PPDF - PPDAI Group Inc.
Fourth Quarter 2018 Unaudited Financial Results
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Company Representatives:
Jimmy Tan, Investor Relations Director
Cliff Zhang, Chairman and Co-Chief Executive Officer
Feng Zhang, Co-Chief Executive Officer
Simon Ho, Chief Financial Officer

Analysts:
Sanjay Sakhrani, Keefe, Bruyette & Woods
Anderson Cai, BNP Paribas
Daphne Poon, Citigroup
Jasmine Kin, China Galaxy International

Presentation

Operator: Hello, ladies and gentlemen. Thank you for participating in the Fourth Quarter and Full Year 2018 earnings conference call for PPDAI Group Inc., also known as Paipaidai.

At this time, all participants are in listen-only mode. After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded. (Operator Instructions).

I will now turn the call over to your host, Mr. Jimmy Tan, Investor Relations Director for the Company. Jimmy, please go ahead.

Jimmy Tan: Hello, everyone, and welcome to Paipaidai's Fourth Quarter and Full Year 2018 earnings conference call.

The Company's results were issued via newswire services earlier today and are posted online. You can download the earnings release and sign up for the Company's distribution list by visiting the IR section of our website at ir.ppdai.com.

Mr. Cliff Zhang, our Chairman and Co-Chief Executive Officer; Mr. Feng Zhang, our Co-Chief Executive Officer; and Mr. Simon Ho, our Chief Financial Officer, will start the call with their prepared remarks and conclude with a Q&A session.

During this call, we will be referring to several non-GAAP financial 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.

Before we continue, please note that today's discussion will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the Company's results may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is included in the Company's filings with the U.S. Securities and Exchange Commission. The Company does not assume any obligation to update any forward-looking statements except as required under applicable law.

Finally, we posted a slide presentation on our IR website providing details of our results for the quarter.

I will now turn the call over to our Chairman and Co-CEO, Cliff. Please go ahead.

Cliff Zhang: Hello, everyone, and thank you for joining us today.

We delivered solid performance in the fourth quarter and fiscal year 2018 with strong profitability. This is highlighted by a 128% year-over-year increase in net profit to RMB 2.47 billion for 2018 in spite of tightening regulations in a volatile market environment.

Our outstanding results reflect a growing and stable business operation, which is built on a foundation of good compliance, concrete framework of risk controls, as well as innovative technologies. All of these strengths come together in order to deliver accessible and convenient financial services to an underserved market. The result of our efforts is a vibrant marketplace of borrowers, investors and financial partners.

As an early mover in China, we are revolutionizing the online consumer finance marketplace, which in the last few years, has garnered critical mass boosted by the country's fast internet penetration rate and adoption of mobile payments. When the market is subject to tightening regulatory scrutiny and ensuing volatility, we have delivered high resiliency supported by an extensive user base, healthy funding structure, as well as proprietary technologies.

Our cumulative registered users reached approximately 89 million, and the number of cumulative borrowers was 14.4 million at the end of December 2018.

As the industry grows and evolves through regulatory oversight and subsequent consolidation, our business will continue to benefit, as demonstrated by the broadening of users within our network.

In addition, the cumulative effect of our big data efforts and platform technology developments have allowed us to further distribute our technologies as a service to a wide range of third-party financial service providers, including banks, consumer finance institutions and online lenders who seek our services in order to better operate in the consumer finance space.

In this rapidly developing market, the data and applications that we provide to our financial partners are both an integral and embedded part of their businesses. As the leading online consumer finance marketplace, we remain committed to enhancing shareholder value.

We are also pleased to announce our first dividend of US$0.19 per ADS as a listed company. This reflects our confidence in our business, our capabilities and the long-term market potential.

Going forward, we will continue to maintain focus on expanding the breadth of loan services, strengthening brand recognition, continuing to invest in proprietary technologies and explore opportunities for expansion both domestically and internationally.

Now, I would like to pass the call over to our Co-CEO Feng to discuss an update of our business.

Feng Zhang: Thank you, Cliff, and hello, everyone. I am Feng Zhang, Co-CEO along with Cliff.

