

GSX Techedu Inc.
Second Quarter 2019 Financial Results
Thursday, August 22, 2019 08:00 AM ET

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the GSX Techedu Second Quarter 2019 Earnings Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note this event is being recorded on Thursday, the 22nd of August of 2019.

I would now like to hand the conference over to your first speaker today, Mr. Tip Fleming from Christensen. Thank you. Please go ahead.

Tip Fleming

Thank you, operator. Hello, everyone, and thank you for joining us today. GSX's earnings release was distributed earlier today, and is available on the Company's IR website.

On the call with me today are Mr. Larry Chen, GSX's Founder, Chairman and Chief Executive Officer, and Ms. Shannon Shen, Chief Financial Officer. Larry will give a general overview, and then Shannon will discuss the financials. Shannon will be available to answer your questions during the Q&A session that follows.

Before we begin, I'd like to remind you that this conference call contains forward-looking statement as defined in the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are based upon management's current expectations and current market and operating conditions, and relate to events that involve known or unknown risks, uncertainties and other factors, all of which are difficult to predict, and many of which are beyond the Company's control, which may cause the Company's actual results, performance or achievements to differ materially.

Further information regarding these and other risks, uncertainties or factors is included in the Company's filings with the SEC. The Company does not undertake any obligation to update any forward-looking statement except as required under applicable law.

It is now my pleasure to introduce Larry. Larry, please go ahead.

Larry Chen

Thank you all for joining us for our second quarter earnings call, and the first call as a public company. We are pleased to report another profitable quarter of growth with net revenues of RMB353.7 million, a 413.4% increase on a year-over-year basis. The strong growth was propelled by robust performance across all of our business lines.

Our K-12 courses, the cornerstone of our Company, continued its rapid expansion, which speaks to the popularity of our services and the tremendous potential of this industry. According to Frost & Sullivan, the K-12 student population is expected to reach 241 million by 2023. 45% of these students are expected to attend online after-school tutoring courses, which is up from just 9.5% in 2018. As the industry leader, we are confident that we are uniquely positioned to reap the benefits of this fast-growing market.

Amid a sea of industries in China currently facing strong macroeconomic headwinds, online after-school tutoring is one of a few islands enjoying strongly favorable conditions, including governmental policies.

The recently announced Opinions on Regulating Online After-school Tutoring allows for greater operational flexibility for online service providers compared with their offline counterparts. This not only gives parents and students more room to make personal choices, but we think it also will strengthen the competitive advantage of industry leaders such as ourselves.

We relentlessly pursue the highest quality in our course offerings. This remains the overarching focus of our growth strategy, which has been reinforced by our enhanced brand recognition as an NYSE-listed public company. Delivering results-oriented high-quality education to our students will continue to be at the heart of everything we do, and will serve as the key to deepening our economic moat for sustained profitable growth.

Now, I will hand the call over to Shannon, our CFO, to walk you guys through the details of our financial and operating results.

Shannon Shen

Thanks, Larry, and thank you, everyone, for joining the call. I will now walk you through our operating and financial results. Please note that all financial data I talk about will be presented in RMB terms.

We entered 2019 with robust growth in the first quarter, and I am pleased to report that we saw continued momentum across all of our key operation metrics, which drove the strong financial performance during the second quarter. We are still laser-focused on online live large class, which we believe is the most effective and scalable model to disseminate the scarce high-quality teaching resources in China to aspiring students all over the country.

Net revenues in the second quarter jumped 413% from the same period of 2018. Our gross billings, which is the metric we pay close attention to, increased by 462% year-over-year to

RMB599.4 million, up from RMB106.6 million in the same period of 2018.

Total enrollment, which refers to enrollments paying more than RMB9.9 Yuan, reached a historical high, hitting the number of 592,000, 3.5 times that of the same period of 2018. Paid enrollments, which refers to enrollments for regular classes, increased to 363,000 from 94,000 in the second quarter. The cross-the-board growth was primarily driven by the continued expansion of our K-12 after-school tutoring business, and to a lesser extent, our foreign language, professional and interest courses.

Now, let's break down our revenue streams. Net revenue from our K-12 courses increased by 463.7% to RMB270.3 million, and accounted for 76.4% of net revenues, increasing from 69.6% in the same period of 2018. This rapid growth was primarily driven by increase in paid course enrollments and K-12 students' tuition fees. Our standard tuition fees for our K-12 courses increased an average of over 20% year-over-year. Another reason for the increase in ASP is that we introduced new courses that have higher standard tuition fees. For example, we launched a critical thinking course in late 2018 that has been well received by parents so far.

