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+++ presentation

Operator^ Good day, and thank you for standing by. Welcome to the Yiren Digital Fourth Quarter and Fiscal Year 2020 Earnings Conference Call. (Operator Instructions)

I would now like to hand the conference over to your first speaker today, Ms. Lydia Yu. Please take over, ma'am.

Lydia Yu^ Thank you, and welcome to Yiren Digital's Fourth Quarter and Fiscal Year 2020 Earnings Conference Call. Today's call features a presentation by the Founder, Chairman and CEO of CreditEase and CEO of Yiren Digital, Mr. Ning Tang; CEO of Yiren Credit, Ms. Mei Zhou; and CFO of Yiren Digital, Mr. Na Mei. And CRO of Yiren Digital, Mr. George Liu; and Mr. Dennis Cong, Director of Yiren Digital, 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 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 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 reconciliations to GAAP measures, please refer to our earnings press release.

I'll now pass on to Ning for opening remarks.

Ning Tang^ Thank you, Lydia. Thank you all for joining our fourth quarter and full year 2020 earnings conference call. Looking back, the year 2020 was an unusual year, as we faced a complex macro dynamic with impact from the pandemic and evolving regulatory environment. Despite that, we are pleased to have accomplished significant milestones and continue our progress in our strategic transition to further solidify our position as China's leading digital personal financial services platform.

Before I go further into detailed business updates, I would like to highlight three key milestones that we've achieved in year 2020. First, we completed a business restructuring at year-end in which we spun off our legacy P2P operation. The spun off operation will be run independently to focus on a smooth transition and winding down. And we expect many investors of our legacy products to transition to our other wealth management products. The restructuring will allow Yiren Digital to solely focus on our strategies to grow our wealth management and the loan facilitation-based credit-tech businesses with full force going forward.

Secondly, our wealth management business has achieved significant growth with strong demand, with the revenue generated from our current wealth management products, excluding our legacy products, accounting for 31% of our total net revenue in the fourth quarter, up from 12% in the third quarter. Yiren Wealth has also finished its strategic rebranding and repositioned itself as a one-stop asset allocation-based professional wealth management platform, providing our clients with a wider range of well-selected products and optimized services.

To date, Yiren Wealth has established partnerships with over 60 financial institutions and provides over 4,000 products to meet the comprehensive needs of China's mass affluent customers. With both strong product service offerings and significant growth of investor base, we expect our wealth management business to provide strong revenue contribution to our overall business in 2021.

Thirdly, as part of our one-stop asset allocation strategy, to further enrich our product portfolio and services, we acquired an insurance broker, Hexiang, in 2020 to initiate our insurance business, and it has been growing at a significantly better-than-expected rate, bringing in strong synergies to our other wealth management products and services. Positioned as a comprehensive insurance broker with both online and offline channels, Hexiang has so far established partnerships with over 150 insurers nationwide and offers over 350 insurance products, covering life and property and casualty insurance, serving both individual and corporate clients.

Hexiang's business priority in 2021 will be to introduce more new products and to increase the proportion of higher take rate products, such as life and health care insurance, to further drive the profitability of our wealth management business.

Now I will provide a business update on our wealth management business and then pass it over to Ms. Mei Zhou, CEO of Yiren Credit, to give an update on our credit business.

On wealth management, we continue to see impressive growth momentum, and the demand remains strong going into the year of 2021. At the end of December 31, 2020, total client assets for our current products, which exclude our legacy products, increased by 71% from prior quarter to RMB 8.6 billion.

In light of the joint notice issued by the PBOC and the CBRC on regulating commercial banks to conduct personal deposit businesses through the Internet, at the end of January, we have stopped facilitating online bank deposits and shifted our focus to other wealth management products. Online deposits represent only a small portion of our revenue from investors. Thus, the financial impact of this adjustment on our business will be minimal.

Meanwhile, our fund products remained a top pick among investors, with total client assets in fund products increasing by 10% quarter-over-quarter to RMB 1.5 billion, and the average investment in fund products per investor reached RMB 61,000 as of end of the fourth quarter. Particularly, our self-selected fund portfolio products enjoy a high demand due to strong performance, which will become a main growth driver going forward.

