[NYSE: YRD] - Yirendai Q1 2017 Earnings Conference Call

8:00a.m. U.S. Eastern Time, May 22, 2017

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

- Ella Ji, China Renaissance
- Richard Xu, Morgan Stanley
- Ryan Roberts, MCM Partners

Presentation

Matthew Li – Director of Investor Relations

Thank you and welcome to Yirendai's first quarter 2017 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.

……

Yihan Fang – Chief Executive Officer

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

We are pleased to achieve sequential growth during the quarter despite the seasonally slow Chinese New Year holiday period. In the first quarter of 2017, loan origination volume increased 4% sequentially to RMB 6.9 billion and showed 101% year-over-year growth rate. This brings our cumulative loan origination volume to RMB 39 billion and outstanding loan balance to RMB 24 billion.

During the quarter, we facilitated loans to 125 thousand qualified borrowers. 7.8% of these borrowers were repeat customers following the launch of our top-up loan product in December 2016. 69% of these borrowers were acquired through online channels, accounting for 51% of our loan origination volume during the quarter. 99.8% of the loan volume acquired through online was facilitated through mobile channels. As of March 31, 2017, we had cumulatively served more than 600 thousand qualified borrowers with cumulative registered borrowers exceeding 26 million. We continue to grow very quickly with cumulative registered borrowers hitting the 30 million milestone recently.

At the same time, we served close to 200 thousand investors during the quarter. All these investors invested through our online channels and 85% of them used our investor mobile app. In Q1, average investment term for our Yidingying product remained healthy at 9.2 months with an average annualized return of 7.9%. As of the end of Q1 2017, we had cumulatively served approximately one million investors with registered investors reaching 5.3 million. AUM per investor came in at close to RMB 90 thousand during the quarter. In addition to growing our investor base and connecting them with high quality borrowers, we are creating a more user-engaging experience within our app by providing our investors with more products and services. Our mobile app's daily average users came in at about 250 thousand by the end of Q1 and continues to grow. And number of active investors was close to 700 thousand as of the end of Q1. "Active investors" is defined as investors who have remaining balance in their Yirendai accounts in the trailing 12 months. We believe this lays a solid foundation for our strategic expansion into online wealth management business to provide an expanded array of investment options to investors. Recently, we rebranded our investor services business to Yiren Wealth Management which strategically focuses on expanding and providing online wealth management services to China's mass affluent population.

Ensuring a smooth regulatory registration process is one of our top priorities this year. Over the past few months, we made concrete progress in navigating through the regulatory evaluation process with relevant government agencies. We are committed to serving as an example within the industry by continuing our close and frequent communication with relative governmental authorities to ensure our compliance with all these requirements.

Now, I would like to re-emphasize on our key strategies this year.

We continue to focus on **Online Growth**. During the quarter, loan volume from online channels exceeded 50%. This is just the beginning and we expect growth from online channels to continue to have bigger momentum. There are several key opportunities: 1. programmatic online marketing. This has helped us significantly improve our targeted marketing and grow effective new online marketing channels such as mobile native ads. 2. improving overall conversion by enhancing data collection efficiency, data quality, supporting telesales by using algorithms, and channel optimization. 3. improving risk management, including enhancing our risk management scoring system to improve average loan size and conversion while maintaining risk performance within our benchmark, as well as optimizing our frontend automatic anti-fraud system. All these are technology driven initiatives and are expected to further expand our lead.

We will focus on **brand** building this year. We have done many customer focus group studies and will strengthen our customer centric key branding messages. During the second half of the year, we will invest heavily on activities in supporting our brand messages consistently. As a technology driven company, we will also start to establish our technology brand. We will continue to share our industrial insights and best practices. In the latest ranking by wangdaizhijia, Yirendai was ranked first among all online lending platforms. We are committed to growing our brand equity and strengthening Yirendai's brand position as China's top Fintech company.

We will focus on creating strong **partnerships**. With respect to borrow acquisition, we are making progress on several key new partnerships with China's internet giants, vertical consumer apps and some relevant software-as-a-service companies. We expect online loan volume from our partners to account for a significant portion during the 2nd half of the year. With respect to platform business, we launched Yirendai Enabling Platform (YEP) in March and YEP has gained significant attention from the industry. Currently about 10 companies are testing or already signed contract with Yirendai on collaborations on data collection, anti-fraud or customer acquisition. With developing more selective partnerships on YEP, Yirendai is growing our new platform business. With respect to funding diversification, we are collaborating with several banks and will launch bank partnerships soon.

