[NYSE: YRD] - Yirendai Q4 & FY 2016 Earnings Conference Call

8:00a.m. U.S. Eastern Time, March 16, 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
- Richard Xu, Morgan Stanley
- Eric Wen, Blue Lotus
- Ryan Roberts, MCM Partners
- Patricia Cheng, CLSA

Presentation

Matthew Li – Director of Investor Relations

Thank you and welcome to Yirendai's fourth quarter and full year 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.

2016 was a milestone year for the online lending industry in China. The overall industry continued to grow at a remarkable rate despite increased regulation and further market consolidation as the number of functional players continues to fall. We have also observed more online platforms shifting towards serving lower quality borrowers with small, short-duration loans. We have clearly positioned Yirendai differently as the go-to platform for prime borrowers with our products and services targeting urban salaried workers with credit cards.

We had another strong quarter with loan origination volume increasing by 19% sequentially and 102% year over year to RMB 6.7 billion. Our full year 2016 loan origination volume increased by 112% year over year to RMB 20.3 billion, bringing our cumulative loan origination volume to RMB 32.3 billion and outstanding loan balance to RMB 20.8 billion.

During the quarter, we facilitated loans to more than 110 thousand qualified borrowers. 57% of these borrowers were acquired through online channels, accounting for 37% of our loan origination volume during the quarter. 99% of the loan volume acquired through online channels was facilitated through mobile. As of December 31, 2016, we have cumulatively served more than 500 thousand borrowers through our online marketplace. During the quarter, we served close to 200 thousand investors, all of which invested through our online channels, with 85% of them using our investor mobile application.

We executed a number of initiatives throughout the year to drive the strong growth momentum of our business. I'm proud to say we made remarkable achievements on many fronts, such as credit underwriting, risk management and product development. Over the past year, we further strengthened our credit underwriting and risk management capabilities by expanding the amount of data sources we use in our analytical systems, fine tuning our risk policies and decision making engines, and enhancing our anti-fraud systems. We upgraded our fast-track 1.0 product by using credit card statements directly from banks which significantly reduces the possibility of fraud. In 2016, we also launched several new products to cater to the rapidly changing needs of our expanding customer base and increase our geographic reach, including housing provident fund, life insurance and repeat borrowing products.

On investor side, our targeted market is the massive online population of mass affluent. As of the end of 2016, we have cumulatively served close to 900 thousand investors. In December 2016, we began cross-selling third-party wealth management products on our investor mobile app to provide an expanded array of investment options to investors. We believe this is an important initiative to retain customers for their asset allocation needs.

We have seen concrete progress made in terms of regulatory developments and industry consolidation since the issuance of the Interim Measures on August 24, 2016. The regulatory framework is expected to be established as "1 measure + 3 guidelines" which includes guidelines for recordation and registration, as well as fund custody arrangements for online lending information intermediary institutions which is already in place. We expect regulators to issue further guidelines for information disclosure practices going forward. We believe these regulations will create a rapidly growing, more rationale and healthier online lending market in China.

2017 will be a critical year for the online lending industry in China as Interim Measures and guidelines are implemented. As a market leader, we are in close communication with various regulatory bodies to demonstrate and educate others with our best practices, ensure Yirendai's full compliance with regulatory requirements and obtain certification as early as possible. At the same time, we will devote significant resources to increase our brand awareness and recognition to make Yirendai the brand of choice for the massive online population of mass affluent investors and prime customers with borrowing needs.

The continued consolidation of the industry provides enormous growth opportunities for leading platforms such as Yirendai. We will continue to drive the growth of our existing products and develop new technology-driven ones to seize future business opportunities. Specifically, we are developing a new product for borrowers acquired from offline channels. This new product will offer a monthly fee collection schedule. We believe this new product will further improve our user experience and significantly enhance our competitive advantage.

We will focus on partnership expansion in 2017. We are actively working in collaboration with consumption verticals and industry solution providers to offer our services to target customers on partner platforms. In addition, we recently launched the Yirendai Enabling platform which allows partner companies to leverage our financial technology capabilities such as data collection, anti-fraud intelligence, and customer acquisition techniques. By leveraging the Yirendai Enabling platform to offer our services to partners, we will not only further optimize our data and anti-fraud technology, but also add additional revenue stream. Furthermore, we are actively negotiating with several banks to diversify our funding sources and reduce funding costs.

We are transitioning into a comprehensive online financial services platform that offers a diversified portfolio of services to cater to various customer needs regardless of what stage in life they are at. Yirendai has served over 1 million borrowers and investors with financial transactions. There are in fact many more users that have approached us but weren't able to take advantage of our services due to segmentation and the transactional nature of our services. Going forward, we will actively enhance customer engagement by offering more products, features and tools provided through Yirendai and its select partners to attract new users and increase user stickiness.