Moreover, we also plan to launch a new securities brokerage business in the second quarter this year, which will further enrich our wealth management offerings and provide investors with high-quality services to the financial markets in both the U.S. and Hong Kong. Targeting the mass affluent and high net worth population, we distinguish ourselves from other online brokers with differentiated value of wider range products and quality services, including customized one-on-one investment consulting services and bond products. So there is a lot to expect in our wealth management businesses this year.

With that, I now turn the call over to Mei, who will highlight some key updates for our credit business.

Mei Zhou^ Thank you, Ning, and hello, everyone. I will now provide an update on our credit business. We continue on our upward growth trend in the fourth quarter, following two consecutive quarters of growth in the loan volume, helping us close the year strong. Our product mix changed significantly in 2020, with our small revolving products, Yi Xiang Hua, and secured auto loan growth into our main revenue contributors as we continue to drive up the scale.

In the fourth quarter of 2020, they together accounted for 87% of the total loan originated as compared to 67% in the third quarter and the proportion has already exceeded 90% now. Compared with our unsecured stand-alone products, these 2 products show better risk performance and endure a higher unit economics, which enable us to further drive up the profitability going forward.

Particularly, it's worth mentioning that our continued efforts in the product design and innovation is playing an increasing role in driving growth. For Yi Xiang Hua, the product has been upgraded to a robust integration of a low and high credit limited revolving products, leveraging years of outstanding products and risk experiences. We have also expanded our ecosystem with our organic cooperation with traffic consumption platforms and also built our own e-commerce mall.

The product better serves the customers in need of cash loan, consumption loan. We pilot launched this new product in the third quarter last year and it has been an immediate success with volume already increasing to 46% of the total volume for Yi Xiang Hua in Q4. Meanwhile, we also explored to offer new value-add services and products in auto-related ecosystem, such as auto insurance, which are potential new area of the growth in the revenue leveraging Hexiang Insurance Broker license, and will bring further synergies to our business.

Furthermore, our operating efficiency shows visible improvement as we are continuing to enhance our operating capabilities. The customer acquisition cost for Yi Xiang Hua declined to around 2% in Q4 from close to 3% last quarter, as on the one side, we deepened our cooperation with the Internet traffic platforms. On the other side, receivable has achieved improving growth at a lower cost as increasing portion of the customers are re-borrowing using the revolving product feature. The product approval rate also showed visible increase as we further refine our marketing strategies and credit underwriting capabilities.

For auto loans, the approval rate reached 75% in Q4, a historical high, due to our continued efforts to better target customers with higher credit quality. Lastly, our asset quality continues to improve as a result of our ongoing efforts to tighten up our risk control, shift to better credit quality customer base as well as transition into the products with better risk performance. Our vintage risk of performance has consistently improved quarter-by-quarter with the comprehensive end-to-end integration of joint risk management with consumption platforms, acquisition, portfolio and collection risk management.

Our 15 to 89 days delinquency ratio is 1.7% for our continuing business as compared to 4.3% for our overall business as of the December 31, 2020. We expect our asset quality to witness a further concrete improvement in 2021.

With that, I will now pass it to our CFO, Na, who will provide a financial update.

Na Mei^ Thank you, Mei. Hello, everyone. For financial update, I will focus on key items of our business operation and the financial performance only. You can refer to the detailed financial results in our earnings release and IR deck that has been posted on our website.

First, our operational highlights. For our wealth management business, as of December 31, 2020, we have served close to 2.3 billion investors,. Client assets in our current products increased to over 7x year-over-year to RMB 8.6 billion as of December31, 2020.

On the credit side, loan originations for the quarter was RMB 4.2 billion, representing an increase of 31% quarter-over-quarter. Secured auto loans and Yi Xiang Hua, our smart revolving loan products continue to be the main drivers of our loan volume growth. Starting from this quarter, our credit business model has transitioned to a pure loan facilitation model, whereby funding for loan is provided 100% from our institutional funding partners, and we provide tech-enabled borrower acquisition and facilitation service to our partners.

Next, on to our financials. In terms of fourth quarter, total revenue increased to 14% from prior quarter to RMB 1.2 billion, with our revenue mix continuing to change as a result of business translation. Our wealth management business is becoming a meaningful contributor to revenue, representing 36% of net revenue this quarter. Other income grew significantly, increasing 95% from prior quarter, mainly due to the ramp up in our insurance business.

