PPDF - PPDAI Group Inc.
Second Quarter 2018 Earnings Conference Call
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Company Representatives:
Jimmy Tan; Investor Relations Director
Cliff Jun Zhang; Chairman and Chief Executive Officer
Feng Zhang; Chief Operating Officer
Simon Ho; Chief Financial Officer

Analysts:
Alice Li; Credit Suisse
Daphne Poon; Citigroup
Sanjay Sakhrani; Keefe, Bruyette & Woods, Inc.
Alex Shi; UBS
Jacky Zuo; Deutsche Bank
Matthew Larson; Wells Fargo
Richard Wang; CICC

Presentation

Operator: Hello, ladies and gentlemen. Thank you for standing by for the Second Quarter 2018 Earnings Conference Call for PPDAI Group Inc. also known as Paipaidai. (Operator Instructions). After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded.

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 second quarter 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.paipaidai.com.

Mr. Cliff Zhang, our Chairman and Chief Executive Officer' Mr. Feng Zhang, our Chief Operating 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 measurements are not intended to be considered in isolation or as a substitute for the financial information prepared and presented in accordance with the 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 laws.

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

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

Cliff Jun Zhang: Hello everyone and thank you for joining our Second Quarter 2018 Earnings Conference Call today. During the second quarter, we remained focused on driving healthy results and maintaining regulatory compliance.

Despite the challenging market sentiment, we achieved solid result in the second quarter, with loan origination volume growth of 36% quarter-on-quarter and an increase in our operating income of 17% quarter-on-quarter.

Also, we continued to grow our user and borrower base. The number of registered users exceeded 78 million and the number of cumulative borrowers reached 12.4 million at the end of June.

As mentioned on our previous earnings call, while we continue to grow our core business in this evolving environment, we are investing in new engines of growth by leveraging on our technological capabilities and massive amounts of data to provide a suite of cutting-edge "technologies as a service" to third party financial service providers. Those services include our AI-driven loan collection robot, our advanced Anti-Fraud detection system, our proprietary Magic Mirror credit scoring system and online customer acquisition.

We are making positive progress and are currently engaging a wide range of financial service providers, not just online lenders, but also licensed financial institutions such as banks, credit card companies and consumer finance companies. The external acceptance of our financial technologies reinforces our leading-edge innovation and core capabilities.

We continue to be recognized as an industry leader and are very proud to be among one of the first 15 lending companies in the country, and only just one of two P2P platforms, to connect with China's first unified credit-reporting platform, Baihang Credit.

We recently entered into a strategic agreement with Zhejiang University to develop an AI research and development center. These partnerships further recognize our industry leadership position and our large customer scale and high-quality data.

We remain focused on capturing the tremendous long-term growth opportunities in our industry, whilst maintaining compliance with regulations as they evolve.

Now I would like to pass the call over to our COO Feng to discuss an update of our business.

Feng Zhang: Thank you, Cliff and hello, everyone. I am Feng Zhang. We are pleased with our operational results in this quarter. Despite the challenges we face, the fundamentals of our core business model remain strong, as evidenced by our continued profitability and improved delinquency trends in the second quarter.

Our 90-day plus delinquencies nearly halved from 8% in March to 4.6% at the end of June. Early delinquencies, that is 15 to 90 days past due, fell sharply from 5.4% in March to 3.1% at the end of June.

On a vintage basis, the delinquency curve for first quarter 2018 originations is now following a similar trend as those vintages back in late 2016 and early 2017.

Although loan tenor is now slightly longer than before, meaning that delinquencies are a little more delayed than before, the first quarter 2018 vintage appears to be performing significantly better than the fourth quarter 2017 vintage.

I want to briefly mention regulations. As you may be aware, the central regulatory authorities last week issued a notice outlining the nationwide inspection standards for P2P platforms, which includes a list of 108 requirements and a deadline of December 31, 2018 for the completion of all such inspections.