With our solid strategy in place, we are confident that we will be able to maintain the strong growth momentum our business has gained and further enhance our market leadership.

Finally, I would like to take this opportunity to introduce a new member of our senior management team. Earlier today, we announced the appointment of Dr. Yichuan Pei as Chief Credit Officer, who will be responsible for the overall management with our Credit Department. Dr. Pei brings with him over 26 years of experience in the financial industry from consumer lending risk management, credit product marketing management, asset-backed securities valuation in the United States. We warmly welcome Dr. Pei to join our team. With him assuming the new roles, we are very confident to further enhance our market leading capabilities of credit underwriting and risk management.

Dr. Pei will also work closely with our Chief Risk Officer, Ms. Yiting Pan to manage the Risk Management Department. Ms. Yiting Pan is expected to transit from her current position as Yirendai's Chief Risk Officer into a new role with CreditEase and relocate to the U.S. at the end of Q2 2017 due to personal reasons. Dr. Pei will take over the full responsibilities of risk management and assume the Chief Risk Officer position at end of the transition period. We would like to express our sincere appreciation to Ms. Yiting Pan for her outstanding contribution to our risk management during her tenure. We wish her all the success for the new role with CreditEase in the U.S.

I will now hand the call over to our CFO, Dennis to discuss our Q4 and full year 2016 financial results.

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Dennis Cong – Chief Financial Officer

Thanks Yihan. Hello everyone, I will give an overview of our fourth quarter and full year 2016 results and provide our business guidance for 2017. We are pleased to conclude full year 2016 with another strong quarter. In Q4 2016, we facilitated RMB 6.7 billion loan during the quarter, an increase of 102% when compared with Q4 2015, result in total 2016 loan origination of RMB 20.3 billion that exceeds our full year 2016 target.

Now looking more closely into our fourth quarter performance, total net revenue in Q4 2016 was RMB 1.1 billion, representing an increase of 137% year over year and 22% on a sequential basis. This increase was primarily driven by the growth in loan origination volume due to strong customer demand.

In Q4 2016, 57% of our borrowers were acquired from online channels, contributing to 37% of the loans facilitated in this quarter, compared to 41% in the previous quarter. The decrease of percentage of loans generated from online channels was mainly due to our tightened risk policy of the online channels after the organized fraud incident in Q3. As we continue to strengthen our capabilities of online customer acquisition and risk management, we expect loan origination from our online channels will reach 50% of total loan volume by the end of 2017.

In terms of our loan product portfolio during the quarter, 87.8% of our new loans facilitated were product D as we continue to see strong credit performance of this price grid. The product volume mix for Product A, B and C were 4.3%, 3.2% and 4.7%, respectively.

On the investor side, our annual Yidingying average investment yield on the platform in Q4 2016 was 8.2%, down from 8.7% in the previous quarter as we continue to benefit from strong investor demand for high quality assets on our platform, stronger brand and market leadership. In order to better meet our investors demand for broader and more diversified investment asset class, we have started cross-selling third-party wealth management products on our Yirenlicai mobile application in December 2016. In addition to generating more revenue opportunity, we believe this initiative will help us build deeper relationship with our investors and capture business opportunities in the large wealth management market.

Turning to operating expenses. Sales and marketing expenses were RMB 538 million ($77 million) for the quarter or 8.1% of loan origination volume, increased from 7.5% in the previous quarter. The increase of sales and marketing expenses was mainly due to higher customer acquisition cost from the online channel due to tightened risk policy. Origination and servicing costs were RMB 58 million ($8 million) for the quarter or 0.9% of loans facilitated, decreased from 1.1% in the previous quarter. Our G&A expense were RMB 80 million ($11 million) for the quarter or 7.4% of total net revenue, decreased from 12.3% in the previous quarter if we exclude the impact of the expense of RMB 81 million related to an organized fraud incident. The decrease of general and administrative expenses as percentage of total net revenue was primarily attributable to the improved operating leverage.

In terms of profitability, our Adjusted EBITDA in Q4 2016 was RMB 401 million (US$58 million), representing Adjusted EBITDA margin of 37%, increased from 25% in the previous quarter; net income in Q4 2016 was RMB 380 million (US$55 million), representing net income margin of 35%, compared to 39% in Q3 2016.

In order to present a more accurate reflection of our credit default cost, we adjusted the calculation of cumulative M3+ net charge off rate in this quarter. For details please refer to slide 28 of our management presentation.

