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Q4 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 Fourth Quarter and Full Year 2019 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your first speaker today, Ms. Lydia Yu. Thank you. Please go ahead.

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

Thank you, and welcome to Yiren Digital's Fourth Quarter and Full Year 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; Mr. Zhong Bi, CFO of Yiren Digital; and Mr. Michael Ji, CRO of Yiren Digital.

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 and 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 reconciliations 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 taking the time to join our fourth quarter and full year 2019 results conference call today. First, I would like to send my greetings to those in Wuhan and all around the world as we are going through this difficult time. We grieve for the families that have been affected by it, and we salute those who have been or are still on the front lines fighting against the outbreak. As I mentioned in my letter to our colleagues, all of us play an important part in fighting this outbreak, and we expect the situation in China to stabilize soon as we are on track for business recovery. During the outbreak, we've made conscious efforts to support our borrowers in the heavily affected areas by loosening their repayment terms.

Now to our business update. Even though 2019 has been a challenging year for the industry with rapidly evolving market conditions and a tightening regulatory environment, we have made significant progress in our strategic transformation to reposition our business as we enter 2020.

First, we have completed the full operational integration of Yirendai with CreditEase inclusive finance and online wealth management business to form Yiren Digital, the leading fintech platform providing full spectrum of credit products to consumers and asset allocation-based wealth management services to mass affluent clients in China.

Second, we made good progress in expanding our credit tax business model into loan facilitation as well as licensed lending operation model.

Lastly, our online wealth management business has built a strong foundation and posed for significant growth in the years to come with strong momentum.

For the full year of 2019, we have achieved RMB 8.6 billion net revenue, RMB 1.2 billion net profit and ended the year with RMB 3.6 billion usable cash, which puts us on a solid footing to weather near-term market volatilities and capture market opportunities as business activities recover.

For our credit tax business, we are rolling out new product services and expanding customer acquisition channels to better reach and serve our borrowers. We launched a new micro credit loan product in November 2019 with smaller loan size and a short tenure, which is a preferred asset by our institutional bank partners. On top of that, in 2020, we plan to roll out a revolving line of credit products to better meet our borrowers' everyday financing needs. To fully leverage our nationwide service network coverage, we will be rolling out auto loans targeted at second-handed cars, which typically have a better risk profile than unsecured consumer loans.

On customer acquisition front, we are looking to partner with large traffic channels like Xiaomi and work together to offer consumer credit services to their user base at the point of consumption.

Next, to wealth management. We are seeing our non-P2P wealth management business gaining strong traction. In the fourth quarter of 2019, asset under advisory for non-P2P products grew 64% quarter-over-quarter and the sales volume grew 232% quarter-over-quarter. In particular, AUA for bank-structured deposit products exceeded RMB 600 million in November 2019. The number of current investors investing in non-P2P products increased to 21,000 as of December 31, 2019, from 15,000 as of prior year-end. To better serve our customers, we partnered with OneConnect and have onboarded a selection of bank deposit products on our platform.

In August 2019, we launched a team of 50 online financial advisers to provide one-on-one wealth management consulting services to fulfill each investor's diversified allocation needs. As of December 31, 2019, the number of investors that have invested in more than one type of asset on our platform increased over 60% from September 2019.

For mutual funds, total asset and advisory of mutual fund has increased to RMB 287 million as of December 31, 2019, from RMB 222 million in previous quarter. And we are seeing a steady increase in average AUA per investor from RMB 23,000 in June 2019 to RMB 30,000 in December 2019.

For insurance, GMV of insurance products increased 6x quarter-over-quarter, and we expect to see a further increase in demand for insurance products post the coronavirus outbreak.

In 2020, we expect to maintain a strong growth momentum for our wealth management business as we continue to roll out more non-P2P products and services, including bond funds and savings space insurance through working with leading partners.

Recently, we have entered into a strategic cooperation agreement with Principal Global Investors, a subsidiary of Principal Financial Group, a global investment management leader offering asset management, retirement services and insurance solutions to institutional clients, businesses and individuals. The partnership will open up a comprehensive strategic business deployment in China's retirement financial services market, helping China's mass affluent population better prepare for retirement.