The requirements are generally in-line with our expectations and in-line with the previous Shanghai local requirements. This is a top priority for us, and we are confident in our ability to meet the P2P registration requirements.

However, in the past few months, the delay and tightening of regulations has contributed to problems for smaller P2P platforms. Although this industry consolidation is within our expectations, it has dampened retail investor confidence across the industry.

We firmly believe industry consolidation and tightening of regulations is a necessary step, and a significant positive for the longer-term health and sustainability of the industry.

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

Simon Ho: Thank you, Feng, and hello, everyone. We had a solid financial performance in the second quarter. We continued to drive operating efficiency and maintained our Non -GAAP operating margin at a healthy level of 46.0%, slightly higher than the previous quarter.

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

Operating revenues for the second quarter of 2018 slightly decreased to RMB1.05 billion from RMB1.07 billion in the same period of 2017, primarily due to lower average transaction fee rate for the quarter. The impact of applying the new revenue standard ASC 606 resulted in an increase in revenue of approximately RMB160 million.

Loan facilitation service fees decreased by 7.1% to RMB753 million for the second quarter of 2018 from RMB811 million in the same period of 2017, primarily due to a lower average transaction fee rate during the second quarter of 2018 compared to the second quarter of 2017. But on a sequential quarter-on-quarter basis, our take rate was largely stable at 6.3%

Post-facilitation service fees increased by 32% to RMB206 million for the second quarter of 2018 from RMB156 million in the same period of 2017, primarily due to the rolling impact of deferred transaction fees and the adoption of ASC 606.

Non-GAAP adjusted operating income, which excludes share-based compensation expenses, was RMB487 million, representing a decrease of 12% from RMB555 million in the same period of 2017.

Other income was RMB297 million for the second quarter of 2018, compared with RMB193 million in the same period of 2017.

Net profit decreased by 3.8% to RMB608 million for the second quarter of 2018 from RMB632 million in the same period of 2017.

We maintained a solid balance sheet and ample liquidity. As of June 30, 2018, we had cash and cash equivalents of about RMB 2.5 billion and short-term investments mainly in wealth management products of about RMB1.4 billion.

As Feng mentioned, we felt some impacts as our loan volumes have slowed a bit in the past 2 months, and we are lowering our expectations on the outlook for loan origination volume in 2018.

For the first 7 months of 2018, we originated approximately RMB34 billion of loans. In July, we originated RMB4.9 billion, an 8% month-on-month decline. In August, we expect loan originations in the range of RMB4 billion and 4.5 billion RMB.

In our view, it is possible that August and September represent the low point for loan originations. The current industry environment is not what the government wishes to see, and the launch of the regulatory inspection for P2P platforms is likely to raise investors' confidence in compliant players. Current market conditions therefore may not persist for a sustained period of time and it is possible to see a recovery in the fourth quarter.

In addition, our Board has approved an increase in our share repurchase program to US$120 million from US$60 million previously. Since March, when we started our repurchase program, we have bought back approximately US$39 million of our shares. We continue to see our shares as deeply undervalued and as explained on this call, we are confident in the outlook of our business. In order to give us more headroom and flexibility, we have asked our Board to increase the size of our buyback program to US$120 million.

Before I hand the call over to Q&A, I'd like to briefly discuss why we believe we are well positioned and will come out of this evolving industry in a stronger position. Firstly, we have a strong balance sheet. As at the end of June, we had RMB3.9 billion of cash and short-term liquidity. The total balance of our quality assurance funds was RMB3.6 billion, which is equivalent to 18% of the total outstanding loans with such protection.

Secondly, we don't have any concerns for liquidity on our platform. This is due to our unique funding structure and the relatively short tenor of our loans. In terms of our funding structure, about half of the investments on the platform are made through single loan investments, where investors directly choose the loans and accept the terms and tenor of each loan. This type of investment poses no liquidity concern to the platform at all.