The recent delinquency rate and vintage charge off performance are trending well and within our expectation, and charge off performances for 2015 and the first three quarters of 2016 vintage loans have shown stable trends, which demonstrate our capabilities in credit underwriting and risk management.

Specifically, as of December 31, 2016, the overall delinquency rate for loans that are 15 – 89 days past due was 1.7%, slightly decreased from 1.9% as of September 30, 2016. The decrease of delinquency rate was primarily due to the increase of total loan balance and more efficient risk management. The cumulative M3+ net charge-off rate for loans originated in 2015 was 6.6% as of Q4 2016, compared to 5.2% as of Q3 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 Rates curve on Slide 27 of the Q4 2016 management presentation, indicating strong credit performance of all products in our loan portfolio. As of December 31, 2016, the outstanding balance of liabilities from risk reserve fund guarantee is at 7.3% of remaining principal of performing loans covered by risk reserve fund.

On the balance sheet side, as of Q4 2016, we had about RMB 968 million ($139 million) in cash and cash equivalents, compared to RMB 1.1 billion as of Q3 2016. The decrease was primarily due to the increase of available-for-sale investments to enhance the return from operating cash. As of Q4 2016, balance of available-for-sale investments was RMB 1.2 billion (US$167 million), increased from RMB 298 million as of Q3 2016. Additionally, we had RMB 1.2 billion ($175 million) of restricted cash in our risk reserve fund account and trust account. We also booked RMB 371 million ($53 million) in loans at fair value as a result of consolidating the trust and ABS.

Our liabilities were mainly comprised of two items: RMB 1.5 billion ($212 million) in liabilities from risk reserve fund guarantee and RMB 419 million ($60 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 first quarter of 2017, we expect loan origination volume to be in the range of RMB 6.4 billion to RMB 6.5 billion; total net revenue to be in the range of RMB 900 million to RMB 930 million; Adjusted EBITDA to be in the range of RMB 280 million to RMB 300 million. For the 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%.

As you might have noticed, the guided Net revenue take rate and Adjusted EBITDA margin for full year 2017 is lower than our 2016 level, mainly due to our strategy of launching more customer-friendly products with monthly fee collection schedule in mid of 2017. Given our revenue recognition policy, under this fee collection schedule, we evenly recognize revenue each month throughout the loan term, thus would defer our revenue to future months. We believe this product will potentially increase our unit economic profit and enhance our financial stability and visibility given the recurring nature of the monthly fee.

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: Richard Xu, Morgan Stanley.

Richard Xu: I just have a question regarding the borrower mix from online and offline channels. I understand that there's some mix change in the fourth quarter after the fraud case in second quarter. Just wondering what was your target for the next -- I guess for next year for the medium term? And what would be the actions taken to gradually increase the online portion again? Thank you very much.

Dennis Cong: Okay. Thanks, Richard. For the 2017, as we continue to ramp up our online acquisition capability in risk management and developing more channels, we expect our online business to grow faster than our overall portfolio growth. So the expected loan mix for the online channels will grow 40% in the early part of the year to close to 50%, or even more than 50%, by the end of the year. So overall volume mix for the 2017, we expect the online portion to be close to 48% or 47% of the total year of volume.

Operator: Eric Wen, Blue Lotus.

Eric Wen: Congratulations on the good results. My question is on your guidance. As your 2017 loan origination growth is very robust, your revenue take rate and EBITDA margin are both down. Dennis, you mentioned this is because you are adopting a new accounting policy to spread out the revenues. I just wonder -- two questions. Number one is will this lead to an increase of your deferred revenue account or any kind of custom advanced account? My second question is that if you are deferring more revenue to future periods, where cost is booked in the current period, that supposedly should lead to higher profit margins in the later period. But it looks like your guidance for this year, your EBITDA margin is actually declining as well. Just wonder why that is. Thanks.

Dennis Cong: Yes, okay. So thanks, Eric, and I will answer your question maybe the second part first, and then we'll address the first part. So in terms of this new product we're introducing, which is monthly collection fee schedule, it's actually very important for us from a competitive dynamic perspective, because this actually would need the platform to have a very strong cash flow capability to be able to offer this product. And also, the user experience, customer experience, is going to be strong and our unit economic profitability is actually better. So there's many benefits to us for introducing this. In terms of the impact of our profitability, we're going to start introducing this product mid of this year due to the revenue origination scheduling. So you're actually going to see more of the revenue being recognized through the rest of the loan life, while the customer acquisition cost is actually recognized upfront. So near term, you're actually going to see a negative impact in terms of marketing profile, but longer term, given that the lifetime unit economic profits is actually potentially increasing. So net-net for the lifetime of the loan, you're actually going to see improving profitability, but it will actually spread out through 2 years or 3 years, whatever the term of the loan is going to be. So I guess near term may have some compression on margin, but longer term, it's just a matter of the revenue and cost recognition schedule matching. And also, as I mentioned in our remarks, given that the recurring and visibility of the future revenue recognition, and also given that most of the cost has been recognized upfront, most of these future revenue are actually highly profitable revenues will actually improve our financial profile and our earning visibilities. So in terms of whether this will actually change our deferred revenue numbers that we're reporting as a non-GAAP item, it is actually not going to have much of an impact from there, because this is not part of our fees billed. So it's completely deferred into the future.