Gross billings contributed by K-12 after-school tutoring business were RMB504 million, compared with RMB79 million in the second quarter in 2018.

Paid course enrollments increased by 372% to 321,000, up from approximately 68,000 for the same period of 2018, demonstrating our superior education quality recognized by parents and students. The ramp-up in paid course enrollments is also a result of our high retention rate, evidenced by the re-register of spring semester students in sequential semesters. Average gross billing per paid course enrollment increased from RMB1,100 in the second quarter of 2018 to RMB1,500 in the second quarter of 2019.

Net revenue from our foreign language, professional and interest courses accounted for 21.8% of net revenues, increasing from 17.4% in the same period of 2018. Net revenue increased by 542.7% to RMB77 million, up from RMB12 million for the same period of 2018. This significant year-over-year increase was primarily because we are able to raise tuition fees by optimizing our course catalog and promoting highly qualified teachers, all of which helped to increase paid cost enrollments. For example, we were able to increase our standard tuition fee for foreign language courses by an average of over 40% and for special interest courses by over 30%.

RMB85.3 million in gross billings were generated by our foreign language, professional and interest courses, compared to RMB20.7 million in the second quarter in 2018. Paid course enrollments were 42,000 in Q2 2019, compared to 26,000 in Q2 2018. Leveraging our know-how with online live large class education, we will further expand into this large industry segment.

Our core business has grown rapidly, as we continually improve retention and take advantage of word-of-mouth referrals. We've also benefited from the strong and rising demand for online education. At the same time, we've managed to achieve and retain profitable growth by improving our ability to control costs and operating expenses.

Our cost of revenues increased by 281% to RMB101.2 million, up from RMB26.6 million year-

over-year. This increase was primarily due to our increased recruitment of teaching staff, including instructors and tutors, as we expand our business operations. We expect our cost of revenues to increase in absolute amounts in the foreseeable future as we serve more students and offer more courses.

Non-GAAP gross profit margin, which excludes share-based compensation, increased to 72.6%, up from 61.5% in the same period of 2018.

We operate a highly scalable business model. Teaching staff compensation, one of the largest cost-items, is declining as a percentage of net revenue primarily due to economics of scale.

Average enrollments per class, further increased from 980 in the first quarter in 2019, to around 1,200 in the second quarter.

We are able to pay our teachers incrementally more, while still enjoy greater operating leverage. The competitive compensation we provide to teaching staff, a byproduct of our scalable business model, contributes to high teaching staff retention rate, which will benefit our students in the end.

Selling expenses increased to RMB169 million, up from RMB18.4 million in the second quarter of 2018. The increase was primarily a result of more marketing expenses spent to expand market share, to attract new students, especially for a summer campaign and for brand enhancement.

Research and development expenses increased by 164.2% to RMB41.1 million. We constantly work on ways to apply the latest technology to improve learning experience. This includes the efficiency and effectiveness of our teaching product delivery, as well as operational efficiency.

We will continue to enhance our proprietary technology infrastructure, upgrade our systems, optimize our IT tools and software, recruit talented personnel, and introduce and apply practical artificial intelligence technology. We also devoted more resources and plan to increase spending as we continue to develop our education content. Given that our revenue growth rate outpaces that of R&D expenses, we believe we can still expand operating leverage despite the incremental investment in research and development.

G&A expenses increased by 194.3% to RMB26.1 million, mainly due to an increase in G&A headcount, and an increase in related compensation.

Income from operations increased to RMB16.2 million from loss from operations of RMB0.5 million in the same period of 2018. Non-GAAP income from operations, which excludes share-based compensation, increased to RMB31.1 million from RMB0.2 million in the same period of 2018.

Operating margin, defined as income from operations as a percentage of net revenues, was 4.6%. Non-GAAP operating margin increased to 8.8% from 0.2% in the same period of 2018.

We would like to highlight that operating margin shows distinct seasonality for K-12 after-school tutoring business, especially for online live large class business model. We offer courses in four semesters, namely the two school semesters in spring and fall, and the two holiday

semesters in summer and winter. The semesters do not perfectly match quarters on calendar.

The revenue generated by the winter and spring semester would swing substantially between first quarter and second quarter due to the floating schedule of spring festival. For instance, certain amount of net revenue swung from the second to the first quarter due to the early schedule of spring festival in 2019, compared to 2018, which results in a faster revenue growth rate in the first quarter of 2019.

