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Q2 2020 Yiren Digital Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Yiren Digital Second Quarter 2020 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

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

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

Thank you, and welcome to Yiren Digital's Second 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 statements. Further information regarding potential risks, uncertainties or factors is included in Yiren Digital's filings with the U.S. Securities and Exchange Commission. Yiren Digital does not undertake any obligation to update any forward-looking statements except as required under applicable law.

During the call, we will be referring to several non-GAAP financial measures and supplemental measures to review and assess our operating performance. These non-GAAP financial measures are not intended to be considered in isolation or as a substitute for the financial information prepared and presented in accordance 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 second quarter 2020 earnings conference call today. With the pandemic still not far behind us and the changing market environment in the second quarter, we are making comprehensive progresses toward our business transition in our creditech business and have achieved meaningful scale in our wealth management business growth.

For our creditech business, I will provide an update on our 3 key areas of focus this year as mentioned on our last call.

First, on product expansion. Our new product initiatives are tracking very well. In connection to the launch of our new revolving loan product, Yi Xiang Hua, we have launched an e-commerce installment consumption platform in August to provide a more integrated service to our customers and establish a longer-lasting relationship with them to realize more lifetime value. Yi Xiang Hua accounted for 13% of our total loan volume this quarter, growing over 500% quarter-over-quarter. On another hand, leveraging our vast off-line service network coverage, we are ramping up auto loans nicely, achieving a 51% growth from last quarter.

In terms of customer acquisition strategy, we are building up a credit ecosystem connecting consumption scenarios with our financial products and services, and we are rapidly expanding our partnerships with large traffic channels, including Sina Weibo, 58, Xiaomi and many others are in the pipeline. Due to our channel partnership strategy, we have significantly cut our online customer acquisition costs and improved conversion efficiency. As of June 2020, online customer acquisition cost represent 3% of loan volume.

Secondly, on our transition to institutional self-funding. We have made great progress in repositioning our credit business by moving from a P2P funding model to a loan facilitation model. In the second quarter, 63% of loans facilitated were funded by institutional partners compared to 40% in the previous quarter, and we expect this proportion to continue to reach close to 100% by the end of this year with a diversified partner base.

Lastly, on risk performance. With our prudent credit policy, ongoing effort to upgrade our borrower base and the new initiatives in loan, rework and collection, we have achieved positive results on the asset quality of our loan book this quarter, and we noted a clear decline in delinquencies, that's trending to pre-pandemic levels.

Next, on wealth management business. We are seeing very strong growth momentum, particularly for our fund products. As of June 30, 2020, the number of current non-P2P investors increased 20% from last quarter to 31,530, and the total asset under administration, or AUA, for non-P2P products increased by 48% quarterly to RMB 2.5 billion. More specifically, new investors for non-P2P products in Q2 increased by 62% from Q1, and AUA for bank products and funds increased 48% as compared with prior quarter. Moreover, average AUA per investor for non-P2P products also see steady growth, with average AUA per investor for bank's fixed income products exceeding RMB 100,000 and for funds over RMB 50,000 which is well above industry average. In June 2020 alone, sales volume for fund portfolio products reached triple-digit growth month-over-month to RMB 162 million. For bank's fixed income products, total AUA exceeded RMB 1.5 billion as of June month end, and the demand continues to be strong in July and August.

We are also rolling out our insurance service offering and expect this to become a meaningful revenue contribution of our wealth management business towards end of this year. To better position Yiren Wealth in China's digital wealth tax market and to better serve our investors, we have invested in 2 new strategic initiatives. This quarter, we completed the acquisition of a licensed insurance broker. To date, the brokerage has established partnerships with 20 insurance companies covering over 190 insurance products. This will provide strong and vital support for us to diversify our product offering and expand our insurance business. We are also preparing for the launch of a securities business in the third quarter, which will provide our investors access to the capital and financial markets.

Looking into the second half of the year, our main priorities for Yiren Wealth will be centered around customer acquisition; enhancing user management, including connecting each investor with exclusive financial advisers; diversifying product mix; and expanding our investment advisory services. For customer acquisition, we aim to enhance our online customer acquisition capabilities through investment in new social media channels as well as offering 3 high-quality online introductory investment courses to attract users.

