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Q3 2019 Yiren Digital Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Yiren Digital Third Quarter 2019 Earnings Conference Call. (Operator Instructions) I'll now hand over to Ms. Lydia Yu. Thank you. Please go ahead.

Lydia Yu ***Yiren Digital Ltd. - IR Officer***

Hi, everyone. Welcome to Yiren Digital's Third Quarter 2019 Earnings Conference Call. Today's call features the presentation by the Founder, Chairman and CEO of CreditEase and CEO of Yiren Digital, Mr. Ning Tang; and our Senior VP of Corporate Business Development, Mr. Dennis Cong.

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 can cause actual results to differ materially from those contained in any such statements. Further information regarding potential risks, uncertainties or factors is included in Yiren Digital's filings with the U.S. Securities and Exchange Commission. Yiren Digital does not undertake any obligation to update any forward-looking statements, except as required under applicable law.

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

I will now pass it on to our CEO, Ning, for opening remarks.

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

Thank you all for attending our third quarter 2019 earnings conference call. I'm pleased to announce that we have achieved another solid quarter of operations in both credit and wealth management businesses.

On the credit side, in the third quarter, we are back into growth mode after we have achieved stable credit performance baseline, and we expect this trend to continue. We achieved improving profit and operating cash flow due to both elevated business volume and better operating efficiencies as we start to bear the fruit of the synergies realized from the business integration post our business realignment. We are launching multiple business initiatives leveraging our combined operation. Just to highlight one of our key operating efficiency initiatives, we are pushing forward with our O2O program and have reached to over 60 cities in which repeat borrowers acquired through offline channels can now achieve 100% online application and approval process. For new borrowers acquired through offline channels, we aim to complete manual application review prior to their first branch visit to improve user experience and increase operating efficiency.

On product development front, we are working to directly access PBOC credit system to enhance our credit underwriting process, which should improve our credit performance as well. Our institutional partnerships, our total line of facilities from partnering banks have reached RMB 35 billion from RMB 30 billion last quarter as we have seen strong interest in our underlying assets from leading financial institutions. In addition, our technology partnership with Ningxia Bank has shown impressive initial results. Since product launch in May this year, their accumulative net loss has been 0, and monthly originations is expected to double in 2020. We hope to replicate and expand this partnership model with other financial institutions.

Next, we have achieved notable results in our wealth management transformation to an asset allocation-based online wealth management model. Non-P2P assets under advisory as of September 30, 2019, has increased to RMB 629.6 million or USD 88.1 million, up 78% from prior quarter. The number of investors in non-P2P products in the third quarter of 2019 has increased to about 20,000, up 35% from prior quarter. In September, we rolled out our online financial advisory services to investors with AUM exceeding RMB 200,000. We noted that the average call time between a financial adviser and an investor is 5 minutes, which is significantly higher than a telemarketing call. In July, we launched 4 mutual fund portfolio products, each aimed at targeting a different investment style, which has been very well received.

Next, on regulatory update. We are expecting for the rollout of the P2P trial program to take place. However, the timing is currently uncertain. In the meantime, we are adjusting our retail funding as per regulatory requirement and diversifying our funding sources to grow our loan balance through institutional funding. I would like to highlight also a very positive regulatory update which is that regulators are currently pushing forward requiring all P2P data to be submitted to PBOC database, which will mark a very significant milestone for the industry.

Thank you all. Now I will turn the call over to Dennis, our Senior VP, to review our third quarter business results.

Yu Cong ***Yiren Digital Ltd. - SVP of Strategic Corporate Business Development & Capital Markets***

Thanks, Ning. Hello, everyone. On the credit business side, total volume of loan originations for the quarter was CNY 10.5 billion, with about 34% of loan volume coming from repeat borrowers. In terms of loan origination channels, approximately 45.7% of the loans are generated online, while 54.3% are generated offline in the third quarter of 2019. The cumulative number of registered borrowers we served reached 85.4 million, and cumulative number of borrowers served is close to 4.6 million as of September 30, 2019.

