[NYSE: YRD] - Yirendai Q2 2016 Earnings Conference Call

8:00a.m. U.S. Eastern Time, August 10, 2016

Presenters

- Mr. Matthew Li, Director of Investor Relations
- Ms. Yihan Fang, Chief Executive Officer
- Mr. Dennis Cong, Chief Financial Officer
- Mr. Huan Chen, Director of Yirendai & Chief Strategy Officer of CreditEase (Q&A only)
- Mr. Yang Cao, Chief Operating Officer & Chief Technology Officer (Q&A only)

Analysts

- Richard Xu, Morgan Stanley
- Blake Wu, Juhe Capital
- Ming Zhao, 86Research
- Evan Zhou, Credit Suisse

Presentation

Matthew Li – Director of Investor Relations

Thank you and welcome to Yirendai's second quarter 2016 earnings conference call. Our earnings press release and supplemental presentation slides are now available on our website. Hope you had the chance to review the materials by now.

Today's call features presentations by our Chief Executive Officer Ms. Yihan Fang, and our Chief Financial Officer Mr. Dennis Cong. Mr. Huan Chen, Director of Yirendai and Chief Strategy Officer of CreditEase, and Mr. Yang Cao, our Chief Operating Officer and Chief Technology Officer 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 a 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.

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Yihan Fang – Chief Executive Officer

Thanks Matthew, and thank you all for joining the call today.

The first half of 2016 has been strong for the industry. With the positive development of regulation, the industry consolidation has begun. At the same time, the total outstanding balance for lending platforms in China has increased almost 50% since last December. As an industry leader, Yirendai has been actively participating in the regulation development, which in turn enhances our leading position among market players.

We're pleased to see continued momentum of business growth in the second quarter of 2016. Our solid results were primarily attributable to the strong demand for our products and services, which was supported by our well-recognized brand, expanded product offering, and improved customer experience.

In this quarter, we provided products and services to 265,000 borrowers and investors with loan volume of 4.5 billion RMB. This brings our cumulative number of customers to about 1 million and cumulative loan volume to 20 billion RMB.

In Q2, 58% of the 69,000 borrowers we served were acquired from online channels; 39.2% of the 4.5 billion RMB loans were facilitated through our mobile application. We stayed committed to expanding product offerings and improving user experience. Total amount of our Housing Provident Fund product exceeded RMB 100 million after 90 days of official launch. We also continued to streamline our loan application process to provide more convenient services to borrowers. We extended the coverage of the fast-track 1.0 product to cover 22 provinces.

During the quarter, we experienced robust investor demand and increased customer stickiness. We facilitated 5.2 billion RMB lending for about 200,000 investors. We have also seen improving lender stickiness as we added more customer engagement features to our marketplace, such as check in and membership reward system. In this quarter, average investment tenure was increased to 13 months. As a strategic move to better address growing investor demand, we intend to broaden Yirendai's business scope towards more comprehensive and integrated financial services. In addition, we will build on the success of our first tranche of ABS issuance to connect with more institutional funding, which will enable us to serve high credit quality borrowers with lower cost products, as well as diversity funding sources.

We continued to strengthen our data and technology capabilities. During the quarter, we expanded our technology team by recruiting talents with experience in related fields. In June, we announced the appointment of Mr. Yang Cao as COO and CTO to lead our technology, product and engineering divisions and oversee business operations.

In terms of risk management, in addition to our continuous refinement of the risk management system, we are enhancing our anti-fraud system to leverage latest machine learning technologies to more effectively detect and intercept new fraud patterns.

Our strategy for the second half of 2016 is clear. We will continue to focus on developing our online marketplace platform and risk management system to better serve our customers and further extend our market leadership position. Several exciting online new products and deep partnerships are on the way. We will expand our strong lender base and make it a more significant revenue driver by offering more investment products and services. We will continue to diversify funding sources and optimize the platform efficiency. We believe that all these data and technology driven efforts and initiatives are important pillars for Yirendai's business growth and will strengthen our leadership. We are committed to delivering more value and a greater user experience to our customers.

With that, I would like to turn the call over to Dennis to discuss about our Q2 financial results.

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Dennis Cong – Chief Financial Officer

Thanks Yihan, I will now go over our second quarter financial results. Overall, we had a very strong quarter in Q2 2016. We facilitated RMB 4.5 billion ($683 million) worth of loans, an increase of 118% year-over-year from Q2 2015. This quarter, we also achieved a milestone by crossing the RMB 20 billion ($3 billion) mark in loan origination, as of June 30 2016 we have facilitated total $3.0 billion (US dollar) loans since our inception. We billed a total of RMB 1.1 billion ($167 million) in fees during the quarter, an increase of 131% when compared with Q2 2015. Transaction fees from borrowers accounted for 92% of total fees billed.