Finally, I would like to announce changes in our management team. First, let me introduce our newly appointed CFO, Ms. Na Mei. She has served as financial controller for CreditEase credit business unit since 2015, and she brings over 12 years of experience from PwC in finance, tax, internal controls and consulting. I would also like to thank Zhong for his contributions to the company, and I wish him the best in his future endeavors.

With our strategic focus to drive wealth management business growth, we also made several key talent hirings to strengthen our management team. [Raymond Hang Fung] will be joining us as Yiren Wealth's COO, and he brings over 28 years of experience in marketing and brand management. In addition, we have also hired 3 highly experienced and senior personnel to manage our insurance, funds and securities business lines who have previous working experiences with leading financial institutions and technology companies. I look forward to working with each of them in their new capacity as Yiren Digital enters its new era of growth.

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 operation and the financial performance. You can refer to the detailed financial results in our earnings release.

On the credit side, loan originations for the quarter was RMB 2.4 billion, representing an increase of 31% quarter-over-quarter, thanks to our strategic initiatives this year in diversification of our loan products. Auto loans and Yi Xiang Hua, our small revolving consumption loan product, now make up a major portion of our loan portfolios, this quarter is representing close to 50% of our loan facilitated.

On wealth management side, as of June 30, 2020, Yiren Wealth has served approximately 2.2 million investors cumulatively and around 195,000 investors currently holding investment on our platform. Total AUA for Yiren Wealth reached RMB 28.4 billion as of June 30, 2020.

Total net revenue was RMB 0.8 billion in the second quarter, representing a decrease of 26% from previous quarter, primarily due to a RMB 245 million revenue shortfall relating to our pandemic customer care program where we offered a payment relief for borrowers who were hit hard by COVID-19 as well as medical workers who fought against pandemic to help ease their financial hardship and show our appreciation to the frontline workers.

We proactively granted a concession to over 50,000 borrowers in principal, interest and fees, so that they can continue to make repayments but at an amount lower than the contractual amounts. This represents a onetime hit to our revenue in an aggregated amount of RMB 245 million. However, we have already seen a significant recovery in the borrowers' repayment behavior as there has been a 2 to 3x jump in monthly collection volume since the implementation of the program. And there is a good chance that the incremental recovery repayment amount will finally surpass the total relief amount.

Sales and marketing expenses was RMB 508 million this quarter, representing 21% of loan volume as compared to 34% last quarter due to better cost control. Allowance for contract assets was RMB 169 million this quarter, equivalent to 7% of loan volume as compared to RMB 143 million last quarter which was equivalent to 7.8% of loan volume.

Net loss for the quarter was RMB 232 million. As mentioned earlier, this is primarily due to customer care program, leading a total of RMB 245 million in principal, interest and late fees for our borrowers this quarter.

Contributions to credit assurance program was at 10.5% this quarter to ensure adequate coverage. Our credit assurance program remains adequately funded with total balance equivalent to 13.8% of the total performing loan.

On the balance sheet side, our cash position remains strong with RMB 3.4 billion of cash and short-term investments as of June 30, 2020.

On funding, we are actively transitioning from a P2P funding model to a loan facilitation model. Over 60% of our loan originations were funded by institutions this quarter as compared to 5% a year ago, and we expect this ratio to increase to close to 100% by the end of this year.

On employee compensation to better attract and retain top talent, the company adopted a new share incentive plan this quarter, which has a 10-year term and a maximum number of 18,560,000 ordinary shares available for issuance. To prevent dilution to existing shareholders, CreditEase will surrender for cancellation and for 0 consideration an equivalent number of shares.

Lastly, I would like to provide an update on our share repurchase program, which was initiated in Q2 2018. To date, we have already repurchased 368,686 ADS. We plan to continue to execute on our share buyback program to improve shareholder value. As we note the continued improvement in market and business conditions, we are confident in the performance of our business for the future.