The industry as a whole has undergone transformation due to the increasingly obvious need for regulatory oversight, and the stricter enforcement of regulations has led to rapid consolidation in the space. With a mature operation and management team, we have evolved accordingly and are seeing the benefits.

To illustrate, as mentioned in our recent press release, our total loan origination volume in the fourth quarter of 2018 reached a healthy RMB17.6 billion, on par with the year-ago period and up 19% from RMB14.8 billion in the third quarter of 2018.

This solid recovery from the challenging industry conditions in the third quarter was supported by the increased funding from our institutional partners and our retail investors' continued confidence in us. This performance is also clear evidence of our strengthened leadership position in the industry.

We have made solid progress in diversifying our funding sources through expanding and deepening relationship with our institutional funding partners.

The proportion of loans funded by institutional partners to total loan origination volume increased to 20% in the fourth quarter of 2018, compared to 14% in the third quarter of 2018 and approximately 10% in the first half of 2018.

As in our recent announcement, we made a solid start in 2019, with total loan origination volume in January further increasing from the average monthly volume experienced in the fourth quarter of 2018.

The proportion of loans facilitated by institutional funding partners to total loan origination volume further increased to 35% in January 2019.

We need to bring your attention that new institutional inflows in January were exceptionally high due to some degree of seasonality and lumpiness in institutional funds. In this regard, we expect the proportion of institutional funds for the first quarter of 2019 will not be as high as that in January, but instead be around 30%.

The important message is that the trend is firmly up, and we are making steady progress in diversifying our funding sources and we are confident in achieving further progress in the rest of 2019.

Now, turning to credit. Delinquency rates for all outstanding loans on the Company's platform have been relatively stable in the fourth quarter. We have a long and proven track record in managing risk prudently and responsively. We have a strong culture of respecting risk and have strong proprietary technologies, such as our Magic Mirror Model, that enable us to effectively manage risk.

On the regulation front, the nationwide inspection process for P2P platforms is still ongoing. We have submitted our self-inspection report. And by the end of last year, the Shanghai Internet Finance Association and the Shanghai financial authorities have completed onsite inspections with us. We are among the first batch of companies to work with the National Internet Finance Association on the inspections.

We are fully cooperating with the regulatory authorities, and are confident in meeting any future requirements. We firmly believe that the strengthened regulatory framework around consumer lending is crucial to supporting a healthy and sustainable industry.

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

Simon Hospital Thank you, Feng, and hello, everyone.

During the quarter, despite the industry volatility, we are delighted to achieve solid operational results in the fourth quarter, with a sequential increase of 19% in loan origination volume and approximately 34% year-over-year increase in operating revenues.

Our efforts to leverage operating efficiencies continuously paid off, as demonstrated by a 44% year-over-year increase in our non-GAAP operating income and a healthy non-GAAP operating margin of 40% in the quarter, and 43% for the full year 2018.

Our balance sheet continues to be strong, with approximately RMB3.3 billion of cash and short-term liquidity.

And our quality assurance fund remains sufficiently funded. The total balance of the quality assurance fund was approximately RMB4.5 billion as of the end of December 2018, equivalent to 23.2% of the total outstanding loans protected by the fund.

PPDAI remains financially sound and well positioned for the future.

Now, let me briefly go over the financial results for the fourth quarter. In the interest of time, I will not walk through each item line-by-line on this call. Please refer to our earnings release for more details.

Operating revenues for the fourth quarter of 2018 increased by 34% to RMB1.2 billion from RMB912 million in the same period of 2017, primarily due to constraints of the old revenue recognition standard used in 2017, and the write-back of provisions for expected discretionary payments to IRF investors.

As a result of the adoption of ASC 606 effective January 1, 2018, revenue is generally recognized earlier in the life of the contract, as there is no contingency revenue cap under the new standard.

For the 3 months ended December 31, 2018, the impact of applying the new revenue standard resulted in an increase of approximately RMB44.5 million in revenues.

