observed results for each of these score ranges. For example, a Yiren Score of 700 borrower's credit performance resembles that of a FICO score 700 consumer in the U.S. market.

The current volume adjusted average Yiren Score of our loan portfolio is around 710, again another strong indication of the prime nature of our borrower base and loan portfolio.

In aims to further enhance our cash management and to better match our services with the cash position associated with the Quality Assurance Program, we have revised the cash contribution rules of the Program, effective July 1st, 2017. The Company will contribute 30% of the transaction fee collected from the borrowers following the actual fee collection schedule over the life of the loan, to a restricted bank account as a quality assurance service fee, the total contribution over the life of a loan approximately equal to 8% of the loan contract amount, which is the same to the current Quality Assurance Program liability accrual ratio.

This amendment of cash contribution rules doesn't change the protection level [we're] providing to the investors, but rather to better match the contribution schedule with the cash collection from the business and enable us to generate higher returns on cash.

On cash flow and balance sheet side, we continue to enjoy strong cash flow from operations and to maintain solid cash position. During this quarter, we generated net cash of RMB 530 million from operating activities. As of June 30th, 2017, our cash and cash equivalents was RMB 891 million, balance of held-to-maturity investments were RMB 589 million, and balance of available-for-sale investments was RMB 1.3 billion.

As of Q2 2017, we had RMB 1.7 billion of restricted cash in our quality assurance program and trust accounts. We also booked RMB 270 million in loans at fair value because of consolidating the trust and ABS.

Our liabilities were mainly comprised of RMB 2 billion in liabilities from the Quality Assurance Program.

Considering our current large cash position and projected strong cash flow generating capability, to improve our shareholders' return, our Board of Directors have approved a special cash dividend in the amount of $1.50 per ADS, which is equivalent to 30% of the accumulative net income through the fiscal year 2015 [to] the first half of 2017.

In addition, our Board of Directors also approved a semi-annual dividend policy. Under this policy, semi-annual dividends will be set at an amount equivalent to approximately 15% of Company's anticipated net income after tax in each half year commencing from the second half of 2017.

We continue to see strong growth trajectory of our online credit and wealth management business and invest aggressively in building our technology capability and establish new product development program. However, given our capital-efficient marketplace business model and strong technology-driven cash generation operation, we believe the dividend payout policy to our shareholders demonstrate our prudent and responsible corporate finance management practice.

With that, let me go over our guidance. For the third quarter of 2017, we expect loan origination volumes to be in the range of RMB 10 billion to RMB 10.5 billion. Total net revenues will be in the range of RMB 1.3 billion to RMB 1.35 billion, and adjusted EBITDA to be in the range of RMB 280 million to RMB 320 million.

At the same time, based on our strong performance in the first half of this year and expectation of the second half, we would like to revise up our guidance for full year 2017. We expect loan origination volume to be in the range of RMB 35 billion to RMB 37 billion, an increase of approximately 6% from our previous guidance, total net revenue to be in the range of RMB 4.8 billion to RMB 5 billion, an increase of approximately 10% from our previous guidance, adjusted EBITDA to be in the range of RMB 1.3 billion to RMB 1.4 billion.

That concludes my remarks. I'd now like to turn the call back to operator for the Q&A session.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions) Richard Xu of Morgan Stanley.

Richard Xu: Two questions from me. One is I don't know if there's any impact on the strategy so far from the rising interest rate environment in China. I realize that investor cash incentives increased a little bit in the second quarter. Does that mean we're going to change a little bit of strategy on the investor acquisition front?

And secondly is on the regulatory front. Certainly the regulators have tightened the regulatory standards for the whole financial services sector, including fintech. What's the impact on Yirendai? Are we seeing competitors, I guess decreasing competition a little bit or more exit of some of the smaller platforms? From that perspective, what does it mean for our investor and borrower acquisitions? Thank you.

Ms. Yihan Fang: This is Yihan. Thank you for the question. In the second quarter, our cash incentives were a little bit higher because we wanted to build a bigger user base for some individual investors because we are planning to grow our wealth management business into a more general online wealth management platform. So we really put effort towards the mass affluent audience. And we did various tests to do more targeted sourcing of our mass affluent customers.

And going forward, not only will we try to acquire more mass affluent customers, we'll also diversify our funding sources to be prepared for any situation. For example, the interest rate change in the banking industry. So we will introduce institution funding like trust and the bank, and as well as developing our individual investor base.

Mr. Dennis Cong: Yes. And also, let me add to Yihan's answer. In general actually, because most all the investor individual actually were less sensitive to the recent interest rate rise in the China institution market, [our] actually annualized returns still keep at 7.5%. So I think that's an advantage that as we have institutional -- investor base of -- individual investor [retail] base that compared to some of other platform may be more sensitive to the institutional [capitals].