Thirdly, in terms of our loan tenor, as mentioned in our earnings release, the average tenor of our loans at origination is about 9 to 10 months. The average remaining maturity of the loan principal on our platform is even shorter, at approximately 4 months as at the end of July, bearing in mind that all of our loans are installment loans and principal is continuously paid down by borrowers every month.

In contrast, our investment programs, which roughly account for the remaining half of the investments on the platform, have an average remaining maturity of approximately 6 months, which is longer than that of our loans. So our loans are in fact being repaid faster than the investment programs are coming due. The liquidity profile on our platform is very comfortable and we do not have any liquidity concerns.

Finally, our business model is intact and strong. We are profitable; we generate positive cash flows. We are a market leader with the longest operating history in the industry and proven technologies and core end-to-end capabilities.

We have a long and proven track record in managing risk prudently and responsively, as evidenced by our sufficient quality assurance fund and quick recovery from the credit loss spike from fourth quarter last year.

Looking through the near-term transition in the industry, we remain very optimistic about our future opportunities in our core P2P business. And as Cliff described, we are also exploring new ways to monetize our capabilities as "technologies as a service."

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

Questions and Answers

Operator: Thank you. 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, please immediately repeat your question in English. (Operator Instructions). And the first question comes from Alice Li with Credit Suisse.

Alice Li: Hi. Thanks for taking my question. And I have two questions. The first one is about recent problematic platforms. So, you also mentioned that the retail investors, they are turned more cautious now. And I would like to have more color on your liquidity conditions. So what's the latest trend of your active investor number or the outstanding loan balance and your funding cost? And I would also like to know the latest breakdown of your funding structure because previously, you have also mentioned that you will also increase the funding from institutional investors. So I would like to know what's the latest mix.

And my second question is on the asset quality. We see significantly improvement in the first quarter cohort and release of the other income. So what's our assumption for the ultimate delinquency ratio for the QAF protected loans? And also for the second quarter cohort, as we accelerate the loan volume growth and the overall industry liquidity tightened, have we seen the early size of asset quality deterioration for the second quarter cohort? This is my two questions. Thanks.

Simon Ho: Okay. Alice, thank you very much. I will address the liquidity conditions and the funding structure, and then Feng will address asset quality. In terms of the sort of recent liquidity trends, let me share with you what we've seen in the recent weeks. Maybe that will help.

Since last week, when news of the nationwide inspection standards first came out, we have seen a noticeable improvement in investor confidence in retail funding trends. This is only one week of data, so it is too early to call this a sustainable trend, but the early signs are encouraging. So as we mentioned earlier in the call, this period we are in could be the low point, and as we go through the inspection and regulatory process in the next few months, investor confidence is likely to return for the compliant platforms. And we could see a recovery in the fourth quarter.

We have also obviously not been sitting on our hands doing nothing. We have also been proactively using a wide range of methods to maintain retail investor confidence. We have been stepping up online sales efforts, for example, using loyalty point systems to increase sales or attract investors' money. We have increased our offline face-to-face group meetings with retail investors across the country. We are running online live broadcasts with investors and every day, our investor sales and customer service teams are educating and addressing investor queries.

In terms of the trends and sort of the funding costs, our retail money -- if you come to our website, you can see for say a 12-month period, the returns investors are getting is roughly around 11% annualized. And this has been little changed over the past several months. In the current environment where obviously, investor confidence is the main issue, it's, in our view, less about how high the returns are, but more about the safety and security of these investors' funds. And I hope that help give some color to the recent -- obviously, the liquidity trends that we're seeing on our platform.

In terms of the institutional funding, the institutional funds are more professional and knowledgeable than the general retail investors. But obviously, in the current environment, there is generally still a greater degree of caution as well from our institutional investors.

However, we do have a decent pipeline of institutional funds and we expect the proportion of institutionally funded loans on the platform will continue to increase in the second half of the year. In the second quarter of 2018, the institutional funded loans accounted for about 10% of our total loan volume in the second quarter of 2018. We foresee that rising in the second half of the year, and it could increase to around, say, 20% later in the year.

