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Q1 2020 Yiren Digital Ltd Earnings Call

EVENT DATE/TIME: JUNE 24, 2020 / 12:00AM GMT

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Yiren Digital First Quarter 2020 Earnings Conference Call. (Operator Instructions)

I'd now like to hand 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 First Quarter 2020 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; CFO of Yiren Digital, Mr. Zhong Bi; and CRO of Yiren Digital, Mr. Michael Ji.

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 statement. 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 with 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 joining our first quarter 2020 earnings conference call today. The first quarter of this year has been a challenging one, as the coronavirus shocked the entire global economy. During this unprecedented time, our core businesses remained stable, while we made substantial progress to diversify and enrich our business lines and continue our business transition to China's leading digital personal financial service platform. We took proactive measures to ensure our business are operating at a healthy level, giving customers the best service we can offer, making our own contribution to fight against the COVID-19.

Now let me talk about our creditech business. To maintain business resilience and to position ourselves for the long term, we will focus on 3 areas in our creditech business this year: first, stabilize and improve risk performance; second, invest in new areas of growth; and third, grow our institutional funding mix. I'll now talk about our actions in each of these areas.

Our first priority is stabilizing and improving risk performance. In the first quarter of 2020, loan originations decreased 77% from prior quarter to RMB 1.8 billion, as we proactively tightened credit and decreased business volume to control credit risk in light of the COVID-19. Our fast and timely response allowed us to operate at profitable level in the first quarter despite a challenging macro environment.

Our second focus is on exploring additional opportunities and investing in new areas of growth. We have recently launched several new credit products to diversify our loan portfolio and to better meet a full spectrum of mainstream consumer credit needs. The short-tenor, smaller-ticket-size revolving loan product offers credit solutions for a wider range of online and off-line consumption scenarios, including travel, lifestyle, e-commerce and mobile wallet. This product has been very well received, growing more than 100% month-over-month. For this product, we will partner with large traffic channels like Xiaomi and OPPO Finance so that we will be able to significantly expand our business with diversified consumption scenarios, reduce customer acquisition costs and improve operating efficiency as well as portfolio quality.

Last quarter, we mentioned that we will be rolling out auto loans this year, as auto loans typically have a better risk profile than unsecured consumer loans. Our auto loan segment has shown a visible growth momentum since March. And in particular, our auto leasing business is estimated to reach RMB 1.5 billion in loan origination in the first half of this year. And we expect this product segment to be one of the main revenue drivers in the second half of this year. In the second half of the year, together with our channel partners, we also hope to build a consumption platform to enrich our credit ecosystem with a member-only online e-commerce platform.

Our third area of focus is on growing our institutional funding mix. We are pleased to report that our institutional funding mix has increased to 40% in the first quarter of 2020, up from 14% last quarter. And we expect this proportion to increase to over 50% in the second quarter this year. We are also actively expanding our institutional partners from banks to chartered companies, other licensed financial institutions and the consumer finance companies.

Next, on wealth management. Our online wealth management business has seen strong growth, in particular, for non-P2P wealth management products and services. The number of non-P2P investors increased by 23% from prior quarter to 26,436 as of March 31, 2020. The AUA of non-P2P products increased 37% -- sorry, 67% quarter-over-quarter to RMB 1.7 billion. Average investor investment amount of non-P2P wealth management products has seen steady growth to RMB 65,000, up from RMB 48,000 in previous quarter, driven by both increased investment amount for single product as well as multiple product selection, representing good progress in our efforts on developing investor habits in using an asset allocation investment strategy.

For mutual fund products within wealth management, we witnessed strong demand during the first quarter, with AUA increasing by 17% and with sales volume increasing by 30% from February to March 2020, driven by our new product offerings. We expect this growth trend to continue through the year. We have also been investing in investor education through a variety of online courses to help investors develop a long-term investment horizon. And we also noted a significant improvement in average AUA per investor in mutual fund products, which has increased to RMB 36,800 in March 2020.

With that, I will now turn the call over to our CFO, Zhong, who will discuss our financial results for the quarter.