In the second quarter, spring semester usually ends in the first week of June, which means that nearly one-third of the second quarter barely contributes net revenues. At the same time, summer marketing campaign requires higher investment in sales and marketing expenses. Both may lead to a lower level of operating margin in the second quarter, compared with the full year margin.

The same trend also applies to operating margin in the third quarter. In the summer semester, we provide very low promotional pricing to students in certain grades, especially at the start of a new level of school; for example, 1st grade, the 7th grade and the 10th grade. Revenue contribution from these promotion classes in summer semester is negligible, while summer marketing campaign continually leads to higher sales and marketing expenses.

The fourth quarter will contribute the largest portion of gross billings, revenue and operating income during the year, as fall semester starts with regular priced classes, and the marketing activities become less intense.

Thanks to our strong organizational capability and operational efficiency, we have been profitable for 5 consecutive quarters from the non-GAAP perspective since the second quarter of 2018. We are one of the few, if not the only, leading players in the market that have achieved sustained profitability. In the future, we will continue to execute our pricing strategy, well-proven market strategy, and provide students with the best-in-class learning experience.

Our basic and diluted net income per ADS were both 0.04 in the second quarter. Non-GAAP basic and diluted net income per ADS, which excluded share-based compensation, were 0.11 and 0.10 respectively.

Net operating cash flow for the second quarter of 2019 was approximately RMB193.8 million.

Now, let's take a quick look at our key financials of the balance sheet.

As of June 30, 2019, we had RMB60.1 million of cash and cash equivalents and RMB1.7 billion of short-term investments.

As of June 30 of 2019, our deferred revenue balance was RMB503.7 million. Deferred revenue primarily consists of the tuition collected in advance.

Lastly, I'd also like to take the moment to introduce progresses we have made to comply with online after-school tutoring regulation. On July 15, 2019, the China Ministry of Education, along with five other ministries and administrations, published Opinions in Regulating Online After-school Tutoring. The detailed regulations are broadly in line with our expectations. As Larry just mentioned, we view the regulation as beneficial to the online education industry, particular

leading players, including ourselves.

In terms of licensing, we are compliant with the ICP and Telecommunications Business Operating license.

In terms of teachers' qualifications, nearly 80% of our teachers are already qualified, or have passed both written and oral tests and are waiting for the registration. We have a robust pipeline of qualified teachers. In case certain teachers do not get the certificates before the grace period is over, we will be able to seamlessly substitute such teachers with minimal level of disruption to our students.

In terms of tutoring time and length, we are already compliant, as all of our K-9 classes end by 9pm, and hence, we expect minimal changes to our K-9 operations in this regard. In addition, it is worth noting that the new regulation limits offline after-school tutoring to 8:30pm, whereas online classes can end at 9pm, further underlying the benefits of our model compared to our transitional offline peers.

Also, in terms of homework, offline tutors are not allowed to assign any homework at all, whereas in online channel, there are only restrictions for the 1st and 2nd grades. We believe our current curriculum and teaching plans do not require any significant changes.

In terms of the 3-month or 60 classes limit for upfront payments, we believe this regulatory stance provides greater clarity and consumer protections for both parents and students. It will motivate us to develop services and products of higher quality. We have promised to provide full refunds to parents and students at any time before the live class is over since we start this business.

Considering our low refund rate and high retention rate, the reduction in payment period will have limited impact on us. Particularly, we believe we are more capable of guaranteeing the safety of prepaid tuition fees compared with a number of our peers, thanks to our profitable operations and the increasing brand recognition.

As one of the leaders in the online education space, we believe we are among the least impacted by the latest regulations, as we have been conducting our business in line with these policy aims and believe that these policies will, in fact, further enhance our leadership position.

We will continue to monitor the development of online education in China, to continue to provide our shareholders with responsible guidance and effective execution, and to continue to deliver strong financial and operational results over the long term.

With that, I will now provide our business outlook. Based on our current estimate, net revenues for the third quarter of 2019 are expected to be between RMB486 million and RMB506 million, representing a projected increase of 390.9% to 411.1% on a year-over-year basis. These estimates reflect the Company's current expectations, which are subject to change.

That concludes my prepared remarks. Operator, we are now ready to take questions, thanks.

Questions and Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions). Our first question comes from Alex Xie from Credit Suisse. Please go ahead.