Loan facilitation service fees increased by 35% to RMB837 million for the fourth quarter of 2018 from RMB620 million in the same period of 2017, primarily due to constraints of the old revenue recognition standard used in 2017.

The average transaction fees charged to borrowers was 7.38% in the period, compared to 7.07% in the third quarter of 2018 and 6.24% in the fourth quarter of 2017.

Post-facilitation service fees increased by 10% to RMB250 million for the fourth quarter of 2018 from RMB227 million in the same period of 2017, primarily due to the adoption of ASC 606 effective January 1, 2018.

Non-GAAP adjusted operating income, which excludes share-based compensation expenses, and a write-back provision for expected discretionary payments to investors in investment programs protected by the investor reserve funds, was RMB472 million for the fourth quarter of 2018, representing an increase of 44% from RMB327 million in the same period of 2017.

Other income was RMB94 million for the fourth quarter of 2018, compared with a loss of RMB695 million in the same period of 2017 due to increased gains from the quality assurance fund.

Income tax credits were RMB194 million for the fourth quarter of 2018, compared with income tax credits of RMB74 million in the same period of 2017, primarily due to the write-back of accrued income tax, as one of our group companies was able to enjoy a preferential tax treatment since it was recognized as a software enterprise by relevant PRC government agencies.

Net profit increased to RMB775 million for the fourth quarter of 2018, compared with a net loss of RMB507 million in the same period of 2017.

We maintained a solid balance sheet and ample liquidity. As of December 31, 2018, we held cash and cash equivalents of about RMB1.6 billion, and short-term investments mainly in wealth management products of about RMB1.6 billion.

To be mindful of the length of our earnings call, for the full year 2018 financial results, I'll encourage listeners to refer to our earnings press release for further details.

Next, let me give an update of our share buyback. Our share repurchase program started in March 2018, and since then we have bought back approximately US$67 million of our shares.

Before I hand the call over to Q&A, I'd like to make a few concluding remarks. The industry is going through significant transformation, facilitated by the implementation of an enhanced regulatory framework by the financial authorities. We remain a beneficiary of the rapid market consolidation that is underway.

We have seen the demand for online consumer finance slowly begin to pick up the pace through the back half of 2018. This recovery, together with the further diversification of funding sources from our network of institutional partners, all bodes well for the new year.

Inevitably, we will be operating in a stronger, more secure, healthier and sustainable marketplace. We look forward to this momentum, and are implementing our strategy to maintain our leadership position in China's online consumer finance marketplace.

With that, I will conclude my prepared remarks. We will now open the call to questions. Operator, please continue.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions).

For the benefit of all participants on today's call, if you wish to ask your question to management in Chinese, we ask that you please kindly repeat your question in English.

The first question comes from Sanjay Sakhrani of KBW.

Sanjay Sakhrani: Good results, given the situation. I guess first question, I appreciate all the update on the P2P registration process, but could you just talk about what the timing would be, or what you've seen in the marketplace after all the tests and onsite investigations, and sort of what the timing is before you get the actual -- any word from the regulators?

Simon Ho: Sure. Sanjay, we're working still through the compliance and inspection checks, as we've said. We're working through with the National Internet Finance Association based in Beijing. There is no hard timeline for that, but it looks -- and we hope and expect -- that this could be wrapped up by the middle of this year. Again, that's just our best estimate. And beyond that, again, as to the registration timetable, again, there is no official date out there as yet.

Simon Ho: And we will cooperate and work very closely with regulators.

Sanjay Sakhrani: And can you remind me, has anyone come through the process already, and sort of where are with that?

Simon Ho: No, I don't believe anybody has come through the -- completely come through the compliance and inspections process.

Sanjay Sakhrani: Okay. Got it. Then, obviously, we're hearing a lot about mixed signals in the economy in China. Have you -- and I understand your credit metrics are quite strong. Have you guys noticed anything on the margins in terms of customer behavior? And have you made any adjustment to your underwriting to sort of capture this trend?

Simon Ho: As you can see, the demand for credit out there remains robust, and as you can -- and we are increasing our volumes and the funding is increasing, particularly from the institutional partners.