I will turn the call to Feng who will address some recent asset quality trends.

Feng Zhang: Thanks, Alice, for the question. Yes, so in terms of recent asset quality, we have seen a significant recovery from Q4 and Q1 this year from last year. To your question, our current expectation of the QAF, the ultimate interest rate or charge-off rate for the QAF-protected loans is probably around 10%; let's say plus/ minus like 2%. And if you compare that to the fund balance of 17.8%, we have a very healthy coverage ratio there.

And to the other part of your question, yes, there is due to the recent deterioration of the retail investor sentiment and shortage of funding supply, many lenders are pulling back. So I think that has created some kind of credit squeeze. We have seen a slight uptick in our recent delinquency, but nothing material and definitely nothing material, nothing what we saw in Q4 last year.

So yes, we would expect to see some deterioration because of the credit squeeze, but on the other side, due to the funding shortage, we have pulled back on our -- we have tightened our credit standard as well. So net-net, I think it will have a very limited impact in our overall asset quality.

Simon Ho: Yes, let me just add a comment to the back of that in terms of the other income that you've seen. There has been a release where a lot of that -- or not necessarily a release; there's been a gain on our quality assurance fund in the second quarter and this is due to a few reasons. Firstly, it's due to the increased proportion of loans that have quality assurance fund support. In the second quarter, 85% of our loans origination had QAF behind it versus 63% in the first quarter.

We still have a positive buffer that's priced in, in our loan pricing, and so there is still an ongoing stream of QAF gains coming in. And of course, there's also been a slight improvement in our expected default rates for the current stock of loans in the portfolio. I hope that helps to answer your question.

Alice Li: Yes, that's very helpful. Thank you very much.

Operator: Thank you. And the next question comes from Daphne Poon with Citi.

Daphne Poon: Hi, management. Thank you for taking my questions. So actually, I guess you have already addressed some of my questions on the funding and asset quality side, but I'm also wondering if, reading into your full year loan volume outlook, whether you're seeing is this still achievable to maintain your previous loan volume guidance, or if not, like how much deviation do you expect?

And the second question is about, you mentioned in the prepared remarks that there has been some new initiatives to provide the test service to other financial institutions. So, can you give more color I guess on the progress and also the expected revenue contribution from this new business initiative? Thanks.

Simon Ho: Sure. Thank you, Daphne. Let me just address the loan guidance that we gave early in the year. Early in the year, we gave a loan guidance for the full year of 70 billion to 80 billion of loan originations. This clearly what we've been saying is this look unachievable in the current environment. The target of 70 billion to 80 billion that we gave early in the year was premised on us achieving registration pretty much by the third quarter of this year. And we were very confident at that point in time, but the situation of course, has changed given the regulatory delay.

So today, we are not giving an explicit full year loan target as such, or loan guidance as such, but we are obviously giving you our loan originations that we have done so far and what we expect for the month of August, which is about 4 billion to 4.5 billion is what we think we will achieve this current month.

Now, if you sort of assumed hypothetically, right, if we continue to run at the August levels for the rest of the year, right, plus the 34 billion of originations near to July that would leave us at roughly around 55 billion for the full year. Now, but this is not an official target; I'm just doing some mathematics and giving you some hypothetical sense of what the numbers are. So no, we don’t have an official outright loan guidance for the full year at this point.

Now, with regards to your second question, your question about our technologies as a service progress, I am very pleased to report it’s progressing well. And as Cliff mentioned, we have a wide range of financial institutions, including licensed financial institutions, who are signing up for our service. One of the leading businesses in this suite is our customer acquisition or lead generator for online lenders. In the second quarter, revenues were in the sort of roughly around 15 million mark, and this has about maybe 100-plus different external customers.