On institutional funding, we have increased our line of facilities from institutional funding partners to CNY 35 billion this quarter, up from CNY 30 billion last quarter. And we are also delighted to announce that the number of our bank partners has increased to 13 in the third quarter of 2019, and we are expecting further growth in institutional partners' demand in the years to come.

On our wealth management business, as of September 30, 2019, we have served over 2.2 million investors cumulatively. Total number of active investors in the third quarter of 2019 was close to 586,000 with total AUM of P2P products for Yiren Wealth at CNY 40.2 billion as of September 30, 2019. Average AUM of P2P products per investor remains stable at CNY 152,000.

On non-P2P products, our sales volume was CNY 767.2 million this quarter, representing an increase of 169.4% from CNY 284.8 million as of last quarter, while our ending balance of non-P2P product was CNY 645.9 million as of September 30, 2019, showing a rapid growth of 80% from CNY 358.6 million at June 30.

For insurance products, we're pleased to note the average effective insurance premium per investor has increased from CNY 2,000 to over CNY 20,000 as of September 30, 2019, which is significantly higher than the industry average of CNY 5,000 thanks to our highly effective insurance advisers who provide one-on-one customized service to our investors. On mutual funds, we launched new mutual funds portfolios in July 2019, which has been very well received by younger investors. The average investment per investor in mutual fund portfolio has increased from CNY 400 in April 2019 to over CNY 30,000 in September 2019.

For our financial update, I'll focus on key items of our business operation and financial performance, and you can refer the detailed financial results to our earnings release. Total net revenue was CNY 2.1 billion during the quarter. Net revenue take rate, which refers to total net revenue net of allowance for contract assets, is 16.3% for third quarter 2019 as compared to 17.7% in the last quarter. This quarter, we maintained our contribution to the credit assurance program at 14% to ensure adequate coverage. Our credit assurance fund remains adequately funded with total balance equivalent to 11.5% of total performing loans covered by the credit assurance program.

Sales and marketing expenses in the third quarter of 2019 was approximately 11.1% of loan volume as compared to 12.5% in the second quarter of 2019, mainly due to increased marketing efficiencies and higher sales team productivity. Specifically, online customer acquisition cost this quarter was 4.9% of loan volume as compared to 5.3% last quarter. Offline customer acquisition cost this quarter was 11.8% of loan volume as compared to 12.8% last quarter. Allowance for contract assets has normalized in the third quarter of 2019 to CNY 345 million, which is equivalent to 3.3% of loan volume as compared to CNY 501 million last quarter, which is equivalent to 5.2% of loan volume. Last quarter, we revised future collectability estimates for new loan origination as well as remaining loan balance.

On the balance sheet side, as of September 30, 2019, our cash and cash equivalents was CNY 2.6 billion. The balance of held-to-maturity investments was CNY 8.1 million and balance of available-for-sale investments was CNY 426.3 million. As of September 30, 2019, our usable cash maintained at a healthy level at CNY 3 billion. In addition, net cash generated from operating activities was CNY 808 million this quarter as compared to CNY 36.4 million last quarter, indicating that we have a profitable and resilient business model. Net cash used in investing activity was CNY 924 million this quarter, mainly due to CNY 846 million paid out to CreditEase for the quarter's contingent consideration payment that's related to our business realignment that completed early this year.

Now I will pass on to the operator for Q&A.

QUESTIONS AND ANSWERS

Operator

Operator Instructions) Our first question comes from John Cai from Morgan Stanley.

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

So just want to ask about, firstly, on the asset quality. I think our credit insurance provision ratios remain high at 14%, but it seems that we are back to the growth mode. So just wonder how should we think about risk and growth going forward. And the second question is about the take rate changes. Just wonder if -- it seems that take rates on a Q-on-Q basis declined sequentially. So just wonder what's the factors in addition to the provision increase.

So my third question is about the regulatory update. And in light of the current P2P registration uncertainty, we are expanding the institutional funding. So just wonder what's the current drawdown of the institutional funding. And do we have any plans to acquire other license like consumer finance or online [micro loan] license because of the current regulatory environment? And finally, on the contingent liabilities, it seems it was declined Q-on-Q basis. Just wonder if there's any valuation adjustment or it's just the cash payout effect.