Alex Xie

Hi, management. Thank you for taking my questions. So I have three questions to ask. First one, I would like to ask about our customer acquisition channels. How much of our new student enrollments were from external channels, and how much from our organic channels? And for external channels, what are major channels that we use, and our expectations for the customer acquisition costs in the second half?

On the second aspect, I would like to ask about our revenue and also enrollment breakdown between the primary, middle school and high school departments, and what strategies do we have to do better in the primary school segment?

And the third aspect I'd like to ask about is the contribution from low-tier cities versus tier 1 and 2 cities. What are the major provinces or cities that contribute revenue of us?

Shannon Shen

Thanks, Alex. Your first question is about the customer acquisition. So actually, most of the new student enrollments we have acquired as through traffic acquisitions. And the main channels we're using is basically, the same as other online education companies, such as WeChat, like WeChat official accounts, WeChat moments, news feed ads, and also with TikTok, Toutiao and Baidu. And also we are exploring new channels as well.

And so talking about the second half year's sales and marketing expenses budget, so it's worth noting that there is also seasonality in K-12 business. Like in summer campaign, summer campaign usually starts in May and it lasts through May until the end of August. So let me talk about the sales and marketing strategies in the second half. We're talking about the activities we are taking in the summer. And like I just mentioned in my prepared remarks, the sales and marketing expenses we are [technical difficulty].

Operator

Pardon me, ladies and gentlemen, it appears we have lost connection to our speaker line. Please stand by while we reconnect it.

Tip Fleming

Sorry, operator, we're back here.

Operator

Okay. You may continue.

Shannon Shen

Okay. Let me recap with our marketing strategy. When we talk about marketing strategy, within our organization, there's a phrase we use frequently; we call it effective growth. So we don't usually see marketing as an expense; we actually see it as an investment. So one of our major advantages is our high efficiency at our customer acquisitions. The students -- the customer acquisition efforts consist of a variety of stages, the value chain is very long, so it starts from the traffic acquisition at the beginning and then it's the free or promotion class we provide. And also following that is the sales side and that we have a really strong sales force that can help convert the parents from a promotion class to a regular class. So since this is a value chain, the company needs to be equally capable on each of the links that to make the whole sales chain more efficient. And so that we have been training our staff in the past 2 to 3 years that we train them to use money wisely, because we haven't raised any money since like 4 years ago. Then so for example, if we can be 5% better in a single stage than others, then maybe we can deliver acquisition efficiency twice, or even several times, as high as our peers.

So we actually -- and we devised a really efficient technology to closely monitor our customer acquisition process, so they calculated ROI closely. That the system we developed is very efficient. By doing the peak season of our traffic distribution, we can monitor the traffic on an hourly basis. We monitor our links and the bar code we send out through all those sales channels, and we can optimize those channels. If we do see like they are being slow, or there's a latency where the customer wants to register the classes.

And also, when we talk about the seasonality of our sales and our marketing expenses, from July to August, we still invest in the market to acquire new students. And usually, in the fourth quarter and especially, when the fall semester starts, there will be less marketing activities there. But since like you may know that this year, the compensation in the summer campaign kind of like heated up a little bit. So we need to react quickly to what's happening on the market, and that's what we have been training for the past 2 years.

And talking about the budget for the second half of the sales and marketing budget, we will adapt to what's going on in the market and quickly act to what's going on in the market. So I think that is your question.

Then your second question is about the enrollments I believe from different segments, and how to do better in the elementary school. So in this quarter, around 25% of our paid course enrollments are from elementary school, 30% from middle school and about 45% were from high school. So in terms of student number, elementary and middle school are catching up quickly.

Sometimes it's because in high school, students tend to buy multiple subjects, that we call the cross-selling. They are contributing more enrollments. And elementary and middle school increase faster than average, especially for elementary. We're having a better performance in this market sector, and we are expecting to see this positive trend to continue in the following time.

We believe that elementary school students are vital to our business, for they are the most fundamental target customers in K-12 market. Also, they are the biggest market because there are 6 grades in elementary. The total is like the total of middle school and high school, and they are likely to contribute much more to our business, as they have a potential larger lifetime value, and we can early build a brand image in them. And also, we put elementary course development as a strategically high priority.

The head of our elementary school department has intensive experience in education, and used to manage over 500 employees. We also put a lot of energy on recruiting capable teachers; the instructors are either from the top two schools like Tsinghua University and Peking University or other top 10 universities. They also recruit teachers with intensive teaching experience, around 2 to 3 years of teaching experience.