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

Thanks, Ning. Hello, everyone. For our financial update, I will focus on key items of our business operations and the financial performance, and you can refer to the detailed financial results in our earnings release.

Under the challenging operating environment amid the pandemic in the first quarter of 2020, we maintained profitability and a strong liquidity position. Loan originations for the quarter was CNY 1.8 billion, a drop of 77% quarter-over-quarter, mainly driven by the COVID-19 outbreak, which heavily hit our offline lending business. More specifically, due to the temporary closure of our physical branches as well as our call centers, which are based in Wuhan, we saw a significant drop in loans originated from offline channels as compared to prior quarter. Total net revenue was CNY 1 billion, down 57% from previous quarter. Despite significant business volume drop during the quarter, our strong cost control and operational efficiency efforts have kept our business at a profit and a good cash position. The sales and marketing expenses reduced by 45% to CNY 616 million. Net profit for the quarter was CNY 19 million, representing a 95% decrease quarter-over-quarter. As of March 31, 2020, our cash and cash equivalents remained stable at CNY 3.2 billion.

We are expecting major business rebound and a substantial growth in the second half of the year as our shorter-term, smaller ticket size loans are quickly ramping up, along with other new credit products launched in the second quarter. Plus a comprehensive consumption finance ecosystem is being built with rich and diversified external partners on various platforms.

On wealth management side, as of March 31, 2020, Yiren Wealth has served approximately 2.2 million investors cumulatively. And close to 221,000 investors currently hold an investment on our platform. The total AUA for Yiren Wealth reached RMB 32.2 billion as of March 31, 2020, with an average AUA per investor remaining stable at RMB 146,000.

For this quarter, our account management service fee, which is mainly from our wealth business, was CNY 413 million, a relatively modest decline of 16% quarter-over-quarter. The allowance for contract assets has declined to CNY 143 million from prior quarter due to the overall lower loan volume. And allowance was equivalent to 7.8% of the loan volume as compared to CNY 588 million last quarter, which was equivalent to 7.4% of loan volume.

Meanwhile, contributions to the credit assurance program was at 12% this quarter to ensure adequate coverage. The decrease of 2% as compared with the last quarter was the result of shorter loan tenors and tightened credit control on new customers. Our credit assurance program remains adequately funded with a total balance equivalent to 10.5% of the total performing loans.

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

Chunjiang Ji ***Yiren Digital Ltd. - Chief Risk Officer***

Thank you, Zhong. Hello, everyone. For credit performance and the risk management, overall, early delinquencies increased in the first quarter and reached its peak at the end of March due to the pandemic situation before it quickly declined in April and then returned to near pre-pandemic level in May.

More specifically, 15- to 90-day delinquency rate stood at 8.9% as of March 31, 2020, compared to 4.8% as of December 31, 2019. However, the delinquencies jumped quickly moving into April, thanks to our tightened risk policy and efficient risk management. As of end of May, delinquency rates for 15 to 29 days, 30 to 59 days and 60 to 89 days had already declined to 1.3%, 2.2% and 2.1%, respectively. And we expect delinquencies to further improve in June. Meanwhile, visible progress has been made in prioritizing our business toward higher-quality customers, which was reflected in risk performance improvement.

Looking at our vintage performance. We are glad to see essential improvement trend in 2019, and we expect a more substantial improved trend in 2020.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Alex Ye from UBS.

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

So I have a couple of questions about your -- the credit business. So first of all is on your traditional large ticket size unsecured business. So could you just remind me whether -- what's your strategy on this specific loan product going forward? So we have seen your repeat customer borrowing for this quarter is almost 0. So going forward, are you going to completely wind down this business? And what's the strategy on it? And also, will it be still offline or online?

And second question is about your auto loan. So given you expect that it's going to be a major contribution to your loan percentage in volume in the second half of this year, so may I just ask for more color on it? So for example, what's the specific product features like is it in the used car or new car market? And where -- what's your customer acquisition channel? I guess it's still mainly offline, right? And so -- and what was the funding coming from? Where does the funding come from?

And my last question is about your loan mix outlook for this year. So given you also have the shorter-term tenor products, just wondering if you could give us some guidance on how you plan to maintain your loan mix in the near term and also from a longer-term perspective.