Net revenue in Q2 was a record RMB 734 million ($110 million), an increase of 140% year-over-year and 32% on a sequential basis. This increase was primarily driven by the growth in loan origination volume due to strong customer demand for our product and services. Looking at our revenue mix, we recognized RMB 713 million ($107 million) for loan origination services provided upfront, and RMB 17 million ($3 million) for post-origination services. RMB 363 million ($55 million) in fees billed associated with risk reserve fund were net included in our income statements.

In terms of our loan product portfolio during the quarter, 83.1% of our new loans facilitated were product D slightly down from 84% in the previous quarter, with a 27.6% average transaction fee rate. And the product volume mix for Product A, B and C were 5.5%, 3.8% and 7.6% respectively, with transaction fee rate ranging from 5.6% to 24.8%.

On the investor side, we started to introduce lower yield products. Our twelve-month Yidingying average investment yield on our platform in Q2 2016 is 8.5%, down from 9.0% in Q1 2016, and average investment tenure is 12.3 months up from 11.6 months in Q1, as we continue to benefit from decreasing interest rate environment as well as strong investor demand for high quality assets on our platform, and benefiting from our strong brand and market leadership.

Turning onto operating expenses. Sales and marketing expenses were RMB 355 million ($53 million) for the quarter or 8% of loan origination volume, compared with 7% in Q1 2016. Origination and servicing costs were RMB 43 million ($6 million) for the quarter or 1% of loans facilitated, similar to that in Q1 2016. Our G&A costs were RMB 73 million ($11 million) for the quarter or 10% of net revenue, compared to RMB 60 million or 11% of net revenue in Q1 2016.

Our profitability further improved in Q2 2016, with EBITDA at RMB 265 million ($40 million) or a 36% EBITDA margin, compared with RMB 112 million in Q2 2015. Net income during the quarter was RMB 261 million ($39 million) with 36% net income margin, compared with RMB 80 million and a 26% margin during the same period last year. This is attributable to the increase in net revenue and timing of revenue recognition due to product mix, and income tax deductibility of risk reserve fund payout. The one-time net income gain from historical risk reserve fund payout tax deductibility is RMB 59 million, and the net income gain from risk reserve fund payout tax deductibility during the quarter is RMB 39 million, excluding all the net income gain from risk reserve fund payout tax deductibility, the net income for the quarter would have been RMB 163 million.

We continue to see solid credit performance from our portfolio, the recent delinquency rate and vintage charge off performance are well within our expectation, and charge off performances for 2015 vintage loans have shown stable trends, which demonstrate our capabilities in credit underwriting and risk management.

Specifically, as of June 30, 2016, the overall delinquency rate for loans that are 15 – 89 days past due was 1.7%, improved from 1.8% as of March 31, 2016. The charge-off rate for loans originated in 2015 was 4.4% as of Q2 2016, compared to 2.6% as of Q1 2016, as the loans further mature. The charge-off rate for each vintage from Q1 to Q4 2015 is improving as indicated in the Cumulative M3+ Net Charge Off Rate curve on Slide 25 of the Q2 2016 management presentation, uploaded on our IR website, indicating strong credit performance of all products in our loan portfolio. As of June 30, 2016, the outstanding balance of liabilities from risk reserve fund guarantee is at 6.7% of remaining principal of performing loans, up from 6.5% in Q1 2016. We expect the solid credit performance to continue as we further refine our risk pricing model, expand our product portfolio into high quality asset and improve delinquency management.

Recently, in early July, during our regular credit underwriting process, we have discovered potential credit card statement fraud behavior from certain group of applicants for certain type of our online fast track loans, we stopped offering this product and conducted immediate investigation, after thorough study and analysis, including systematic data checks and in person offline investigation works, we have preliminary concluded that there is likely an organized fraud incident that impacted on a group of approved borrowers mainly in early July with total contract loan volume of RMB 72 million. Since then, we have implemented more stringent anti-fraud rules and taken extra technology measures to prevent similar frauds and prepared strong collection efforts and legal actions to minimize the loss. Now we have gradually restarted the offering of this type of loans with tight risk and anti-fraud policies.

On the balance sheet side, we had a very strong cash position with about RMB 1.3 billion ($201 million) in cash and cash equivalents. Additionally, we also had RMB 793 million ($119 million) in restricted cash in our risk reserve fund account and trust account. We also booked RMB 176 million ($26 million) in loans at fair value as a result of consolidating the trust and ABS.

Our liabilities were mainly comprised of two items: RMB 928 million ($140 million) in liabilities from risk reserve fund guarantee and RMB 166 million ($25 million) payable to investors at fair value as a result of consolidating the trust and ABS.