Further, that we are centralizing the curriculum, centralizing the content development and building like animation videos to make the curriculum more fun in the class. And our teaching philosophy is to ignite the interest. We also -- I know in the industry, a lot of the companies are using -- they are recruiting more fresh college students, or from all those prestigious universities and provide training courses. After that, these teachers can deliver a really good class.

But from our perspective, even for children at a younger age, they still need to follow those teachers that have strong confidence that can ignite their interest in the courses and also build confidence in the subject. So we do have the confidence that we can feel like our elementary school and middle school can contribute more to revenue and to our business.

And your third question is about the cities and the provinces we are covering. So actually, the enrollments are quite evenly distributed across tiers of cities. For the first-tier cities and the new first-tier cities and second-tier cities specifically contributed about 50% of the enrollments; and for the lower cities, they contributed another half. And actually, we did a really good job of penetrating lower-tier cities.

So if we do a comparison between 2018 and the first quarter in 2019 and the second quarter, the first quarter in 2019 actually, the penetration rate, the enrollments contributed from the third-tier cities and the fourth-tier cities and the fifth-tier cities increased about 5% in total. And in this quarter, we do see a 3% quarter-over-quarter increase in the third-tier cities and the fourth-tier cities, so which means we basically, we did a really good job on penetrating lower-tier cities.

Also I also want to remind you that based on the enrollment number we have right now compared to the 200 million students out there, it's still a really small number. And it may not have that particular meaning for how we are doing on lowest-tier cities. But we do see different demand from the first-tier cities and the lower-tier cities.

For instance, for the first-tier cities and the new first-tier cities, parents are more sophisticated with those classes, which means our teachers, including our sales staff, need to be very familiar with the product they are promoting. And for lower-tier cities, a lot of parents may have never gotten a chance to see so many good teachers. So they are very thrilled that they have this chance, or this exposure, to the good teachers. So we got a different demand from first-tier, from the higher-tier cities and the lower-tier cities.

And talking about the distribution on provinces, basically, it's consistent with the population distribution. The top provinces we are covering are Guangzhou, Shandong, Zhejiang, Jiangsu, and also like Henan, Hebei. These are all the provinces that have the largest student base.

I think that covers your questions. Thanks, Alex.

Alex Xie

Thank you, Shannon, very clear. Thank you.

Operator

The next question comes from Gregory Zhao with Barclays. Please go ahead.

Gregory Zhao

Hi Chen Lao Shi (Chinese), Hi Shannon. Very strong quarter, and congratulation on IPO. So this is your first earnings call after the IPO. So I want to ask three questions, if I may. The first one is about a big picture of the industry. So we know the market has very huge opportunities, considering the potential, the user base and the addressable market. So is there any way you can help us to quantify the market opportunity, such as the potential penetration rate and ARPU upside. So, this is my first question.

The second one is I want to understand the competitive landscape and your user acquisition strategy. So we heard your competitors are also very aggressively expanding into the online space, even they have some traditional -- some legacy issue in the offline. And we know they invest a lot in online acquisition. We just want to know your source, that front, how to compete with them. And also how do you differentiate your course content from your peers?

The last one is a quick follow-up on the higher-tier city and the lower-tier city questions. So you just reported a very impressive penetration rate in the lower-tier city. And your courses are given online, so I assume the prices across all the different tier cities should be the same. I just want to confirm that.

Shannon Shen

Thanks, Greg. And yes, your first question is about the quantitative market opportunity. So K-12 is actually a tremendous market; it's a trillion-level market, has a huge opportunity. For instance, in 2018, the online market penetration rate was only 9.5%, so in 5 years, it will reach to 45.5% based on our Frost & Sullivan report. But we're in the industry; actually, we do see the penetration rate much more higher than the Outsider had observed.

So let's just do a quick math. For instance, it's like a trillion level market; then in 5 years, 50% is online. Then within the online business, probably 60% is for large-class business. Then that already gives you like a 300 million [30 billion (corrected by the management)] market; it's really huge.

Then let me talk about online live large class. It has a higher entry barrier than other players

because all the technology infrastructures you need to have, like the live broadcasting technologies, big data and AI technology; and also you need to have a large group of people to serve such a large group of students. So that entry barrier, kind of like, decides the top players will have a higher market concentration rate. So let's say if the top 3 players hold 50% of the market share, then that already gives you like an annual net revenue of about 20 billion. So that's a really huge market opportunity for us and for other players right now.