In addition, in Q4 2019, we obtained a Hong Kong stock brokerage license, and our stock trading app was officially launched in December 2019. We plan to roll out stock trading and consulting services in Q2 2020.

Today, we also announced changes in our management team. Mr. Michael Ji will assume Chief Risk Officer of the company. Michael brings over 18 years of experiences in risk management and decision science with multiple top financial organizations, including Citigroup, JPMorgan Chase and Fleet Boston Bank. Mr. Jiangxu Xiang will be assuming the position of Chief Technology Officer of the company. Prior to joining us, Jiangxu had held multiple tech-related senior management roles at Suning, Microsoft and Cisco.

In light of new regulatory guidelines for P2P companies, in 2020, we will be transitioning under different [tops] simultaneously. First, we will increasingly use our existing nationwide online micro lending license to lend. We are also considering applying for new financial licenses. Second, we will continue to expand our partnerships with licensed financial institutions to diversify funding sources. We have made strong progress in onboarding institutional funding this quarter, with RMB 40 billion line of credit secured and expect to further increase significantly in 2020 as we continue to expand our funding partners beyond commercial banks to trust and licensed consumer finance companies.

Third, we are looking to make strategic investments in consumer finance company as well as potentially commercial bank. We are also applying for local financial guarantee license to ensure that our business will be fully licensed and compliant.

Lastly, I would like to talk about how the coronavirus has impacted us. Over the past 2 months, we have proactively controlled loan volume growth as we started to see volatilities in delinquencies, largely impacted by a slow economy as well as disruption to our workforce, especially with our call center being based in Wuhan. As of the first week of March, 81% of our off-line workforce have returned to work and 85% of our call center have returned to work, and of which 65% are working from home due to ongoing traffic control in Wuhan. We expect business to gradually recover starting in April, and we are fully prepared to ramp up our business and expect a strong second half 2020.

Now I'd like to turn over the call to our CFO, Zhong Bi, who will discuss our financial results for the quarter.

Zhong Bi ***Yiren Digital Ltd. - CFO***

Thanks, Ning. Hello, everyone. We are pleased to deliver another solid quarter with healthy margins as we are moving towards more diversified business models and the challenging operating environment in the industry.

Total net revenue for the quarter was CNY 2.4 billion, up 15% from previous quarter. Net profit for the quarter was CNY 404 million, up from CNY 228 million in the previous quarter, representing a 77% increase.

On the credit business side, total volume of loan originations for the quarter was CNY 8 billion, with about 16.5% of loan volume coming from repeat customers as we prioritize our business towards new customers with better credit quality.

On wealth management, as of year-end 2019, Yiren Wealth has served approximately 2.2 million investors cumulatively. And close to 250,000 investors hold an investment on our platform as of December 31, 2019. The total AUA for Yiren Wealth reached CNY 35.3 billion as of December 31, 2019, with average AUA per investor remaining stable at CNY 143,000.

What is noticeable is that we have seen a rapid growth in total GMV of non-P2P products, with amounts jumping into CNY 2.55 billion in the fourth quarter from CNY 767 million in the third quarter, showing a 233% growth quarter-on-quarter.

In addition, AUA for non-P2P product increased to CNY 1 billion this quarter as compared to CNY 626 million in the prior quarter. Bank's wealth management products and the mutual funds are among the most popular non-P2P products on the platform, with AUA of those 2 product categories increasing 113% and 20%, respectively, as compared with last quarter. We are also seeing increasing demand for insurance with the total insurance premiums increasing by 87% in the fourth quarter.

For our financial update, I will focus on key items of our business operation and the financial performance. And you can refer to the detailed financial results in our earnings release. The net revenue take rate stood at 22.2% during the quarter, up from previous quarter due to strong wealth revenue, lending product mix and higher loan facilitation fees as our borrowers are getting less active in early repayment. Allowance for contract assets has increased to CNY 588 million, equivalent to 7.4% of loan volume as we adjust our credit loss assumption to reflect the challenging and dynamic market environment. This allowance was CNY 345 million last quarter, equivalent to 3.3% of loan volume.