Yu Cong ***Yiren Digital Ltd. - SVP of Strategic Corporate Business Development & Capital Markets***

So maybe, Ning, give a little bit update on the regulatory front and our license initiative and I'll cover the rest of the financials.

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

Yes, we are expecting that the P2P trial program or pilot program shall, yes, take place, yes, although the exact time line is still uncertain. And so our future strategy will be that we have multiple funding sources for our borrowers from retail investors, from institutional investors and different types of institutional investors including banks, trust companies, consumer finance companies, micro credit companies, so on, yes. So such diverse funding source will help our borrowers, and we have learned lessons from the U.S. and other parts of the world that limited funding source actually is not helpful. So we continue to strategically expand our funding source. At the same time, we are in full compliance for the upcoming P2P pilot program.

Yu Cong ***Yiren Digital Ltd. - SVP of Strategic Corporate Business Development & Capital Markets***

Okay. Regarding the asset quality, as we have mentioned, we have been adjusting our risk policy earlier this year to maintain a very conservative risk policy, and we have seen the consistent results in the near-term asset performance from both existing vintages as well as the new vintages, that clearly we're reaching a comfortable baseline as can indicated from both the overall -- the charge-off of historical as well as the new Q1 2019 that we have demonstrated in our press release. And also the 15 to 89 days delinquency rate has also showed a very healthy trend. So that we have established a good risk performance on our various product lines and channels that we feel comfortable in terms of the business growth. So you see, our Q3 is up from Q2, and we expect this to continue into the Q4 and the near term.

In terms of the revenue -- net revenue take rate, yes, it drops a little bit. I think part is associated with provision. The other part is also the product mix. As we integrate with more institutional fundings, we have adjusted certain part of our portfolio mix. That has some impacts on the overall revenue take rate, but it's still a minor adjustment, not significant in terms of overall revenue opportunities. And of course, that also need to be taken into consideration of the allowance for contract asset impact.

And in terms of institutional fundings, that continue to be a strategic direction for us. As we mentioned, we're actually getting more and more interest from the institutional partners in working with us closely. However, it does take a little bit longer time than what we expect. The reason being that our loans tend to be longer duration, larger ticket size. And sometimes, the institutional partners are taking a little bit longer time to evaluate the asset performance. They have their own internal process that we go through before we ramp up the volume. So right now, I think we're maintaining at the similar level. In terms of new loan origination, we're in the 10 or low-teen percentage of new loan sales volume. But all these partners are very long term. We have established a very deep working relationship, and we expect this ramp up to continue. And we should expect a very stable funding sources from institutional partners coming in the coming years.

In terms of contingent consideration, that's purely the cash payment related to the business realignment that we completed earlier this year. There's no other factor. That's purely the cash payment that we paid out during the quarter as the payout schedule we have agreed with our parent.

Operator

(Operator Instructions) Our next question comes from Yiran Zhong from Crédit Suisse.

Yiran Zhong ***Crédit Suisse AG, Research Division - Research Analyst***

I noticed that the P2P loan volume on the Yirendai platform side seems to have picked up in October about RMB 2 billion versus RMB 1 billion in September. I wonder what's changed in October on the P2P front. Is there any change in regulatory guidance?

Yu Cong ***Yiren Digital Ltd. - SVP of Strategic Corporate Business Development & Capital Markets***

I think there's no guidance in terms also our business policy working in compliance with the regulatory guidance. I think the guidance was more for the total ending balance to maintain that level or certain trends. But in terms our new growth, we're still below our average normalized run rate if you were thinking about the loans being paid down and the new loan originated. So that's why we actually have quite some room to grow even for the P2P side of the business.

Operator

Our next question comes from Alex Ye from UBS.