We are also getting good traction with our loan collections service, which includes our AI voice-driven loan collections robot. As of June, this business had about 15 external customers and many more are in the pipeline who are assessing the capability of our system. We have also started up -- opening up our Anti-Fraud detection system, our Magic Mirror credit scoring system to third-parties as well.

Daphne Poon: Okay. That’s very helpful. Thank you.

Operator: Thank you. And the next question comes from Sanjay Sakhrani with KBW.

Sanjay Sakhrani: Thanks. And just to follow up on some of the previous questions and your commentary, when we think about that $50 billion to $55 billion of origination, the timing you mentioned, when we think about the risk to that number, is it more along the lines of demand? And it sounds like you're comfortable from the funding standpoint in terms of investor participation?

Simon Ho: Yes, Sanjay, so first of all, I am not going to comment directly on the $55 billion figure I mentioned because it’s all hypothetical and it’s not part of any official guidance. Clearly, the constraint right now is investor funding on the platform. Loan demand for our loan products and assets are very, very strong. So I think it's largely on the funding side of the platform as a result of all the problematic P2P platforms, that's obviously impacted the retail investor sentiment. As you could imagine, for some of these retail investors, they may not be -- some may be sophisticated, understand the differences; but others may not understand much of differences between platform A and platform B.

So what you need is an ability to help them differentiate and coming through with more news and action and development on the regulatory side on these inspections on registration will help, because not every platform is going to get through this process. So that's what I mean when I said investor confidence and retail investor confidence obviously could come back, as this sort of regulatory process moves forward.

Feng Zhang: Okay. This is Feng. I will just add that we are optimistic. I think the government has clearly as Simon mentioned, the government has clearly saw the issue. And they don't want to see these things -- these trends will continue and that's why they have issued this 108 checklist. And actually, like since the issuance of that list, we have seen like in the recent days, some recovery that's pointing to the right direction in terms of our investor sentiment.

I think we were optimistic that with the just like things getting clearer and investors' sentiment may recover, but obviously, it is very hard to predict when and by how much. That's why we are not issuing any new guidance. But overall, I think that there is a pretty good chance that really depends on how the regulatory check move forward. But there is a timeline by end of this year, the inspection needs to be finished, so there is a set deadline and things should move in a positive direction.

Sanjay Sakhrani: I guess a follow-up is just on this registration process news, have the institutional investors perked up more because they would seem to be more -- it would be easier to convince that things are changing constructively?

Feng Zhang: Yes, I think you are absolutely right. The institutional investors are definitely more sophisticated. However, I would say like in the last 2 months or so, they will impact as well, because they will kind of say, hey, things are still like too much for us and why shouldn't I wait? Now, I think with the issuance of the clear guidance, regulatory guidance, I think the confidence will pick up faster than the retail investor side.

Sanjay Sakhrani: Okay. And one final question just in terms of the timing of the registration process. I know the goal is by the end of the year, will any idea whether some players might be notified ahead of that timeframe versus others?

Simon Ho: So Sanjay, let me take that question. So first of all, the deadline is for the end of 2018 for the inspection process to complete. The registration process will then be granted after that into 2019. The process is such that the Company first performs a self-inspection or a self-check. Then the National Internet Finance Association and also the Shanghai Association will perform their inspections at the next stage. And then the local government, P2P working office, which consists of the local CBIRC, also performs inspections and they will report to the national P2P working office.

So that's sort of the process and this is supposed to have been complete by the end of 2018. We haven't received any timetable yet from the regulators. We will begin our own self-inspection and submit our report in a timely manner.

Sanjay Sakhrani: Okay, thank you.

Operator: Thank you. And the next question comes from Alex Zhou with UBS.

Alex Zhou: Hi, management. Thanks for taking my questions. I have couple of follow-up questions. First one is on the delinquency. So it's encouraging to see an improvement in delinquency in Q2. Can I ask, is it more due to an improvement in the general trend of the whole industry; or it is more due to PPDAI's tightened credit control and tightened approval rate and like also a lower risk appetite?