But still, as Yihan mentioned, longer term, the strategic view of us is to have a diversified source of funding so would have more balance in terms of anticipating any potential micro [shock] or liquidity issues.

Follow-up on the next two questions, first, regarding the regulation. The tighten down on the industry risk I think is definitely a good thing for us, as we have demonstrate from our recent Yiren Score, our asset quality performance has been outstanding. And we believe with the better tightening of the overall financial industry, we're actually going to see much more healthy risk environment within the financial industry.

And the next question regarding the competition among the P2P platform, I think with the implementation of the new online lending guidance from the CBRC, there are many second tier and third tier and some even larger platform are starting to exiting the industry, as you see in the market news. Then also as we have already indicate early on, as the industry leader, we will enjoy the benefits of the more well-regulated environment going forward.

Richard Xu: Thank you.

Operator: Ella Ji of China Renaissance.

Ella Ji: Congratulations on strong quarter. So my first question is relating to the average loan size and average borrower, investor size. So if our calculation is correct, the average loan size for each borrower, it has been declining in the past few quarters. But this quarter, this average size goes up. And the contrary for each investor, the average loan size has been going up in the past few quarters, but this quarter is the first quarter that it goes down sequentially.

I just wonder if management can provide some color behind the turning of the trend. Thank you very much.

Mr. Dennis Cong: Yes. I think I will answer the first average loan size. I think as we continue to optimize our risk models, especially with the new scoring system, we were able to optimize the loan approval rate for our best quality borrower base. What means that not only we enhancing our approval rate for the overall risk performance of the borrower, we actually getting a higher loan amounts to the better quality borrowers. So in general, you will see slight trending up of the average loan size, but also the overall loan performance has actually improved.

Ms. Yihan Fang: Yes. Ella, regarding to the investor loan size, we actually measure the AUM, asset under management, per investor. That's one of our PPI for investor. And I am positive that each quarter it's been increasing. And this quarter, the average AUM per investor has reached RMB 103,000. I believe last quarter it definitely lower than RMB 100,000. And this proves that we target more accurately towards higher quality investors or our investors have more trust in our platform and add more funds in their account or combination of both. Thank you.

Ella Ji: Thank you. So as a follow-up, so we have discussed that overall the liquidity on China's finance market seems to be tightening. In the meanwhile, the regulatory environment for the whole P2P market, it seems also to be tightening, which we think may force out, shake out underperformers.

So with these two things considered, I just wonder what's management's expectation for both borrower and investor acquisition cost going forward? So meaning on the one side the whole liquidity going down, so it may make it more difficult for you to find investors, but in the meanwhile, smaller players falling out of the market may give you more opportunity for market share consolidation.

So just wonder if management can talk about these two things, how that's going to affect your business. Thank you.

Mr. Dennis Cong: Yes. I think as a regulation implementation as well as the recent overall, the [government] direction of controlling the financial risk in the financial sector, we actually see we're going to benefit significantly from the trend. Basically you can already see that from our recent Q3 performance, as well as our 2017 guidance, you'll actually see less competition and better customer demand, enjoying better demand as we actually revise our business guidance.

We are in [compliance] already with the CBRC online lending guidance. That's a very clear indication of our unique position in the market. The current tightening of the regulation is actually putting a lot of less competitive or other non-performing platform out of market that will actually help us in terms of the overall borrower acquisition. And also, we believe at the leading qualified, [we're in] compliance platform in China or [enjoy] very special market position and brand in terms of attracting the investor [size] customers.

Yirendai's asset quality is very outstanding as we have seen from the sturdy risk performance and the [proved] return we generate from our investors. We believe we will stand out even more through this regulation tightening process that will become to strengthen our market leader position going forward.

Ella Ji: Thank you very much.

Operator: [Erik] Wen of Blue Lotus.

Erik Wen: Thanks management for taking my questions, and congratulations on the strong quarter and guidance. I have two questions. One is there have been several competitors offering loan products with different loan size, duration and target customers. What is Company's view on those, especially on payday loans market, and whether we intend to pursue this market?

And my second question is regarding the dividend. Can you elaborate on the thought process of initiating this dividend policy and why the management decide to return the cash back to the investors? Thanks.

Ms. Yihan Fang: Erik, I'll take the first one. For the other segmentation, Yirendai is clearly positioned to target (inaudible) worker with loan size of like 50,000 to 60,000 term loan, which helps their like life events, consumer needs. And there have been many new companies that serve very small and very short duration. And currently we don't have plan to enter that phase. We think that's a totally different segmentation than Yirendai expertise. And we think our best margin opportunity is still the larger size online loan product.