With these strategies and initiatives in place, we are confident to continue the robust momentum of our business growth.

I will now hand the call over to our CFO, Dennis to discuss our Q1 2017 financial results.

……….

Dennis Cong – Chief Financial Officer

Thanks Yihan. Hello everyone, I will first go over our first quarter 2017 financial results followed by our guidance for next quarter.

We again delivered solid results for the past quarter with strong top and bottom-line growth. Q1 2017 **total net revenue** beat our guidance by approximately 10%, increasing 84% from the same period of 2016 to RMB 1.02 billion. The strong revenue growth was mainly due to growth of loan volume, increased service fees billed to investors and monthly fees billed to borrowers as our remaining loan balance continued to expand. It was partially offset by the impact of deferring revenue recognition nature of the loans facilitated from online channels, which has a fee collection schedule with monthly payments in addition to a portion paid up front.

Driven mainly by loan volume growth, we billed fees of RMB 1.6 billion to borrowers and investors in Q1 2017, an increase of 87% from the same period in 2016. Our take rate of fees billed, which is defined as total fees billed divided by loan facilitation volume during the same period, was 23% in Q1 2017, compared to 24% in the previous quarter and 25% in Q1 2016.

Going into more detail, **upfront fees billed to borrowers** during the quarter were RMB 1.3 billion, an increase of 73% from Q1 2016. **Monthly fees billed to borrowers** in Q1 were RMB 173 million, an increase of 172% from the same period in 2016. The significant year-over-year growth of monthly fees billed to borrowers was primarily attributable to the catch up effect of our monthly fees driven by increase in our loan balance. **Service fees billed to investors** in the quarter were RMB 177 million, an increase of 174% from Q1 2016. The significant year-over-year growth in service fees billed to investors was mainly due to the growth of our total investor AUM on our platform. These monthly fee driven revenue streams will take an increasing percentage of the total fees billed on our platform, and shall provide more stable and expanding margin in the longer term.

During the quarter, we managed to spend less on **operating costs and expenses**, which decreased by 7% from the previous quarter to RMB 629 million. The decrease in operating costs and expenses during the quarter was mainly due to a decrease in sales and marketing expenses as percentage of loan facilitation volume. Q1 is a seasonally strong quarter for investor demand which usually results in lower investor acquisition costs. We are also seeing an improvement in our borrower acquisition efficiency from online channels, supported by our continued optimization of the customer acquisition and credit underwriting processes. For Q1 2017, sales and marketing expenses accounted for 6.8% of the amount of loans facilitated, a decrease from 8.1% in the previous quarter and 7.4% in the same period of 2016.

As a result of strong top-line growth and an improvement in operating efficiency, we achieved an **adjusted EBITDA margin** of 39.2%, compared to 37.5% in the previous quarter and 37.1% in the same period of 2016. **Net income** in Q1 2017 was RMB 351 million, an increase by 166% from the same period of 2016.

On the risk management front, we continued to maintain solid anti-fraud and credit underwriting process and closely monitor the risk performance of our loan portfolio. As 2015 and 2016 vintage loans continue to mature, the risk performance of our loans is consistent with our expectations, as demonstrated by the stable delinquency rates and consistent vintage charge-off performance of our loan portfolio.

On the cash flow and balance sheet side, we continue to enjoy strong cash flow from operations and maintain solid cash position. During this quarter, we generated net cash of RMB 565 million from operating activities. As of the end of Q1 2017, we had about RMB 864 million in cash and cash equivalents. During the quarter, we have increased our investment in available-for-sale investments and held-to-maturity investments, to enhance the return from operating cash. As of Q1 2017, balance of held-to-maturity investments was RMB 495 million. Balance of available-for-sale investments was RMB 1.2 billion.