In terms of the delinquencies, we are mostly -- as you can see from the numbers -- we have mostly been pretty stable during most of the fourth quarter, despite obviously the softening economy in China. We did see a slight pickup in delinquencies towards the very end of the year, and it has kind of continued and carried on in the early part of Q1. Some of this could be seasonal; some could be related to the weakening economy, but we are vigilantly monitoring.

And we continue to expect our vintage delinquency rates of between 6% to 8%, which is no change from the range that we have been guiding towards since pretty much the beginning of last year. So that's sort of an update on what we're seeing on the ground right now.

Sanjay Sakhrani: Okay. Then final question -- appreciate the dividend and all the capital return. As we think about this current dividend that you've instituted, how should we think about the recurring nature of this dividend? Is it sort of a one-time dividend, or is this an ongoing dividend?

Simon Ho: So Sanjay, our dividend payment reflects the healthy profitability of our business, and the confidence we have in our business. And we do hope that we can pay dividends each year and we hope that, if conditions allow and certainty improves in the industry, there is even obviously room to increase those dividends. But of course, this payment of dividends each year depends on our cash flow and our operations, and of course, is subject to review and still discretion by the management and our board.

I hope that helps.

Sanjay Sakhrani: All right, great. Thank you.

Operator: Anderson Cha, BNP.

Anderson Cha: This is Anderson from BNP Paribas. First of all, congrats to your solid results and let me ask you two questions. First of all, looking at your P&L, there appears to be a new line item called provision for doubtful accounts. So can you please elaborate on that, please?

And also, it may or may not be related; I see the gain from quality assurance program also decreased quite significantly in the fourth quarter. So does it actually reflect the actual deterioration in underlying asset quality, or does it have its own dynamics? And also, please guide us how much credit-related cost do we have to expect for 2019 versus 2018?

And my second question is about your 2019 outlook. So if you can share, I would like you to share some outlook for 2019 in terms of business and other loan origination volume and other numbers.

Simon Ho: Okay. Thanks, Anderson, for your question. So for your first question, yes, will notice there's a new line item under our operating expenses related to provisions for doubtful accounts or doubtful receivables. So basically, these relate to the provisions for delinquent transaction fees that we charge our borrowers. And in the fourth quarter, we started to separately break this provision out. This provision has always existed, but it's the first time we separately put in line item in there.

And just to go back into sort of the background of this practice of transaction fees, as you know, since December 2017, we started collecting our transaction fees on a monthly basis. So when loans go delinquent, we may not receive our transaction fees in full and therefore need to make a provision.

In the previous quarters, this provision was included under net interest income and provisions. You'll see that's just the line just right before net revenues. But since the fourth quarter and our full year 2018 accounts, we have separately listed this under our operating expenses as provisions for doubtful accounts receivable.

So it's pretty much always been part of our P&L for the whole of 2018, and because the line is getting obviously larger, so we decided to start breaking this down.

To your second question, now why the small QAF gains in the fourth quarter obviously versus larger gains in previous quarters, and yes, that's mainly due to the slight pickup or minor pickup in delinquencies at the end of the year, as I just mentioned. And this has -- what happens is this leads to higher QAF liabilities and therefore, there's less income statement gains.

So but also in -- just to put it into some context, you would recall that in the third quarter, we had relatively large -- larger QAF gains and -- which was due to actual credit losses being better than what had been previously assumed. So this gain was not only from loans facilitated in Q3, but also from loans made in the prior quarters before that, okay?

And going forward, I think given the credit risk environment, we would probably guide you to expect relatively smaller or minimal QAF gains to be sort of more the norm going forward.

And your last question relates to the outlook for 2019. Now, we are aiming for moderate loan volume growth in 2019, driven by the expansion in institutional funds. As Feng mentioned, we expect our institutional funds to be around 30% of our loan origination volume in the first quarter. And we hope that by the end of this year, this ratio could reach to over 40% by the end of the year.

We have started 2019 positively, and we expect loan origination volumes in the first quarter to be roughly in the range of RMB18 billion to RMB19 billion, which is higher than the RMB17.6 billion achieved in the fourth quarter of 2018. I hope this addresses your questions.