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

Okay. Thanks, Alex. I'll try to answer your question, and then maybe Bi Zhong can add on any of the points that may be missing.

So from the large ticket size traditional loan we have, our strategy right now is that for the online business, we're going to focus on the smaller-size, shorter-tenor revolving loans, as we mentioned in our remark. And it's actually getting very good tractions. And then for the larger ticket size traditional business, we'll continue to operate but mainly on our offline networks because that does have a unique credit screening process that helps us to improve the quality of the loan asset performance. The reason that in the first quarter the repeat business was significantly lower is that, first, for the online business, we're moving to the higher credit grade. So we significantly changed the customer segmentation. And then for the offline, as our CFO has mentioned, it was impacted by the pandemic situation. So the productivity really dropped significantly for the offline operation. So that's why the repeat business is pretty low in the first quarter.

So in terms of the auto loans, we actually have 2 type of auto loans business. One is that we have been already operating, which is the borrowers that -- they already have cars. So basically, it's a credit enhancement business. And that business is actually, as we mentioned, it's been ramping up to CNY 1.5 billion in the first half. This business has shown quite well credit performance. The ticket size and the pricing is rather similar to the larger ticket size traditional consumer loans we have, CNY 70,000 or CNY 80,000 per loans, 36 months -- 24 to 36 months, and the fees are relatively similar. However, the credit performance is actually significantly better. It's -- if you think about the full vintage charge-off, it's in the mid-single-digit level. So as you can see, it's a quite well -- quite profitable business. And from a funding perspective, we're working with licensed financial institutions to provide the funding for this type of auto loans. And then we are starting the secondhand car consumption loans basically at the point of purchase for this is -- as you know, it's also offline-driven operation. We are building the team and getting very early good tractions. The channels will be from the auto cars sales centers. Also, we're working with some online auto channels that we hope to do online-to-offline conversion as well. And then for this business, we will -- all are being funded by institutional fundings, yes.

And then in terms of the loan mix towards the year, from an online perspective, the shorter-term revolving loan will be majority going through the year. And for offline, you can think about the auto loan and the traditional larger ticket-sized consumer loans half and half, so that we'll probably reduce our overall loan tenor to more close to 20 months from previous more 30-month range as we go through building up the volume through the year.

Yes, see if, Bi Zhong, you have any to add to this?

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

Well, I think you answered it fairly thorough. I'd just probably add one more point. Our funding partners, their risk appetite towards longer-tenor loans is significantly reduced towards longer-tenor loans. So that's why as presented by Danny's remark, average loan tenors in Q1 reduced to 22 months versus Q4. And we foresee the average loan tenor will continue to reduce. And so it will be easier for us to secure institutional funding. That's all my -- I want to add.

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

Okay. Very clear. So just want to kind of state my follow-up questions. So first of all, on the loan mix, so for the online and versus offline, could you also give us color on how you're planning to split the 2 in terms of volume for this year?

And second, so about your short-term revolving loan, do you have an expectation about the current vintage loss rate on that particular product type?

And lastly, on the -- could you also give us some update on your P2P operations? So like you also have some funding coming from P2P in Q1. And what's the current status on the compliance perspective? And would you -- to what extent do you expect that funding to also continue in the rest of this year?

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

Okay. So I think maybe I can answer the online/offline split. It's around 50% from a sales volume perspective, and it's probably going to maintain that way through the year. As you can see, the major part of the auto loans are classified in the offline. So that's going to be an important portion. And plus the traditional larger ticket size business, we're continuing to ramp up -- recover the volume. I think maybe Michael can actually give comments on the credit performance expectation on the shorter-term loans. And later on, we will talk about the P2P operation and compliance status.

Chunjiang Ji ***Yiren Digital Ltd. - Chief Risk Officer***

Thanks, Dennis. So let me take on the question for the shorter loan -- shorter-term revolving loan credit performance. For this type of loans, we are expecting to see some -- the performance to be on par to our competitors. From the vintage performance perspective, it should be in the single digits because we have a pretty well-defined -- a well-established and tightened credit screening exercise at the acquisitions. That is to ensure our credit performance will be at the market level.