During this quarter, we renamed our Risk Reserve Fund mechanism to Quality Assurance Program to better reflect the business nature of this service we provide to our investors and better define our platform's legal liability. As of Q1 2017, we had RMB 1.4 billion of restricted cash in our quality assurance program and trust accounts. We also booked RMB 320 million in loans at fair value as a result of consolidating the trust and ABS.

Our liabilities were mainly comprised of two items: one, RMB 1.7 billion in liabilities from the quality assurance program, and two, RMB 380 million payable to investors at fair value as a result of consolidating the trust and ABS.

With that, let me go over our guidance. **For the second quarter of 2017**, we expect loan origination volume to be in the range of RMB 7.7 billion to RMB 7.9 billion; total net revenue to be in the range of RMB 1.07 billion to RMB 1.09 billion; and adjusted EBITDA margin to be in the range of 24% to 26%. At the same time, we would like to reiterate our guidance for **full year of 2017**, we expect loan origination volume to be in the range of RMB 33 billion to RMB 35 billion; total net revenue to be in the range of RMB 4.4 billion to RMB 4.6 billion; Adjusted EBITDA margin to be in the range of 23% to 26%.

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

……...

Question and Answer

Operator: We will now begin the question-and-answer session. (Operator Instructions). Ella Ji with China Renaissance.

Ella Ji: Congratulations on the strong quarter. I have two questions. The first one is about your EBITDA margin. Your EBITDA margin achieved a very high level this quarter; it's even higher than 4Q last year. But your guidance for next quarter, there seems to be a big drop. Can you help explain that? Thank you.

Dennis Cong: Yes, I think I will answer the EBITDA margin question. As we mentioned in our previous call and the full year guidance for 2017, in the middle of Q2, we'll initiate our new product with the monthly collection fee schedule. That will have a deferred revenue feature of this product that's going to reduce our overall EBITDA margin structure in Q2. That is the main reason for us to guide the full year 2017 EBITDA margin of 23% to 26% and for Q2, the margin to be in the range of 24% to 26%.

Also, I'd like to highlight, as our overall business model longer term EBITDA margin, we'd like to have in the mid-20s, as we're still in the very early stage of our business model. And there is significant potential for us to grow some multiple fronts for our business. So we believe longer term, a 25% range of EBITDA margin is our ideal level.

Ella Ji: Got it. Thank you. My second question is about your loan mix. We notice that your loan mix in this quarter changes a little bit. For example, it appears that in loan B, the percentage grows up sequentially. So just wonder if this is something seasonal, or do you see this as a structural trend? And what is the reason behind this loan mix change? Thanks.

Dennis Cong: So first, I think we've established our risk pricing mechanism that we separate the loan products by the impairment risk of different customer profiles. And this has been the majority of our business, where we actually see very stable performance from our loan portfolio.

If you look at the historical performance of each vintages, they have been performing very, very well, and if you look at the yearly vintages that the D type of performance actually, in certain instances, is actually lower than C type. So I'd say, first, the D type of borrower base are very stable performance. They're a very high quality of borrower that we classify them as prime; and second is that this business actually generates very good profitability for us.

However, going forward, we'd expect, as we continue to expand our customer acquisition channels, diversify our product mix, we will see more balanced growth in other categories of borrower base. If you look at the D type trends, actually in Q4 2016, the D type accounted for 88%, while in Q1 2017, it's now actually 83%. So actually sequentially, it's actually slightly coming down trend.

Going forward to the rest of 2017, we actually expect a more balanced portfolio mix as we continue to grow our new products and penetrating new categories and have a more diversified customer segmentation.

Operator: (Operator Instructions). Richard Xu with Morgan Stanley.

Richard Xu: I have a question on basically the customer and borrower acquisition channels. On the call, you mentioned that basically during the quarter, you improved efficiency, as well as broadened the borrower acquisition channels. Could you talk a little bit more about that, exactly what you'd be able to achieve to improve the -- essentially reduce the borrower acquisition cost during the quarter?

What's the current average loan size versus before? Any data on the approval rates that you can share with us. And going forward, do you see any further room to improve this and any guidance towards the pace of improvement going forward, if possible? Thank you very much.