And the same thinking is behind why we are doing the online tutoring in large class format. Think about what's the real demand from the students and the parents. They're always searching for the best teachers, and if we look at the teachers' supply chain. One-on-one teachers, they cannot be the best, like college students can do one-on-one tutoring and if we can find graduates having good potentials and we train them up, and they can be very good small-class teachers.

But think about only the top-notch teachers can deliver the teaching content in a large-class format, which means the large-class teachers are always the best teachers. If one day, all the students and the parents know that the best teachers are all in online and they are all in large-class formats, they're going to follow the teachers. That's why we are quite confident that online live large class has a huge and tremendous opportunity there.

So then your second question is about the competitive landscape. So the competition was kind of like heated up in this summer, especially for this year. We all heard the news that top players in the industry, they kind of invested over RMB10 million per day since June, and we did see like different dynamics this year. First, the market penetration rate is much higher and it grows even faster than they expected. If we put together the enrollments across all of the online platforms, the number added up to a big one real quick. At an early stage, it's a really good thing to have multiple players to educate the market together.

We see promotions from both online and offline, like posters and radios from subways, bus station and television, and we do see more and more parents are getting to know online education, especially for those lower-tier cities.

And the second, and also a very interesting scenario, is that parents were spending up on multiple platforms in a larger expense; this is something new and it's different from last year. We did a survey with our parents; a lot of them are paying for promotion classes on two to three platforms, or even parents, they're spending for four companies. One reason is that the promotion classes are not that costly, and the other reason may be perhaps algorithm on social platforms decides that education companies have similar exposure to the same group of parents. This way, the parents can now be more selective than ever before. That's what's happening in this summer.

So then, which means talking about the competitive advantage that a company of its teaching products we are providing, needs to be excellent, needs to excel; it cannot be just average or slightly above average. When the parents have become more picky, you need to -- we need to grab their attention at the first place, and let them know that we are, kind of, providing the best teaching product in that market. So that's why we spend a lot of time on training our teachers, help them transition their teaching model from offline to online, or from their old model to the new model.

So we also have our teachers adopt a lot of new teaching skills; like, they need to adopt those online live large class skills to attract the students in a higher level. That's the competitive landscape right now, and there's a phrase Larry usually says, like the dart of a strategy should not be your competitor; it should always be our customer. And that's why we put customer achievement at the first sentence in our corporate value. We believe if we can continually provide our customer with the best teaching quality, that our customers can follow us and they will keep retain with our platform.

I think your third question is about course content development. So the course content development for a large class teaching format is kind of like different from the centralized small class content development process. The course content development should be from upside-down, that because when we hire the teachers with intensive experience in the education industry, we are leveraging all the skills, all the experience they have that has been proven in their past experience.

So, the way we're doing content development right now is like all of our instructors are part of the content development process, so they can -- they do group discussions and they routinely organize those meetings to discuss and come up with the most efficient teaching methods, so we can centralize -- we can standardize them. And we also have a support team to support those instructors. They are doing the power points for the teachers; they are doing animations, videos to help teachers to deliver the lessons in a more efficient way.

And also, talking about the teachers' training, we are building up a strong instructor pipeline, that they kind of like -- we are building the ladder. We have those -- top teachers have over 15 years of teaching experience, and then also we have younger teachers that they can constantly learn from their role models.

And your next question is from -- it's most like the pricing strategy I think, like the price we charge with our customers from different tiers of cities. So offline, the pricing strategy for offline is kind of like different from online because when we talk about offline business, we have different operational cost on first-tier cities and lower-tier cities. In first-tier cities, the rental was higher and the teachers' compensation is higher, but that costs is lower in the lower-tier cities. So for us, since we are doing business online, the costs are basically the same for all of our customers. But we are developing a variety of products that can be adopted to lower-tier cities maybe with a lower price that can be more affordable to those parents.

I think that concludes your questions.

Gregory Zhao

Yes, very helpful. Thank you, Shannon.

Operator

The next question today comes from Jeffrey Chen with CLSA. Please go ahead.

Jeffrey Chen

Hello. Thank you management for taking my questions. I have three questions. The first one is just a recap. Can management help me to recap on the gross billings per paid course enrollment by category, which means by K-12 and by the interest and foreign language course? My second question is what is the subject exposure now? Is it math still account for the highest proportion, and how about English and Chinese?

And my last question is, is there any specific strategy for management in recruiting new instructors, given the higher competition landscape?

Shannon Shen

So Jeffrey, can you repeat your last question?

Jeffrey Chen

My last question was is there any like specific strategy in recruiting new instructors, given the higher competition landscape?