Cash flows in Q2 2016 were also very healthy. We generated RMB 196 million ($30 million) in cash from operating activities, which was mainly generated from transaction fees charged to borrowers; RMB 105 million ($16 million) received in investing activities, which was mainly related to the redemption of short term investments.

With that, let me go over our guidance for the third quarter and full year 2016. We expect loan origination volume for the third quarter of 2016 to be in the range of RMB 5.2 billion to 5.4 billion, net revenue in the range of RMB 800 million to 850 million and third quarter EBITDA in the range of RMB 140 million to 160 million with the consideration of our product mix shift, customer acquisition cost trends and potential needs to reserve contingent risk reserve liability in relating to the early July credit card statement fraud incident.

We have also revised our full year 2016 outlook, loan origination volume is expected to be in the range of RMB 19 billion to RMB 20 billion, equivalent to US$2.9 billion to $3.0 billion, up from original guidance of US$2.8 billion to $2.9 billion. Full year net revenue in the range of RMB 3.0 billion to RMB 3.1 billion equivalent to US$451 million to $466 million, up from US$400 million to $410million guidance, and EBITDA from RMB 800 million to RMB 850 million equivalent to US$120 million to $128 million, up from previous guidance of US$100 million to $105 million.

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

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Question and Answer

Operator: Our first question comes from Richard Xu of Morgan Stanley. Please go ahead.

Richard Xu: Thank you for giving me the first opportunity to ask the question. My question is regarding the future strategy. Given the receival of the tax deductibility for the charge-off, that certainly will provide some competitive advantage on the cost side. So just wondering whether that will accelerate, I guess, some products shift to maybe product C or B or A product, given some reduction on the cost side from the tax expenses perspective. Thank you very much.

Dennis Cong: Yes, sure, thanks, Richard, for the question. Yes, as we benefit from the tax policy, as well as our continued decreasing funding cost on the investor side, we'll be able to provide a more competitive rate of loan products to serve more higher quality of our borrower base. So we have a better, more diversified borrower portfolio, a more balanced portfolio performance.

And we believe that will also enable us to invest more resource into new technology development and new product development and new business models.

Richard Xu: Right. I guess is there any change in product shift guidance in terms of the product mix at the moment or probably still taking time to digest the change in the tax rate and everything to update the planning?

Dennis Cong: Sure. I think right now in terms of the credit performance of various pricing grade of our loans, they're continuing to perform very, very well. So we believe this transition will be taken gradually. One example is that our online percentage of our loan origination has been growing up from 34% into 40% in Q2. So you probably see the trend of this continuing to grow in the near future. Given that we have more diversified product portfolios on online products, you will see the gradual transition to a more balanced volume mix of different pricing grades of products.

Richard Xu: Thank you.

Operator: Our next question comes from Blake Wu of Juhe Capital. Please go ahead.

Blake Wu: I have a question about the delinquency rate for the type D loans. Actually, we all know that the macro-economy environment in China is quite challenging now, but I notice that the delinquency rate for Yirendai's type D loans is actually very low, although it's a little bit higher than the first quarter, but it's still very low.

And I also noticed that it's even lower than the delinquency rates for the type A and type B loans. So I want to know how does Yirendai conduct your risk control strategy to keep that rate low?

Dennis Cong: Yes, I think you're referring to our net charge-off rate table in our earnings press release showing the vintage performance of each year and by different pricing rate categories.

First, these vintages are still maturing, i.e., they're still growing. So it's not the lifetime charge-off of these loans yet. So that's why you see that. The loans start from a low point and continue to grow quarter-over-quarter.
For example, right now, the D type of loans from 2015 vintages is at 4.2%, but that's not the lifetime charge-off of these type of loans. And as the portfolio matures, you will see this gradually grow.

On the other side, you do see the different pricing grade loans have somewhat similar charge-off performance. We would have to inform you that the actual risk pricing model implementation was started late 2015. So in most of the 2015 vintages, you're actually probably going to see more similar probably of the A, B, C type of loans. But the D type of loans will be different from the A, B, C type of performance. However, given that the short duration or the aging of the loans that the full charge-off has not developed yet.

Even so, we believe that as the market leader and pioneer of the online lending platform, we have accumulated and benefited from CreditEase's historical risk management experience, many data that we have been benefiting from that we developed the industry-leading risk management capability to be able to achieve low charge-off performance on the average of our portfolios.

Blake Wu: Okay. Thank you.

Operator: Our next question comes from Ming Zhao of 86 Research. Please go ahead.

Ming Zhao: Thank you for picking my question. My question is really about your parent company, CreditEase. So I wonder if you could tell us a bit more. Specifically, do they also have a P2P lending business? And if so, what's the relationship between your P2P business and your parent company's P2P business?