Yang Cao: Hi, Richard, this is Yang. I'll take this question. So for the customer acquisition costs, we mostly see three areas of improvement. One is working with our acquisition partners and advertising partners. We use the data to optimize the selection of the customers, and we provide what we think is the right customer in terms of their characteristics. And we'll provide labels to our acquisition partners and then they can more effectively select those customers. And that, overall, will keep our volume and will reduce the cost.
And then second thing is we improve our product and also are adding tele-sales into the user experience, such that our user -- because loan is a very complicated product; a user having difficulty entering the data or finding information about their own accounts. We'll be able to provide the help. That will help the user to move through the process more smoothly.

And third as we work with our risk team, and we're working with them to provide more data and work with them to refine the risk management algorithms, such that we improve the approval rate, while keeping the risk performance steady.

So with these things combined together, we have been able to achieve improved customer acquisition costs. We do expect this to continue to improve while we work with partners and work with our product team and risk team, such that we can gain more efficiency into higher conversion and acquisition channels. So that's what the expectation and also we see the direction.

Dennis Cong: Also maybe, I just -- from the projection or guidance presented in terms of our sales and marketing percentage of our loan volume, I think in Q1, there's a combination of both as what Yang has mentioned, our continuing improvement, our customer acquisition, to reduce our borrower acquisition costs, and also seasonality-driven investor side acquisition cost savings.

Going forward, we would expect the overall trend to improve quarter-over-quarter compared with the level of sales marketing as a loan percentage in 2016. So if you look at 2016, we're ranging between 7.5% to 8%, so we would like to see this number to be trending lower towards the 7% range for the rest of 2017.

Richard Xu: Okay. Thank you very much.

Operator: Ryan Roberts with MCM Partners.

Ryan Roberts: I just want to actually ask more of a question about some of the platform business and some of the non-core businesses and kind of the growth trajectory for some of those. When we can expect those to make some kind of an impact on the top line? I have a follow-up to that as well.

Yang Cao: Okay. So our Q1, we actually made quite significant progress in terms of testing and integrating with our partners. And so far, we see a quite large amount of potential partners and the partners have a strong interest in our technology, including our data acquisition, anti-fraud and customer acquisition.
So that said, we're still in the early stage in terms of growing the business. And we do see this quarter in Q2, there will be quite a few more customers or partners coming onto the platform. And in terms of business impact, in my opinion, is still in the early stage and we hope to update you in next call with more material data to show our progress.

Ryan Roberts: Okay. Okay. Thank you. I guess the next question was kind of more about the outlook for spending on sales and marketing and kind of the brand-building effort. I think we said that we're going to significantly increase that spending in the second half. And I'm just kind of curious how we should be looking at that, yes, for the second half, as well as going forward afterwards?

Dennis Cong: Yes, I think for sales and marketing customer acquisition costs, as we mentioned, we're probably going to see trend down, but on the branding side, I think Yihan will make more comments.
Yihan Fang: Yes, as I've mentioned in my presentation, actually, we will spend on branding more, three things -- one is that we'll spend more on customer-centric, customer-facing branding; we'll do more spending on that. And we'll also start to advertise for our technology spending, for example, the YEP platform. And we'll do more enterprise branding as well, as we're working more closely with partnerships. Before we didn't invest too much on enterprise branding, so we expect the spending as a percentage will go up.

Dennis Cong: But it's still a very manageable level if you look at our current percentage. I think what Yihan means that we'll pay more -- stronger emphasize on our overall brand building, both consumer-facing as well as institution-facing.

Ryan Roberts: So will that be offset at all by some of the reduced investor acquisition and borrower acquisition costs? Is that kind of a strategy there on the cost line?

Dennis Cong: Yes, if you look at that, I think right now if you look at our planning costs, it's 0.1% or 0.2%, it's a very small percentage of that. I think it's more of our business strategy rather than a dollar amount.

Yang Cao: Yes, can I just add one more thing, is we often would like to align our customer acquisition, the messaging part of customer acquisition, along with the brand message, such that we both acquire the customer and we provide a strong brand impression, brand presence with the customer. So we'll make the acquisition more consistent with our brand position.

Ryan Roberts: Yes, okay. Thank you. That's very helpful. And congratulations on a very nice quarter.

Operator: (Operator Instructions). This concludes our question-and-answer session and also our conference. Thank you for attending today's presentation. You may now disconnect.