Shannon Shen

Okay. So your first question is about the average spending for enrollment. I also want to remind you that that also has a seasonality. For instance, in the -- yes, in the second quarter, a lot of students are registering for summer class and for part of the fall class. Some of the students belong to what we call the entrance-grade level, like the 1st grade in elementary school, or the 1st grade in middle school. The price of the class is lower; it's basically only RMB49 Yuan per enrollment, so that will kind of like drag down the average spending per enrollment.

But if we talk about if we move the scenario to the first quarter, then the first quarter students are enrolling for a spring semester. Usually, the average course price, the ASP is higher, so that gives you a higher average spending per enrollment. So if we compare quarter-over-quarter, the average spending per enrollment doesn't change a lot; just kind of wrap-up, the impact on the ASP increase is about 1,500.

And your second question is about the subject exposure. Yes, so in this quarter, math, K-12 English and Chinese combined contributed around like 80% of our paid course enrollment of our K-12 courses. Math still contributes the highest proportions; it's around -- it's about 30%. But we did a really good job on English and Chinese as well; these two subjects contributed about 40% as well.

So that's another advantage we have, that because we have our revenue distribution on these three major subjects very, very even, so that which means we have great, good teachers that are evenly distributed on those subjects, which allows the students to have more alternatives, and we can do a better job with the cross-selling. And that's another reason why we can achieve our profitable in the long run.

And also, we can see a decreasing trend of math proportion and an increasing trend of English enrollments. So in the future, the paid course enrollments are expected to spread more evenly over these three subjects.

And also, I want to let you know that we also did a really good job on those we call the smaller subjects like physics and chemistry, because sometimes, even for those offline institutions and for other online institutions, it's really hard to find a good teacher to cover these subjects. So a lot of students, when they cannot find a good teacher in physics and in chemistry, they are -- they tend to search online for those teachers. So that's why we have exposure to them, and once they register with us, we also recommend like other math and chemistry to them. So that's why we have a really good cross-selling rate in our high school sector. I think that's your second question.

And also, we talk about the strategy of recruiting our instructors. Yes, so we do see like as an education company, it is always the ability to recruit, to train and to motivate the teachers is the core ability. And for us, we have a really high bar to recruit instructors. In 2018, the interview acceptance rate was lower than 2%, which means within 100 interviewees, only less than 2 can pass our interviews.

And so actually, really, we don't see the competitive landscape has too many impacts on our teaching recruitment process. Thanks to our public initial offering in the NYSE, we did a really good job on promoting our brand awareness, which makes it much more easier for us to recruit new teachers right now. And in the past, we need to persuade the teachers that we are a really good company, that we have really high operating efficiency, but right now, with all the transparency, with all the public data we can provide to the publicity, that a lot of teachers, they come to us and because they see like how efficient we are running our business.

And also, I want to address that our teachers have a really -- our instructors have a really low -- have a really high retention rate and a really low turnover rate. In 2018, only 9 of our instructors actually left our company; 2 of them were public school teachers because they are not allowed to teach online anymore. And the rest 7, it's mainly because like when we monitor their operating data like the sales conversion rate and the retention rate, their data is not that satisfying. So we convert them into our content development team.

So we did a really good job on training our teachers as well. We had a teaching quality supervision team that are dedicated to do that job. And we are probably the only company in the sector that we do a 100% supervision of all our online live large classes.

And our teaching quality supervision team, we generated a supervision report in 24 hours, and we request all those teachers to respond to those issues in 24 hours. And sometimes, the report is also copied to our CEO, just like just want you to know how much attention we pay to those teachers and all the efforts we put in keeping improving our teaching quality.

I think that answers your questions.

Jeffrey Chen

Yes, this is very helpful. Thank you and congratulants on the outstanding results.

Operator

The next question today comes from Sheng Zhong with Morgan Stanley. Please go ahead.

Sheng Zhong

Thanks for taking my question. I just have one question about the teachers. Now, in the K-12 segment, how many instructors and tutors do you have? And for your top teachers, what's the current student-teacher ratio, and because it continues to increase, so will you monitor this? Along with the ratio increase, do you see any change in the key metrics that you say sales conversion rate, retention rate? And also, how much potential room do you see can improve the student-teacher ratio?

Shannon Shen

Thanks, Sheng Zhong. So your first question is about the number of our tutors and the instructors. By the end of the first quarter, we have 169 instructors, and by the end of the second quarter, that number adds up to less than 200. And by the end of the first quarter, we have 552 tutors and by the end of the second quarter, the number adds up to over 1,000.