For this quarter, our account management service fee remains stable at CNY 490 million, despite the decline in loan volume origination. This is due to our investor service revenue being more AUA-based in nature.

Meanwhile, we maintained our contributions of the credit assurance of program at 14% this quarter to ensure adequate coverage. Our credit assurance fund remains adequately funded with total balance equivalent to 8.9% of the total performing loans covered by the credit assurance program.

On the balance sheet side, as of December 31, 2019, our cash and cash equivalents were CNY 3.2 billion, an increase of 21.5% quarter-on-quarter. Our usable cash maintained at a healthy level at CNY 3.6 billion, a 20% increase compared with last quarter.

Our cash position improvement was a result of effective cash flow management and a resilient business operation. It's also worth mentioning that our contingent consideration liability has reduced to 0 as CreditEase has agreed to waive all remaining cash payments related to our business realignment transaction. The total amount of contingent consideration waved was CNY 1.2 billion.

With that, I will now pass it on to Michael, our new CRO, for an update on credit risk.

Michael Ji ***Yiren Digital Ltd. - CRO***

Thanks, Zhong. Hello, everyone. For credit performance and the risk management, early delinquencies have increased by a few percentage points in the fourth quarter due to a tightening collection practices and, to a lesser extent, limitation on external data usage.

Looking at our M3+ rates by linkages. We are happy to see an improving trend from Q4 2017 to Q4 2018, proving our efforts in managing risk worked out. Overall, risk performance in Q4 was within our expected ranges. We have been more focused on serving higher-quality customers. This strategy was through 2019. The newly originated loans in high-risk grades 1 and 2 increased from 38% in 2018 to 48% in 2019, while the loans in lower-risk rate [1 5] jumped from 40% to 28% during the same period.

In Q1 2020, as a result of the coronavirus outbreak, we observed high volatilities in delinquencies. We improved our overall risk performance and mitigate the impact of coronavirus outbreaks. We have been actively tightening our risk policy and modifying our product portfolio to reduce risk exposure and continue focusing on serving higher-quality borrowers. The latest data suggested that the delinquencies had been coming down in recent weeks in a pretty fast pace, showing a very encouraging trend, which led us to expect that the impact from the coronavirus would rather be short term than be prolonged. Given the situation is still evolving globally, we will continue monitoring closely and managing the risk prudently.

I will conclude my prepared remarks here and give it to the operator. Operator, please continue.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of John Cai.

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

I have 3 questions. So the first one is on the take rate in the fourth quarter. It's a very strong improvement quarter-on-quarter, and we mentioned several factors related to higher facilitation fee, wealth business and potentially some product mix changes. So just wonder if there's more colors on the change and what sort of the outlook on this take rate are we expecting for coming quarters? Should we expect this to be a normal take rate at 22%? And then that's my first question.

The second question is on the virus impact on the first quarter. So is there any quantify risk volatility that can be provided? So -- and also, given the lower volume and potentially higher provision, should we expect any loss-making in the first quarter?

And I guess my final question is on the regulations. And I think we are getting more and more license. And just wonder what's the capital requirements we need to put in to acquire this license. And also, the -- I think we mentioned about the creditech in the facilitation business. And just wonder what's the mix between on balance sheet lending and the facilitation.

And I'm sorry, just one more question to add is, what's the P&L impact of the contingent consideration wave?

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

Okay. This is Dennis. I'm the Senior VP of the capital markets. So maybe we will have Michael to answer about the risk volatility related to the virus impact first, and then we will answer the rest of the question.

Michael Ji ***Yiren Digital Ltd. - CRO***

Okay. Thank you, Dennis. As mentioned earlier, the latest data suggested the impact from the coronavirus would rather be short term. And we did see a pretty high volatility in Q1, but it's coming down pretty quickly in our recent weeks.