Eric Wen: Thanks, that's very helpful.

Operator: Ryan Roberts, MCM Partners.

Ryan Roberts: Just a quick one for me, actually, also kind of a follow-up on the guidance. You mentioned that new kind of long-tail, the monthly payment product is going to launch. I think you said something in the middle of the year. I'm just kind of curious what some of your assumptions are for Q1. It looks like that revenue take rate slips from about 16 down to about 14 by midpoint. Just curious if you could give us some color on that?

Dennis Cong: Okay. I think for the first quarter of 2017, most of the product mix is actually similar to 2016. However, as we mentioned that we're getting very strong traction in terms of the online business growth, online customer acquisition. We actually expect our online percentage for the loan volume to increase in 2017 first quarter. So that's where you see a slightly dip of our revenue take rate. It's due to the increasing percentage of the online channel products. Even for that, the decrease of the revenue take rate is also part of the deferred revenue into the future. It's not that the revenue that's being missed.

Ryan Roberts: Got it, thanks. That's very helpful. If I could just ask you a quick second question just about some of the new wealth management products we're trying to sell to some of the investors in the platform. Just curious, could you give us some more detail on where those come from, who they're partnering with, just what kind of needs we're trying to meet for investors and how we see that business shaping up now let's say into the end of 2017 and maybe beyond.

Yihan Fang: Yes, our investor mobile app, we are currently offering some online insurance products, as well as some fund products. And a lot of those are selected by us. We're not offering a supermarket, but we select very selectively good products that we think complete our customer needs.

Ryan Roberts: Okay. Thank you very much. Thank you.

Operator: Patricia Cheng, CLSA.

Patricia Cheng: I have a couple of questions; one is a follow-up on the new product you mentioned just now and the other one on the guidance. For the new product, can you give us some idea of what kind of customers are you targeting? Are you targeting existing customers or like new sort of like product features? And how much loan facilitation do you think the new product can generate? And on the guidance, for your guidance for loan facilitation, your full year target is more than 4 times higher than the target for the first quarter. So does this have anything to do with this new product launch in the middle of the year, or what are your plans in the acceleration of the loan facilitation in the second half of the year? Thank you.

Dennis Cong: Sure. I think the new product, indeed, we'll actually introduce through certain channels, a certain type of customer acquisitions. Basically, we will introduce these type of products for the customer who owns cars, who actually already have properties. So they're slightly different from our current product offering. And then the volume that we expect of this product is probably in the 7% or 8% of our business volume in 2017, and it's going to start middle of this year. And then in terms of our 2017 overall loan volume guidance, of course, Q1 has been strong and usually, we see a sequential growth quarter-over-quarter through the year. So if you look at the trajectory that we usually follow, you probably -- not too difficult to come with the overall -- total volume for the year. So usually, Q1, Q2, Q3, Q4 tends to be a sequential growth through the year as we see our business opportunities unfold.

Patricia Cheng: Thank you.

Operator: Ryan Roberts.

Ryan Roberts: Sorry, management; thank you for indulging me. I just want to ask a quick question about YEP, just how you guys are looking at that as being a contributor to the overall results, and how you see that growing for the Company in the future?

Yang Cao: Thank you, Robert, this is Yang. And our Yirendai Enabling Platform is three components; one is for data acquisition and data management, and the other is for anti-fraud. And the final one is for sharing user acquisitions. So we have a few key reasons to release the YEP to enable the industry to be more efficient because we have the most advanced user-authorized technology. So we'd like to help partners to be very -- a better way to acquire the data. And for the user acquisition, we do have a lot of capability to acquire the user, but now not all of them are users that we can serve. So sharing with a selected partner will make the user experience better. In terms of business results, this year we would like to see some revenue come from it, but we would not be able to estimate the actual number until we start rolling out the product with partners.

Ryan Roberts: And do you think that rollout is going to happen the first half, second half, or when should we look for that?

Yang Cao: It's already happening and in the process of rolling out. We probably should be able to see some results in Q3-Q4 timeframe.

Ryan Roberts: Fantastic, look forward to hearing about it. Thank you very much.

Dennis Cong: Okay. Thank you.