Eventually, should we think the parent company will sell all its P2P business to you? So any color on their default rate compared with yours and any related party transaction during the quarter? That would be very helpful. Thank you.

Dennis Cong: Okay, sure. CreditEase is one of the largest financial service platforms in China. It has many products and services, including peer-to-peer lending business.

However, as we have mentioned during our previous communication, that the Yirendai has very unique market segmentation, which serves the salary workers with credit card population for the unsecured consumer lending business. And the CreditEase platform will not serve this population, so we have a separation in terms of our business practice.
And we believe both platforms will continue to develop business independently.

Of course, there is synergies in terms of working together. We do get customer referral from CreditEase offline sales network. We do exchange or share our risk management data and also, Yirendai benefits from the offline collection service that CreditEase provides. So that's the three business areas that we have benefited from the relationship with CreditEase.

Ming Zhao: My follow-up question is if you're doing the lower risk segment and they're doing the higher risk segment, so their default rate could be a lot higher than yours. And how is that possible for them and are they going to do any strategic change regarding this kind of segmentation? So the investors we talk to worry about if this is sustainable for this kind of segmentation.

Dennis Cong: I think from CreditEase perspective, there's many different types of loan business, including secured, unsecured leasing. So the risk behavior is quite different from the unsecured lending that Yirendai has. So the risk performance of the CreditEase loan portfolio is very, very healthy.

In terms of the cost of borrowing in China, I think the number one is really the difficulty of a funding source in China because the China market situation, there's less developed credit infrastructure. There's also high cost of funding and inefficiency in terms of quality borrower sourcing. Those all contribute to a certain higher level of the funding costs in China.

That is actually exactly what Yirendai or CreditEase is working on, by leveraging online data sources to better assess the borrowers' credit worthiness, their risk profile, to provide a more accurate assessment and more accurate pricing for their credit worthiness.

And also, as we grow our platform to be able to source lower cost of capital, including connecting to the funding source from institutions, we will be able to lower down the overall borrowing cost for the creditworthy borrower base.

Ming Zhao: Okay. Thanks for that. Was there any related party transaction during the quarter and what's the nature of that? Thank you very much.

Dennis Cong: I think it has been already disclosed before, in our IPO prospectus as well as the recent annual report, that we source customers from the CreditEase offline sales network that we would pay them commission. And then we would also pay CreditEase for the offline collection work that they provide for Yirendai.

Ming Zhao: Thank you.

Operator: Our next question comes from Evan Zhou of Credit Suisse. Please go ahead.

Evan Zhou: This is Evan Zhou from Credit Suisse. Actually, two questions from me -- so the first one is, you mentioned about the roughly 72 million RMB of loans that maybe got affected in early July that you have actually taken into consideration in the 3Q guidance. I just want to make it clear that you actually -- because when I look at 3Q guidance, the EBITDA seems to be quite a bit low compared to the 2Q level.

So can we assume that you basically are writing that by 72 million roughly loan volume off within the third quarter? And I have follow-up question. Thank you.

Dennis Cong: Sure, yes. I think, Evan, you're correct. From a very prudent policy perspective, we've taken the full loan amount as a consideration when we project the EBITDA guidance for Q3 2016.

Evan Zhou: I see. So it would be like a withdrawal from the risk reserve fund or it's not going to go through that? It's just going to be a direct charge-off on the P&L?

Dennis Cong: This will be extra cash, being a reserve, on top of the current risk reserve fund practice.

Evan Zhou: I understand. Thank you. That sounds very prudent. And the second question is a more strategic one, I think, because we do archive pretty impressive possibility in cash flow in the past couple of quarters. Do we have any strategic source around potential overseas acquisitions?

We do see a lot of examples in other parts in the world, like in the gaming space, like Tencent bought Supercell, like Giant bought Playtika. So I was wondering if it's sort of how global peers, it seems like their valuations went down a lot already. So I was wondering any kind of thoughts on that would be helpful. Thank you.

Yihan Fang: Yes, Evan, yes, we are actively looking at different opportunities. We are more interested in like data and the technology-driven companies, as well as apps that have our targeted users. We're actively looking, but until there's a good fit, we wouldn't pull the trigger.

Dennis Cong: Also I think given the current regulatory environment, as the market leader, we're in a very good position. I think there is some consolidation opportunities in China that we will be opportunistic going forward.

Evan Zhou: Got it. Thanks. Thanks a lot Dennis and thanks a lot Yihan.

Dennis: Thank you.

Operator: And this concludes the question-and-answer session, and this also concludes today's conference call. Thank you for attending today's presentation. You may now disconnect your lines. Have a great day.