Meanwhile, to mitigate the risk, we already proactively tightened our strategies to focus on higher-grade borrowers. As I mentioned, we continued the strategy from 2019. Plus, we also adjusted our loan amount assignment strategy to manage the risk exposure further. With that being said, at this time, I don't expect major uptake of Q1 vintages, especially in terms of the full life cycle of the loans. Compare the short-term impact versus the long-term returns, I don't really expect a major update.

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

Okay. Thanks, Michael. Regarding the take rate in Q4, as mentioned in our CFO's remark, it's due to both product mix as well as the investor side management fee to be sturdy, given it's AUM-driven, and of course, there's also certain adjustments due to the borrowers' behavior in terms of early repayment that also helped a bit pushing the take rate upward to the 22%.

I think if you're looking forward, we expect the product mix continue to be healthy, the investor side of service revenue continue to be sturdy. So probably, if you were to model our business, a 20% also hit rate forward is a reasonable number that you can use for.

In terms of the business in our Q1, it's coming to the end. We're still tightening all the numbers. Given the overall environment, we are pretty prudent in terms of controlling the business volume, particularly on the loan origination side. And at the same time, we have also been very prudent and diligent in terms of overall cost control structures. So we're still looking at the business. And our business, even though we had quite some fixed component in our cost, but given some of the recurring revenue stream, as well as our optimized, rationalized cost base and capacity, we're still looking for a reasonable quarter.

From the regulation perspective, as Ning has mentioned, we're pursuing multiple paths in terms of extending, developing our credit business. From the capital requirement perspective, we already have 1 billion of [regis] capital in place. And also, for various license, we're comfortable in terms of meeting the requirement when we apply for those licenses.

From the contingent liability cancellation, it was a good help or a good value for our Yiren Digital. Because the volatility and the business slowdown, CreditEase has waived the remaining cash payment for the business realignment. And then there's a pure balance sheet impact. There's no P&L impact. It's just that the remaining cash payment was completely waived. I hope that answered your question.

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

Yes. Thank you very much.

Operator

(Operator Instructions) Your next question comes from the line of Alex Ye.

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

I have a few follow-up questions here. The first one on the take rate. So you mentioned one of the reasons for the improvement is on product mix. Could you give us some more color on that? What kind of program is in the adjustment here? And related to this, so you mentioned on your remarks that you are going to do to some secondhand cars in 2020. So shall we expect that to become a major component of your business going forward?

Secondly, on the loan volume. Could you give us some outlook for perhaps Q1 or rest of the 2020? And regarding the funding, so given that we are probably -- 2018, our P2P funding here. So just wondering what would be the mix of funding going forward. And you have mentioned that you're going to use more of your existing micro credit license to lend. I wonder what's the maximum on balance that license could support. Yes, that's my question.

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

Okay. So I will answer these questions. And if there's other things, other management can jump in. So in terms of product mix, it's the optimization in terms of the loan durations and pricing grade that helped us in certain part of the pricing. And also, we are moving more from the upfront fee collections to the monthly repayment amortized fee collection products. That also helps as well. And also, of course, the investment side revenue continued to be sturdy.

In terms of the auto loan, it is already ramping up. We actually had initial volume starting taking off in Q4 already. And we do expect this business to becoming a meaningful portion of our business. Given that, these are more secured nature loans that usually exhibit a better credit performance than unsecured business. And also during this downturn, we're more mindful in terms of the credit volatilities. And usually, consumers with cars are tend to be somewhat better equipped for the downturn and repayment.

From a loan outlook perspective, I think as we mentioned, the virus impact is still not clear yet. But from our current customer demand as well as what we see from our business model, we actually expect a very sharp V-shape recovery already starting in March, but probably accelerate in April and May. So if you look at 2020, probably Q1 is a bit low point, but Q2, Q3 and Q4, we should have a rather steep growth quarter-on-quarter. However, as you all know, we are a credit business. So usually, in this type of time, you want to be careful in [continual] growth even though the demand is pretty strong. So we probably expect in Q3 time frame, we're probably back to what our 2019 normalized quarterly run rate. That's what we see for the year 2020.