And second question is on the transaction fee rate. So I noticed in your earnings release, you mentioned that part of the reason for the reduction in the average transaction rate is due to the exclusion of some of the products that are not applicable for the transaction fee rate. Can you give us some more color on that?

And perhaps can we have some apples-to-apples comparison in terms of what's the pricing have you changed in Q2 and perhaps in terms of APR? And lastly, in terms of the institutional funding, can I ask what is the main challenge we are facing for more institutional funding? Because I think many of your peers are competing for this kind of institutional lending, especially from banks and licensed financial institutions. So any more color will be helpful. Thanks.

Simon Ho: Thanks, Alex. Feng will take the delinquency question and the institutional funds question, and I will take the transaction fee rate.

Feng Zhang: So I will take the first, yes, okay, cool. Thanks, Alex. Yes, in terms of the 1Q recovery, I think it contributes; it is coming from multiple factors. I think largely, it comes from the industry-wide recovery, as we have the credit spike happened in Q4, Q1 really was to combine the regulatory change at that time and the very quick pull-back, pulling out of many P2P players. So that created a very sharp credit squeeze and created a very strong and quick spike. So, we have that spike has gone through and that creates a lot of recovery.

But on the other side, we also benefited from partly our credit tightening in Q1 and also as well as the optimizations we have done very quickly, the quick actions we have taken to optimize and improve our credit policy and modeling. So it's really coming from multiple factors. But if we, I think by and large, the biggest impact is probably industry-wide probably, but we also had a lot of hard work in optimizing our strategy. That also contributed to the recovery.

To your question about institutional funding, yes, I think there is a strong competition there. But I think the main challenge that we face is many licensed institutions, they are concerned about the risk on their side, especially given the recent turbulence. They are very worried about, hey, will you guys be able to get registration; are you healthy enough, so these type of things.

And I think in the we are very optimistic because we -- overall, I think we have a very strong brand, and we have a very strong capital position. And we have a very strong and a proven track record of good-quality assets. So those are the benefits, the advantages we have compared to many competitors in the industry in terms of securing more institutional funding.

So with the turbulence going through and with more clearance on the registration process, we are very optimistic that we will be able to partner -- a few more partnerships with licensed financial institutions for institutional funding.

Simon Ho: So Alex, let me just address the transaction fee rate question that you mentioned. So basically, the transaction fee rate of 6.31% that we quoted for the second quarter of 2018, we have made a small amendment to this definition basically beginning this current quarter or the second quarter. Our transaction fee rate definition excludes certain types of institutionally funded loans, typically with trusts, where our income model is different, so it doesn't actually, those loans we originate for these trusts do not include a transaction fee. This type of structure didn't much exist prior to the second quarter, and as part of sort of our push obviously into attracting taking in more institutional funds.

And in the second quarter, this particular type of loans that actually don't have a transaction fee incorporated is about I think about 2% of the volume in the second quarter. So that gives very minimal impact. So, when you look at our 6.31% for the second quarter, the 6.32% in the first quarter, it is a true apples-to-apples pretty much a true apples-to-apples comparison. Did that answer your question?

Alex Zhou: Yes, yes, sure. Thanks.

Operator: Thank you. And the next question comes from Jacky Zuo with Deutsche Bank.

Jacky Zuo: Hi, Simon. Hi, Feng. Thanks for taking my questions. I have two questions to ask. One is the regulation. So you mentioned the 108 detailed rules for the new round of inspection. So, any current -- so on the current operation, based on the new rules, anything you expect need to change, particularly on the like APR disclosure, investor protection, our QAF, type things? Any significant change you expect to be compliant?

And based on the current schedule, when do you think the current business scale control will be removed? Is that at the end of this inspection check, or we need to wait until the formal registration?