Anderson Cha: Yes, that's very clear. Thank you.

Operator: Daphne Poon of Citi.

Daphne Poon: So I just want to check on the funding cost trend. So we see that the liquidity situation on the [expense] side has improved quite a lot in the past few months. So I guess the question is how has that reflected in your funding cost trend in both the P2P side and also the institutional funding side?

Simon Ho: Sure. Thanks, Daphne. The funding cost for institutions has been largely stable in the last several months. It's still running between 10% to 12%. For retail investors, their returns are currently around 8% to 9%. We have been lowering our -- the returns to retail investors, and during the fourth quarter, this figure actually came down by about 2 percentage points. And we do believe there is room to lower the funding cost from the institutions as we grow the funds further and broaden the partners that we work with.

Feng Zhang: Yes, this is Feng. I'll just add, as we see with the government trying to stimulate the economy and the liquidity situation for the entire economy is getting [looser], we do see trends of lowering -- we do start to see trends of lowering cost from the institutional side. And we are very optimistic throughout the year. As we grow our base of institutional partners, we'll continue to some benefit of reducing funding costs on the institutional side as well.

Daphne Poon: Right. So just to follow up and so in terms of the institutional funding partners that you work with, it's my understanding there is still many trust companies. So I'm wondering like what do you have plan to like sort of expand or diversify the funding source into commercial banks; and maybe what you see as to key challenge to ramp up from the bank side.

Simon Ho: Sure. Daphne, so if you look at the sort of mix of the types of institutions that we work with, the majority actually comes from licensed financial institutions. And you're right, trusts have traditionally been a very significant source for us and it's still the largest category, which account for over half of our institutional funds. We have recently started working with a commercial bank, and so we do expect the contribution from banks to increase going forward.

Sorry, Daphne.

(Cross-Talk)

Daphne Poon: So with that --

Simon Ho: Sorry, please go on; please go. I think there was a second part in your question?

Daphne Poon: Yes. So for the bank, do they have any like requirements in terms of your loan (inaudible) or your delinquency rate?

Simon Ho: We tend to be at the sort of higher-quality end of the spectrum that we operate.

Daphne Poon: But there's no like specific cap that the banks will require?

Simon Ho: It just needs to be within the regulatory cap of 36%. And obviously, each institution has slightly different requirements and we would tailor and work towards, and work with them.

Daphne Poon: Okay, sure. Thank you.

Operator: (Operator Instructions). Jasmine Kin of China Galaxy International.

Jasmine Kin: So I have two questions. The first one is that so last year, we have Document 175. So I'd like to know whether you have any comments on this one because this document tries to guide smaller problematic platform to exit from the industry.

And the second one is that I would like to know do you have any observation on the quality of new loans so far in this year? And do you think that this can be a result, the industry-wide result, or it's a result of your risk management?

Simon Ho: Yes, Jasmine, sure. Document 175, I think the major focus is, in our view, is to manage and wind down the risks in the P2P industry related to the large number of smaller platforms and non-compliant platforms. So this is clearly number one in the government's agenda and it's to reduce obviously the risks posed by the P2P industry.

We have always been one of the most compliant players in the industry, so we are comfortable that we will not be amongst the ones that will be cleaned out of the industry. In fact, we're pretty confident that we are able to meet further regulatory requirements, should they come. Today, there are no significant major issues that we received from our regulators in terms of our business practices.

In terms of the quality of new loans, as we just mentioned previously, we have seen an uptick, a slight uptick, in delinquencies in the last several months. And I think if you speak to other industry players, you would see quite a varied experience. There are others which are seeing significantly weaker performance as well.

So I think the resilience, relative resilience, that we're seeing definitely is a result of the risk management capability that we've built up over the years. Without that, I don't think we'd be able to be performing the way we are today.

Jasmine Kin: Okay. Thank you. Thank you very much.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to the Company for any closing remarks.

Jimmy Tan: Thank you once again for joining us today. If you have further questions, please feel free to contact Paipaidai Investor Relations through the contact information provided on our website or in our press release.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.