And in terms of a funding mix, as we mentioned, we're pursuing multiple path in terms of the business model transition. We have a CNY 40 billion secured line of credit facilities from our institutional partners. And we expect the percentage of the new business volume that's financed by licensed institutional partners should grow meaningfully in the year upwards towards 50%.

And then in terms of the micro credit license where they have -- yes, actually, we have already been utilizing that in doing our business. Going forward, that's going to be part of our business, but probably not going to be a majority of business. If you think about we have both loan facilitation and also for the auto loans, which is the secured nature, a lot of institution partners are very in favor of this type of assets. And we're gaining very good traction with all these various institutional partners.

So I would say, you can think about that our business going forward will have a major part as a loan facilitization model. Some part continue to be financed by various way of investors' investment. And then, of course, when we have the micro credit license that we have and we can also leverage that with our own capital. As you see that we have a CNY 3.6 billion cash, or you can call it equity, on our balance sheet. That's quite meaningful in terms of driving our business.

Operator

Your next question comes from the line of Daphne Poon.

Daphne Poon ***Citigroup Inc, Research Division - Associate***

So my first question is regarding -- so you mentioned at the beginning that you have some -- you have loosened some repayment terms for your borrowers during this coronavirus outbreak. So can you give more details in terms of what types of borrowers you are targeting and how bad -- how big is that amount compared to your outstanding loan balance and whether you would still count those as NPL or overdue loans as acquisition for those?

And the second question is about the product, the new micro credit product. Can you give more details on the long tenor, ticket size and also the pricing of that new product? How does that compare to your original core products? And since you mentioned that it's like of structured durations, small ticket size, so does that mean it will be less profitable or have a lower take rate compared to the original product?

And lastly, just want to clarify a bit on the point you just made that -- so you mentioned part of the reason for the revenue take rate increase is because you moved away from the upfront fee to more like monthly fee collection. But my understanding is that, that should actually lower your take rate, like defer your revenue recognition. So just want to understand more the reasons behind.

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

Okay. I'll provide some answers, and yes. So in terms of the -- some of the loosening of the terms, which it's more specifically to the heavily impacted area, meaning an area where basically not to -- we're basically reducing the effort in terms of collection and also giving the customers some longer time to continue repayment, maybe release some of the penalties, but all these will continue to be recorded into our NPL and charge-offs. So that's not going to impact in terms of the financial or credit risk performance. The volume within that region is pretty small. That particular Hubei region is only less than 2% of our total volume. So I think overall impact is pretty small.

So in terms of the micro credit product, duration-wise, 12 months, and then alongside a few thousand to about 10,000. And the pricing, I think it's similar. And we're starting this with more of our existing customers that usually have already exhibited good credit quality. And we are also developing revolving product on top of that to maximize our customers' value for the long term. This -- you can think about this is an add-on product to our existing product portfolios. So we expect this to actually contribute to our business growth.

In terms of the take rate, given our revenue recognition, actually, I think the monthly fees are actually giving us a decent take rate or better. The upfront actually less.

Operator

Your next question comes from the line of John Cai.

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

So just one more question because some peers mentioned about the potential material impact from the accounting change due to the adoption of ASC 326 (sic) [ASC 606] on the current expected credit loss content model. So just wonder, do you see a similar impact on our financial from this accounting change?

Zhong Bi *Yiren Digital Ltd. - CFO*

John, it's probably -- our take on this is about the U.S. GAAP accounting change, in particular on the credit contingent liabilities moving towards a lifetime model.

We are now in the middle of developing our risk and financial models to follow the rules, and the detailed analysis yet take some time to finalize.

Overall, we wouldn't expect material impact to our P&L going forward, mainly because our current -- most of the risk provisions has considered a good portion of the lifetime behavior nature. So once we have more color from that, we will elaborate in more detail during the first quarter release. Thank you.

Operator

(Operator Instructions) There's no more question at this time. I would now like to hand the conference back to today's speakers. Please continue.

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

Okay. Thanks, everyone. That concludes our conference call.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.