Going down to expenses. Our total expenses increased by 19% from prior quarter to RMB 1.7 billion. Sales and marketing expense decreased 39% from prior quarter to RMB 295.1 million. Borrower acquisition expense is currently a major component of our sales and marketing expense and the decrease this quarter was mainly driven by organization restructuring to optimize operational efficiency. Our origination and service expense increased 149% from prior quarter to RMB 597 million, mainly due to an increase in loan servicing costs plus increased commission expense paid to sales channels as a result of the expanding insurance volume.

Provision for contract assets, receivables and others was RMB 34.5 million this quarter, equivalent to 0.8% of loan volume as compared to 0.8% last quarter due to improved risk performance driven by a shift in loan product mix. Loss of disposal of RMB 655.8 million is a one-time loss recognized in relation to our business restructuring. The disposal consideration was determined using a DCF model that explains the future expected losses to be incurred by Hengcheng entity included in the fairness report issued by an independent valuer.

Net loss for the quarter was RMB 559.6 million.Excluded the onetime impact as mentioned above. Non-GAAP net income for the quarter was RMB 96.2 million, representing an increase of 21% quarter-over-quarter. On the balance sheet side, our cash position remains strong with RMB 2.6 billion of cash and short-term investments as of December 31, 2020.

Before I end with our business outlook, I would like to emphasize that as we transition and upgrade our credit business model to a loan facilitation model and fromproviding a single stand-loan product to focus on diverse products with better risk performance and higher earnings potential, coupled with strong growth momentum in our wealth management business, our continuing business has and will continue to deliver strong financial performance.

Looking into 2021, we expect wealth management sales volume of current products to be in the range of RMB 20 billion to RMB 30 billion, and the total loans facilitated to be in the range of RMB 20 billion to the RMB 25 billion. This forecast reflects our current and preliminary views of the market and operational conditions, which are subject to change.

This concludes our closing remarks. Operator, we are waiting for Q&A.

+++ q-and-a

Operator^ (Operator Instructions) We have a question coming from the line of Matt Larson from National Securities.

Matthew Lewton Larson^ It's kind of a complicated quarter. From what I understand, you've disposed your legacy P2P business, took a charge and you're focusing on higher quality micro-lending and asset-backed lending with the auto loans and things like that plus you're building out a wealth management platform. And you're doing so because you have a legacy client base that you've had, frankly, since you went public. I was at Morgan Stanley when you went public in December 2015. And I think you really are the first P2P company do so, and were very successful until that business got regulated out.

But other companies have transitioned like -- in particular, I could suggest that FinVolution, which used to be closed something else, has successfully transitioned their P2P business to a, what's the term they use -- well, they get all their funding from the banks. You decided not to go that route. And I think your best asset is your significant customer base, your legacy people and you're transitioning into asset management, mutual funds, things like that and then letting the money.

The thing that caught my interest was that in the second quarter, you should have a brokerage unit setup because that's really where you're seeing some super growth, at least in some companies that are listed here, Tiger, Futu and because of the real interest in trading securities in brokerage that we're seeing globally. Can you give us any estimates about how that's going to impact your earnings and revenues because the growth of the businesses you've just discussed looks good, but it's coming from a very small base? Your growth in insurance and assets under management, they're still quite small.

And I'll conclude with one of the assets that is appealing to your company as you have a huge cash position relative to your market cap. But as far as the growth of earnings, can you give us any guidance of what you can expect for 2021, particularly if you get the brokerage unit up and going?

Ning Tang^ Thank you for the question. And this is Ning, and I'll take a crack and other colleagues, including Dennis, can provide more details. And a couple of thoughts. One is that, actually, on the borrower side, on the creditech side, we do have this loan facilitation model doing very well, growing fast. Actually, we work with banks, which provide funding to borrowers. And on that front, our very unique front is in our online/offline combination model, which is we have online capability, and we also have a national physical and that's what helping us do better credit assessment work for certain types of credit business. And that's for the borrower side of the legacy P2P.

And on the lender side now is becoming the wealth management business, as you correctly described. Also, we have this insurance part that is growing fast, serving both the borrower side and the investor side. And the online brokerage business will go live in the second quarter. This is we expect a value driver for our business. We have the investor base, which we like to serve better with more service offering like the online brokerage offering. So yes, this is going to be a key value driver, in my view.