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. On credit performance, thanks to our continued efforts in risk management, delinquency rates have shown a progressive improving trend. 15 to 90 days delinquency has decreased to 5.5% as of June 30, 2020, from 8.9% as of March 31, 2020. 15 to 90 days delinquency further decreased to 5.2% as of July 31, 2020, as a result of our strengthened efforts in tightening controls and improving borrowers' credit quality.

This quarter, our team focused on the following initiatives in risk management. We restructured our collection team and simplified the organizational structure to increase the team's operating efficiency as well as to transition our collection method, emphasizing data-driven strategies and to be result-oriented. To mitigate the risk caused by COVID-19 and help customers went through the financial hardship, we have launched 7 relating special collection projects in Q2. Including continued pandemic customer care program, which offered payment relief for the customers who were hit by COVID-19 and health care providers who are fighting the disease. These special collection projects helped us achieve a decline in NCL by over 10% as compared with projections at the beginning of the year, even facing the economic headwind. We will continue to strengthen our risk management and expect delinquency rates to further improve in the second half of the year.

I will conclude my prepared remarks here and give it to the operator. Operator, we are ready for the Q&A.

QUESTIONS AND ANSWERS

Operator

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

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

I have 3 questions here. First one is about the recently lowered interest rate cap. So just wondering, how would that affect your business? What is the current average pricing of your different products? And what's your future plan in adjusting the pricing in order to be compliant? That's my first question. And my second question is about your current product mix. So you currently have 3 types of products offering, if I understand correctly, so the short-term revolving, the autos and your traditional large-ticket products. So could you give us a breakdown in terms of the contribution to the current quarter loan volume? And also related to that, what is the current expected vintage delinquency for each of these products given they are now, obviously, under very different types of tenure and risk performance, I guess. So -- and my last question is wondering if you could give us any color on the revenue contribution from the non-P2P products in your wealth management business.

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

Sure. Thanks, Alex. I will start providing some answers to your question, then we'll have Michael and Zhong answer some part of the remaining questions. In terms of the recap from the new decision by the Supreme Court, we're studying the details and also consulting with the regulator as it is more addressing the private lending. As you can see, we're rapidly transitioning from P2P funding into institutional funding partnership and how would the rest of industry to comply with the decision is still in discussion. However, we have also evaluated the feasibility or the financial impact if we were to transition our product in full compliance with the 27% IRR pricing perspective. Right now, if you look at our average product mix, pricing for the recent quarters, we're about in the low 30 APR IRR base. So there will be a bit of reduction on our revenue take rate.

However, we believe with the lower pricing, we will be able to manage the risk -- credit risk cost better that will give us some benefits. And also, we expect, in general, the overall funding cost for the industry to trend down. And at the same time, as you can see, we're already making progress in terms of customer acquisition as well as the operational efficiency improvement, particularly for some of our off-line operations in terms of the overall cost control. So even though with the 27% IRR-based pricing, we're very confident that we'll have a sustainable, profitable business model for our credit business.

So in terms of the product mix, so right now, in the recent quarters, the online portion of our business is around 20% or so, meaning our smaller-tenured revolving type of loans. And then for -- the auto loans probably take about 50%. And then the rest of them are either our traditional off-line larger-ticket loans and also some of our small business loans that are really in partnership with the e-commerce transaction platforms. And so in terms of the delinquencies, I think we will have Michael to address that in terms of our delinquency expectations on these products.

And I think your last question is about the revenue contribution from our wealth management products. We expect the total revenue coming from our non-P2P wealth management business becoming very meaningful by the end of this year, maybe close to RMB 100 million level. And as you know, this is our recurring revenues that usually is more sticky. And once we have the customer acquire -- invest in our platform, we see very high retention and actually even increasing their AUAs per customer base. So we're very encouraged by the trend that we're seeing.

So maybe, Michael, you can give a comment on the vintage part.