Xiaoxiong Ye ***UBS Investment Bank, Research Division - China Financials Research Associate***

So my first question is about -- so do you have an idea of what's the revenue contribution from our non-P2P asset management products? And secondly, regarding loan volume growth outlook, it looks like we are comfortable to continue to grow our loan volume on a Q-on-Q basis in Q4. What's the magnitude we are looking at? So are we [committable to] significantly grow our loan volume or still relatively cautious at this moment and also [including] our loan growth outlook into the next year? And thirdly, so recently there has been heightened regulatory oversight on the loan collection practice. So just wondering, any new measures we have taken on that front?

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

What's the last question?

Yu Cong ***Yiren Digital Ltd. - SVP of Strategic Corporate Business Development & Capital Markets***

Sorry, there's some static. What's the last question again?

Xiaoxiong Ye ***UBS Investment Bank, Research Division - China Financials Research Associate***

Yes, sure. So my last question is recently, there has been increased regulatory oversight on the loan collection practice, especially the third-party service provider. So wonder, do we take any measures on that front?

Yu Cong ***Yiren Digital Ltd. - SVP of Strategic Corporate Business Development & Capital Markets***

Sure. Yes, so in terms of loan collection, we have, as we communicated early on, we have very professional collection teams and actually our services are qualified by the bank partners. So we have a very good practice. And we do get certain impacts recently due to the -- some of the telecom policies but we have made adjustment to overcome those issues. And we have always been very [strategic] in terms of the type of data that we can use so that we have never breached any of those issues. So we don't have -- see or have any impact in terms of collections in our business. Actually, the adjustment we've done to our collection policy actually helped stabilize our risk policies recently.

In terms of the non-P2P part of the business, revenue contribution are still small, but you really have to look at the moment. If you look at the growth rate of the non-P2P product, it's very respectful even though it's off a small base. But give us a few more quarters, you will see the significant scalability of this business going forward. And also, I think the key is really looking at the number of investors that start to taking on the service of non-P2P products. That's actually also growing very, very healthy. That usually will translate into a much better business still in the future. And we have also noticed that some of these non-P2P product investors are actually tend to be the larger AUM customers. They actually have a deeper pocket and they can take on more volume as we kind of (inaudible) product (inaudible).

So from a gross perspective, near term, we will maintain, even though we're back in the growth mode, but we'll probably still more control growth mode as we know that this is a risk business that you don't want to overrun. And also, we still expect certain volatilities in the industry as some of the non-qualified P2P platform are being phasing out. So we're still cautious, but we feel considering all these outside and internal operations, we concentrate to resume the growth, but the growth is probably a bit of a controlled mode. Into next year, we don't have the guidance yet, but maybe when we report our Q4, we'll provide more clarity for the first half of next year how we see of our growth momentum and things like that.

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

Yes, let me also add that strategically, our wealth management business is as important as our lending business. And we've -- the parent company, CreditEase, has built an impressive business serving high net worth, ultrahigh net worth investors in China. And our listed company, Yiren Digital, is leveraging the capabilities developed through that process to better serve the mass affluent investor community in China. Yes, I think this is a highly differentiated business model, and we strive to build a leading wealth management business focusing on this customer segment.

Operator

Our next question comes from John Cai from Morgan Stanley.

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

So it's a very quick follow-up. I think I saw there was one division that was spin off from the company in 3Q. Just wonder if there's any more details or colors about that division.

Yu Cong ***Yiren Digital Ltd. - SVP of Strategic Corporate Business Development & Capital Markets***

I think that's a very small business. Yes, it's very, very small business. Yes, it's actually a historical business that we have that only stop -- actually stopped operation in 2016. So it was just that from the transaction perspective, that -- yes. So yes, there's very small business residues that has not been fully separated, so we just conduct the separation in the quarter.

Yes, it's a discontinued business, yes. It's just that when we first complete the transaction, business realignment that we had included them in. But now given this is discontinued business, so we just complete separate them.

Operator

(Operator Instructions) As there are no further questions, I'll pass back to management for closing remarks.

Lydia Yu ***Yiren Digital Ltd. - IR Officer***

Thanks, everyone, for joining the call today. This concludes our third quarter 2019 earnings conference call.

Operator

Thank you. Ladies and gentlemen, this does conclude the call today. Thank you so much for your attendance. You may now disconnect.