And second question is on the cost. I saw that we actually did very good on the OpEx, on the cost control, especially on the origination and servicing expenses, which this accounted for 1.4% of loan volume, down from 2% from last quarter. So what drives the improvement and what ratio we should expect going forward? Thank you.

Simon Ho: Sure. Jacky, thanks for your questions. With regards to your first question is pretty much what's the impact from the 108 requirements, and whether we make any changes to our business? Now, just to mention, I think just to start off, the positive aspect among obviously all the problems with the smaller P2P platforms is that it has firstly accelerated, as you can see, the regulatory process by at least half a year. And secondly, it also confirms that the government recognizes the benefits of financial inclusion and technology innovation in the P2P industry that we bring to the table.

Now based on our preliminary assessment of the 108 requirements, some work, of course, needs to be done, but we do not anticipate the need for significant adjustments to our business. The list of 108 requirements is substantially in line with the previous Shanghai government requirements that we have been working very hard towards. Obviously, we still need to discuss with our regulators. So this is only our preliminary assessment and view, and if there is any significant changes, we will update you.

With regards to the loan balance gap removal, I would expect that this will occur upon successful registration and not as part of the inspection. I would assume it's the registration.

And finally, your questions on our expenses, in particular, the origination and servicing expenses, what you are referring to is that in the second quarter, our origination and servicing expenses declined 5% quarter-on-quarter. This was due mainly to lower staff costs. Our headcount declined 18% quarter-on-quarter to about 4,000 in June mainly due to the decline in loan collections staff, and yes, that's mainly the reason. And we expect our headcount to remain relatively stable at this level for the rest of the year.

Jacky Zuo: All right. Got it. Thank you.

Operator: Thank you. And the next question comes from Matthew Larson with Wells Fargo.

Matthew Larson: Hi, thanks for the call. My questions have all been answered, thank you very much, by the previous speakers.

Operator: Thank you. And the next question comes from Richard Wang with CICC.

Richard Wang: I will read my question in Chinese first and then in English. (Speaking Chinese). I have two questions. The first one is again related to the regulatory environment. Given that the regulators are not going to give anybody a formal license likely before 2019, is it possible that for the next several months, such implementation of 108 specific requirements will actually accelerate the sort of lot of the smaller P2P players, which will not only further dampen the investor confidence, but also potentially slow down the speed of PPDAI to have institutional funding? Because if regulated on the licensed institutions, they can always wait for now several months before they finally see PPDAI formalizes? My second question is, is there any plan for a cash dividend pay-out?

Feng Zhang: Hi, this is Feng. I will answer the first question. Yes, I think it is possible that the scenario you have raised, we would expect many smaller players will quit because they are not able to meet the run-rate checklist. However, I would say that relatively speaking, compared to what we have seen the situation in the last 2 months, we would expect things to recover, the sentiment to recover, from this point, from the last 2 months because there is a lot more clarity now versus like 2 weeks ago, right? Now, we have these run-rate requirements and we have a very clear deadline by which all the inspections will be done, right?

Now, we are not far away from December 31 and there will be like self-inspection; there will be inspection by the association; and then there will be the final inspection. So we will start moving towards that and probably very quickly, we will finish our self-inspection, right? And yes, in the process, we will see smaller players continue to quit and probably increase but we will also see clear separation that and I think our retail investors, the media, they will see clear separation. So that will help recover or gather investors to our platform.

Now, to your second question about the institutional funding, I think again, I would just call out relative to what we have been experiencing in the last 2, 3 months, I think the institutions' confidence, the willingness to partner with us, will significantly improve. Yes, we are nowhere it's not possible to get the final registration done because that's not happening this year.

But with the clarity, I think their confidence, their willingness to partner, will significantly improve. And even without the clarity, if we compare looking back to the last 6 months, we have made significant headway into securing more institutional funding. So we are cautiously optimistic that moving forward, we will be able to secure more institutional funding.