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

Thank you. To address question about the vintage delinquencies, as mentioned in the prior conference call and plus this one, we have employed a very prudent risk management approach to carefully manage our credit risk, especially on the new acquisition loans. We have employed this strategy in the past quarters to pretty much improve our customer credit quality, make sure we will focus on serving the customers with better credit quality. All of these approaches will help us to reduce our vintage sales. And we do have the expectation, we will see the improvement over time. And the effort is still continuing. So this will be a continued effort. Regardless, we have -- we are facing the new rate cap policy. For now, this is just our steady approach and the strategy. Hopefully, that will answer your question.

Operator

Our next question comes from the line of [Ethan Wong] from CLSA.

Unidentified Analyst

So I have 2 questions. So we mentioned that towards the end of this year, almost 100% of our loan originations will come from financial institutions. Just wondering what is our current strategy on P2P? So does that mean P2P products will no longer support the new loan growth down the road? That's my first question. And second question is on our cooperation with insurance companies. So are we still cooperating with them? And do we see some pressure from like companies like PICC Group? They mentioned to decrease this business.

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

Yes. Thanks for the question. Yes, that's correct. We're in the transition into the loan facilitation business model following the industry trends that most of our business will be founded by the institutional fundings towards the end of the year. Of course, we're also working with the regulator with their guidance in terms of the overall transition schedule. And from the insurance partnership we had previously, right now, for all the partnership relationship with the institutional founding partners, we no longer need the insurance design anymore. So right now, that business is no longer a carry on. So we're basically working with all the institution partners directly in terms of funding sources.

Operator

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

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

So just 2 questions for me. So first one is regarding your online loan volume. It looks like it has dropped a lot over the past 2 quarters and also on a Q-o-Q basis. So just wondering what's happening with your online customer acquisition strategy there? And do you expect the online portion to continue to decline and whether you are, like, shifting your focus more towards the off-line channel? And second is regarding your customer care program you mentioned earlier, I just want to better understand. So first, like, how many borrowers were receiving this kind of payment relief under this program? And is it like you waive the entire outstanding principal interest? Or is it just a portion of that? So if you can explain more on that part, it will be helpful.

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

Sure. I will answer the first question, and maybe Michael can provide more color on the customer care program related questions. So yes, the percentage mix of online business volume dropped a little bit in the recent quarters. I think the main thing is that as we transition from the traditional larger-ticket, longer-tenure online loans into more revolving type, small-size and shorter-duration loans, we are taking a bit of a careful approach. However, you can see that the volume is actually ramping up quite nicely. And we expect this new online product to continue to grow towards the end of the year and becoming a meaningful portion of our business, probably reaching 1/3 at least in terms of sales volume going forward.

And supporting this business, as we have mentioned, we're both working with a large Internet traffic platform in the partnership perspective with a very efficient customer acquisition cost. And also, we're rolling out an e-commerce platform where we bring e-commerce providers onto our platform to serve our existing customers. And in that sense, we both provide our customer a consumption scenario and also, we have a better understanding of how they spend and how their credit quality is evolving. So we expect this to become a very meaningful part of our new business initiated for our online business operation.

So maybe with that, Michael can give more color on the customer care program.

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

Sure. Thank you. To the customer care program, cumulatively, we have over 100,000 customers who benefited from this payment relief program and received very good response and good customer experience and good customer relationship building. To the question about the principal waivers, actually, we -- the program includes waiver of principal interest and the late fees as Mr. Zhong mentioned earlier, but for the principals, we don't waive with the entire principal. It's just a portion of that.

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

Will you be able to share -- will you be able to disclose like roughly how -- what's the percentage of principal?

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

It depends. It's a mix strategy. It depends on customers' situation and the loan itself. It's really a pretty complicated strategy. There's no -- you can't give just a straight line, a simple number. It is very well defined, very well-designed strategy.

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

Yes. Maybe just one thing to add on that, as we mentioned in the prepared remarks, after the implementation of this policy, we already see very encouraging signs of jump in the borrowers' repayment schedules. So we believe actually this investment is actually probably going to be -- create a good return for us by using this program.

Operator

(Operator Instructions) There's no more question at this time. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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

Okay. Thank you. Bye.