Mr. Dennis Cong: Yes. And also, I think after that, all our customer actually credit card holders. We believe the type of platforms that you mentioned, they provide shorter duration, small amount loans to consumers who mostly don't have a credit card. This is basically serving a revolving debt to them. That's not the key market that we're serving.

However, as we have accumulated to serve close to a million borrower base with such a high quality prime consumer base, we will plan to initiate some of our new products. Other than larger ticket size, longer durations, we potentially provide a shorter duration, smaller size financing to them to meet their other shorter term consumer needs.

So we will expand into these type of markets. But in terms of the (inaudible) segmentation, we'll continue to remain focused on our core, prime credit card holder consumer base.

In terms of the dividend policy, as you probably can see that our current cash balance, combining all the investments and all the [sales to] maturity balance together, we probably have about 2.7 billion capital on our balance sheet and will continue to enjoy 600 million or 700 million quarterly positive cash flow.

With our current unique capital [execution] model, even we have been very actively invest in our technology capability, we are a technology-driven platform that is -- and we do not need a significant working capital to run our business.

We're also actively looking for potential strategic directions. We are considering all these options. Even with that, we believe a prudent dividend policy we have set up now, about RMB 600 million one-times event, about 15% semi-annual-based dividend paying policy will still leave us enough, more than enough capital to drive our strategic growth.

Erik Wen: Thank you very much.

Operator: Ryan Roberts of MCM Partners.

Ryan Roberts: I'd like to add my congratulations on the strong quarter and nice guidance. My question just kind of quick, just on the origination and servicing costs, it's a very small item, you mentioned that the slight uptick was due to increased efforts on loan collections in the quarter. Just wondering if you can kind of give us some more color on what the background is.

Ms Joanne Liu: Thanks for the question. It's Joanne. The efforts we put to enhance the collection procedure is mainly on the pre-collection procedure. Before the loan gets to the payment [phase], we remind borrowers to pay, to repay the loan. And also, for the loan delinquent for less than 30 days, we enhance collection procedures as well, including phone calls and home visits.

Ryan Roberts: Got you, okay. Thank you. If I could just ask kind of just a follow-up on an earlier question. With respect to diversification kind of in the product portfolio -- sorry -- the loan portfolio, we mentioned potentially considering more kind of revolving consumption kind of credit.

I'm just kind of curious what management's thoughts are on when that might become more of an interesting factor for us.

Ms. Yihan Fang: Ryan, yes, actually, we are actively exploring [evolving] and a slightly smaller loan size to give a better customer experience. And actually, we are partnering with some leading platform offering line like and revolving products, which will be rolled out this year, yes.

But the size of the line would be [mighty] smaller than the [come-to]-term loan, but definitely not near the payday loan category.

Mr. Dennis Cong: Yes. In terms of business volume-wise, it will still be small this year, probably will grow into a meaningful percentage in 2018.

Ryan Roberts: Got you, okay. Thank you, management. Appreciate it.

Operator: [Pu Han] of CICC.

Pu Han: My question's about the guidance of the adjusted EBITDA. [We notice] a sequential drop in the guidance of this number in the third quarter. Could you help explain the main reason for the potential decline? Thanks.

Ms. Yihan Fang: Yes. For the dropping of the adjusted EBITDA for the fourth quarter, it's mainly impacted by the new product we introduced in Q2. That's a monthly product with a fee collection schedule, with a collection schedule featured by a monthly collection.

So in this [product], currently the main portfolio, the fee collection schedule is either 100% upfront or like around 40% to 50% upfront collection, with a monthly fee collection schedule. And this new product is actually with a very small portion of upfront fee, and the majority of the fee is collected on a monthly basis throughout the loan lifetime. And our revenue recognition is actually following the cash collected schedule. So in the first month or in the short term it will [naturally] impact our EBITDA margin.

Mr. Dennis Cong: Yes. I think it's a product mix of our online product as well as the new monthly collection fee loan products. As we highlighted before, we'd like to have a long-term EBITDA margin around 25%. I think that will be a good benchmark that you can use to look at our business going forward, as our loan volume continue to grow in a very strong trajectory, particular our online channels is growing very strong. We believe if you keep the 25% EBITDA margin, you will be able to see our [need to] longer term growth in terms of earnings and the profitability. I think I would suggest investor to look at our business that way. These are deferred revenue nature because the fee collection schedules. But the product can be even more profitable on [unit] (inaudible) basis.

Pu Han: Thanks very much.

Operator: (Operator Instructions) Ladies and gentlemen, this will conclude our question-and-answer session and also conclude the Yirendai Limited second quarter 2017 earnings conference call. Thank you for attending today's presentation. You may now disconnect your lines.