But other businesses, what we just discussed, like the loan facilitation, credit-tech business, the wealth management fund portfolio business as well as the insurance business, in my view, are also high-quality businesses that clients really like, and the company will benefit from.

Yu Cong^ So yes, thanks, Ning, and let me add a very few points. I think, as Ning mentioned, the P2P transition is actually very successful underway. And we are continuing to work on the credit business side, as Ning mentioned. On the wealth management business, if you look at the Q4 revenue contribution from the pure wealth management business, which is excluding the legacy P2P business completely, the revenue contribution is already reaching 31%. That's quite significant compared to only 12% in Q3, clearly demonstrates the momentum and business demand from our large investor base.

In terms of the online broker business, it's one part of our overall asset allocation strategy for our mass affluent investor base in China because they have their demand for mutual funds, bank products, insurance, but they are also interested in capital markets. We see stronger demand from customers, especially in 2020, as the overall capital market is becoming very active in China, and we believe providing these online brokerage services will help us to better serve our client base and provide synergistic opportunity to get more of their assets under our platform.

And then in terms of how much contribution from wealth management business, if you look at the sales volume guidance, you'll probably see for the loan business, we're looking at growth double. For the sales volume of the wealth management business, we're also looking at significant growth percentage year-over-year, so which means that the overall wealth management business on our platform will become a very meaningful part of the whole platform. And of course, right now, for the online brokerage business, we'll start serving our existing customer first. But as you have mentioned, it's a very high-growth market in China, and we expect to expand that into larger market perspective -- opportunities as the business matures.

Matthew Lewton Larson^ Okay. So it looks like you're transitioning from your legacy P2P business into just a full-service wealth manager, where you're offering a collection of loans, asset-backed loans, some unsecured loans still, but not P2P. These would be, what they call -- well, funded directly through banks and then you're offering insurance and then in the future brokerage so that you have a legacy client base, okay, a very large one that emanates from years back when you were a P2P lender, that you can leverage the relationships from these people and move them into more traditional investment products and loans that are, I guess, looked upon more favorably by regulators because the P2P business, of course, had to be downsized or converted.

I mean other companies like 360 Finance, LexinFintech, and I don't know what else is there over there in the PRC, they have successfully gone to the credit light business model with different successes. So am I correct in defining your company as kind of a full-service wealth manager, offering a number of products and benefiting the investor from the massive growth of this type of business for people in the PRC as people's interest in investment products grow because there's a lot of walking generated over there and maybe less will be directed towards real estate and more towards investment products and loans? Is that an accurate way to describe your company?

Ning Tang^ Yes.

Matthew Lewton Larson^ Okay. And last question because I didn't have much time to really look at the earnings release. One of the attractions to me, and I've been an investor in your firm, not only when you went public way back when at Morgan Stanley and -- but recently because your company has been repositioning itself and de-risking, reducing your risk, particularly with getting away from the P2P business. But you've had your balance sheet that has been extremely strong. And it looked like your cash balance has declined quite a bit, even though it's still quite substantial. Can you give me a sense of where your cash balance is right now out of any debt versus, say, last quarter?

Na Mei^ Yes. Thank you. As of December 31, 2020, our cash balance and cash position is RMB 2.6 billion of cash and short-term investments and including about RMB 2 billion about cash deposit, yes. It's most of the current...

Matthew Lewton Larson^ So RMB 2.6 billion, I'm trying to do the conversion, that's over RMB 400 million, is that an accurate way to -- in net cash, is that reasonably accurate?

Ning Tang^ Yes, about.

Na Mei^ Yes.

Matthew Lewton Larson^ In U.S., right? And then if I just -- I am a value investor to a certain degree, and so if I look at the market cap of your company, I mean you're trading essentially at what cash value is worth, give or take a bit. So if -- within that framework, you have an extremely strong balance sheet to grow out your business. And for an investor, you're kind of getting the sense that you all can grow the business dramatically over time. But in the meantime, one can own Yiren Digital essentially of what the liquid assets are worth of cash, would that be an accurate assessment?

Ning Tang^ Thank you for thinking that way.

Operator^ (Operator Instructions) We have no further questions at this moment. Ladies and gentlemen, this concludes today's conference call. Thank you all for your participation. You may disconnect now.

Ning Tang^ Thank you.