As to the next question, probably, I will give it back to Dennis about the P2P operation.

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

Yes. I think from funding mix perspective, as we mentioned, we already reached more than 50% of the new sales volumes funded by the institution. And we have sufficient funding sources and partners that we will be able to significantly increase that portion of the funding of our total business volume. However, at this current moment, our P2P operation are still operating with the compliance with our local regulator. So we'll see how that part, regulators' requirement, will evolve. And then we can always adjust accordingly so that we can switch up our institutional funding to meet all the demand if we need to. Right now it's more of our own judgment. We are continuing to operate both funding sources in parallel.

Operator

(Operator Instructions) Our next question comes from Daphne Poon from Citi.

Daphne Poon ***Citigroup Inc, Research Division - VP & Senior Associate***

So just 2 questions for me. The first one is regarding your loan volume. Yes, so just wondering if you can give any color on -- in terms of what level of loan origination volume you are seeing or expecting in the second quarter. And also, would you have any rough guidance on a full year basis?

And then the second question is regarding your account management fee that, if I understand correctly, most of the fee is still coming from the P2P part that you -- basically, you get to earn the spread between your actual return versus the expected return that you are offering to investors. So currently, the fee rate is actually quite high. It's at around 5% annualized of your average AUM. So I'm just wondering that if you continue to shrink your P2P business while ramp up the non-P2P part, should we expect this fee rate to decline? And yes -- and if you can share like what is the fee rate for the P2P part versus that of the non-P2P business.

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

Okay. So I will try to answer this question, and Bi Zhong can add in later on if anything points. So from the loan volume perspective, as we mentioned before, we're still on our planned trajectory to recover and ramp up our overall loan volume, sales volume run rate back to our 2019 average level by mid or later part of second half of this year. If you look at our 2019 quarterly run rate, it's probably around CNY 10 billion, CNY 8 million or CNY 9 billion to CNY 10 billion level. So if you divide it by 3, that's the monthly run rate that we're targeting by the middle of the second half. As for full year, we don't want to give a guidance. But you can use that math, try to curve it up, then you probably can get an estimate assumption on the -- on our sales volume for the year. But however, as -- you probably also want to look at the revenue side, as we have more multiple streams of revenues now. That probably gives you a better sense of our business and scale and growth.

In terms of account management service fee, yes, you're right. I think majority of that is coming from the balance of the P2P amount. As we are shifting more from the P2P investors into more institution investors, actually, that -- the revenue opportunity is not missed. It's just that's going to be captured from the revenue take rate upfront. So you are -- so we're not missing that part of revenue. Of course, if our new loan origination volume does not catch up to the repayment schedule of the remaining loan balance, overall ending balance dropping definitely is going to impact this portion of the revenue coming in. But we think, as we mentioned, we're in the progress of recovering the run rate back to normal, and you will see that catch up later on.

And then from the non-P2P business, we are ramping up nicely from both the sales volume as well as the AUA. You have seen that AUA is actually growing very steadily quarter-over-quarter more than 60%. And then in terms of the take rate, I think the standard wealth management product, it's a bit of -- it has a bit of different scheme. Some of the product could be 0.5%. Some of the product could be 1%. In particular, if we were able to work with some of the product supplier on a strategic level and exclusive base, we can actually get up to 1%. But at the same time, I think we have mentioned, other than the bank wealth management products, mutual fund products, we are also introducing the insurance products to our wealth management clients. And as you know that for the wealth management products, the commission rate is rather high, and we're actually expecting some good contribution from this business. So in the mix, we will see whether overall, on an AUA basis, we'll be able to reach the similar level. But longer term, definitely, we're going to see the non-P2P wealth management business to become a significant revenue contribution in 2021 and beyond.

Operator

(Operator Instructions) We have no further questions at this time. I will pass back to management for closing comments.

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

Okay. Thank you very much. That concludes the call.

Operator

Thank you. Ladies and gentlemen, that does conclude the call today. Thank you for attending. You may now disconnect.