Simon Ho: Richard, I think I will also add a quick comment on the back of what Feng said about sort of the tail of the P2P platforms that needs to exit. And clearly, this is a necessary process, this consolidation and exit of this tail. But there are two things I think that will differentiate between what was happening in June and July versus now going forward. One is in June-July, they were disorderly exits of P2P platforms; you had people running away from the owners running away from the platforms, etc.

And retail investors could not differentiate between good and bad platforms; they couldn't differentiate some couldn't differentiate us versus others. I think the difference going forward is we are going to see much more orderly exits of P2P platforms. The government is doing all they can to ensure these exits will be orderly, right, and they will take different measures for that. And secondly, I think with the inspections going on, I think the retail investors will be able to differentiate between good and bad platforms. I think that will be much increasingly clear. So I think there is a difference, and the consolidation has to happen, but the environment I think will be somewhat different from what we have seen in a few months ago.

Now, towards your question about dividends, just to give you some context, the reason why we are doing these buybacks is because we have the cash flow. We have it on our balance sheet; we are generating positive cash flows. And we think the share price is too low. So we are taking an opportunistic approach in terms of the price at which we are buying back, because we think it's too cheap right now. So that's why we chose buyback over dividends. It's more flexible for us at this juncture. We don't have concrete plans at the moment in the near term to pay dividends, but it's a policy that we will continuously consider and discuss internally.

Richard Wang: Thank you, Simon.

Operator: Thank you. And we have another question from Matthew Larson with Wells Fargo.

Matthew Larson: Hi, I got back in the queue. Thanks. I just wanted to make a comment. Most of the questions that have been on this conference call have been expressing caution and concern about what's going on. I'll just say this, is that it's not so much how much a firm like PPDAI, or some of the other firms that are in this space that recently went public; are they going to prosper, or they are just going to survive? And if you survive, your stocks are going to go up dramatically. And clearly, with a lot of the competition getting swept away, the tertiary players and that, who can't -- don't have the market capitalization or the wherewithal to adhere to the new rules are going to be gone and leaving a larger pie for the remaining players.

To me, your firm sounds like it will be a survivor. You've got plenty of cash; you've been in the business for 10 years. You expressed yourself very, very transparently and eloquently on the conference call. And I can say this, just speaking in my own book, I took some losses because I owned some stocks in the space, but when one of your I don't know if it's a competitor, but another name in the space, China Rapid Finance, which is a very small player, had an earnings call last week; and they suggested a huge share buyback and they survived. I went across-the-board and bought many stocks.

It's an asymmetrical situation now and I just where the downside is maybe $1 or more for a company share, but the upside is open ended. You just have to look at Lending Tree here in the U.S. or maybe Credit Acceptance Corp.; these things are up 7, 8, or 9-fold.

So I just want to express for any individual investor who is listening to this conference call that you've got to just close out the noise. And if you feel people in the PRC have the same goals and ambitions that people in the U.S. have, which is they want buy things; they want to consume. And it's hard to get a loan in the PRC from a bank; you have to go to these shadow banking sectors. And the better managed ones will win out.

And you know what? In a year or two, this will all be kind of forgotten in the same way that our own banking crisis back in 2009, places like JPMorgan and Bank of America have more and more deposits than they ever did back then. And they were supposedly too big to fail.

So, I just wanted to throw that out, not just cheerleading or to talk up my book, but just to kind of just counter what I consider most of the questions are have a negative bent. So with that said, I will let somebody else step in and make a comment.

Simon Ho: Matthew, thanks very much for your comments. Obviously, we can't agree more. We are well positioned to get through this transitional process in the industry, and I think the longer term outlook and opportunity in this space is enormous. And we look forward to capturing those opportunities. And hopefully, the line of questioning on the calls will become much more optimistic in due course. Very much appreciate your comments, Mathew.

Operator: Thank you. And as there are no further questions now, I would like to turn it back over to the Company for closing remarks.

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

Operator: Thank you. This concludes this conference call. You may now disconnect your lines. Thank you.