Our organization actually grows really quick, so that's a privilege we can enjoy because we have a really strong management team that Larry, he used to manage over 30,000 employees. So it's kind of like we're going into his comfort zone; that when our organization became a really large one, that he knows exactly how to train up these tutors, that they can provide a better service to our parents and to our students.

Your second question is about the teacher and student ratio. We have two ratios; one ratio is for instructor and student ratio, and the other ratio is the tutor student ratio. So for the instructor and student ratio, I just mentioned that the average enrollments per class, during my prepared remarks. And we did pay close attention to the class scale. We monitor class scale at 600, 800, 1,000, 1,200, just to keep a close attention to when the class scale becomes larger, whether the ongoing KPIs will become worse. So we closely monitor a lot of ongoing KPIs, such as class attendance, class completion rates, homework submission rates, homework correction rates.

And from our observation, the ongoing KPIs largely depends on the teachers' teaching quality. And sometimes, our teachers are quite capable; even though his class has over 2,000 students in, we can still see these numbers are getting better and better. But some younger teachers are teachers in the early stage; they did not take enough training. Their numbers may become a little bit worse; I won't be using the word "worse." We just don't see the number going up, probably with a class scale of 600 or 800. For those kind of teachers, we will provide additional training to them and closely monitor how their ongoing KPIs go.

And talking about the tutor and student ratios, currently, in the second quarter, the average student of tutors taking in the same time of period, is less than 300. It's about 270. From our view, it's still very important to keep the intimacy between students and the tutors. The reason why we're doing it in the dual teacher classes is from one side, we saw the demand that we're providing the best instructors, we're providing the best teaching quality.

And from the other side, we need also to provide the best service and provide emotional support, as well as the intimacy that offline institutions usually can do better. So that's why we pay close attention to recruit our tutors as well. We do see them as a valuable asset to our Company, so we want to keep the ratio at certain extent.

And also, a lot of investors may ask is 300 a little bit too much? But leveraging all the technology we have right now, like the apps or the homework grading system, like leveraging all the graphic recognition, voice recognition. Now, right now, our tutors can fix homework in 50 seconds; that saves them a lot of time to do all those human contact, all those emotional connects with our parents.

And your last question would be the --

Sheng Zhong

Retention rate.

Shannon Shen

So the retention rate we observed from the second quarter is really impressive from our perspective. So for the past 5 quarters, we have been able to improve our retention rate on a quarterly basis, and we are quite confident that we did a really good job on the high school sector. And for middle school and primary -- elementary school sector, we are improving the numbers really quickly.

And we didn't disclose the retention rate; it's because we want all the KPIs to be the relating whole one. Retention rate is -- we call a true-north KPI in our Company. We use the retention rate to evaluate instructors' performance, to evaluate children's performance, and we have a really conservative calculation of the retention rate.

The retention rate in our Company is only calculated by one course, the same instructor and the same tutors, that the students in the class are re-registering for the sequential semester, which means if a student, they switch class from one instructor to another, or switch from one tutor to another, that will not be calculated into the retention rate. And I think like some day when the industry comes up with more acceptable ways to calculate the retention rate, we will be much more happy to disclose that number.

And I also want you to pay attention to another factor that may impact the retention rate. First, it's the price of the class, so when they do reregistering, we didn't do discounts, and sometimes, we even slightly increased the ASP.

And the second is like the time window we provide for the retention period. We still use the traditional way; there are 4 days for the retention period; it's usually from Thursday to Sunday. And we do see a lot of companies in the industry, they kind of extend the retention time window to 10 days, or even to 15 days. So it makes the KPIs less meaningful to compare.

So I think that address your questions.

Sheng Zhong

Yes, thank you. And I want to follow up with the teachers, the student-teacher ratio. So the top teachers is very good resources. Do you think there will still have much room to increase the top teachers, the student-teacher ratio?

Shannon Shen

So for the top teachers, there is a thing I also need to remind you. So I think that leads to another question that a lot of people, they may pay attention to our sales concentration rate, that our top teachers contributed over 40% of the revenue in 2018 as well as in this first quarter in 2019.

So there's a reason for the concentration because in 2018, even though by the end of the year, we have 163 instructors on hand, only half of them are at the full capacity because we provide longer than 6 months' time of training to those teachers. And there's a character for K-12 business is that they need time for instructor to grow the scale of his class, his or her class, so because there's --

For instance, if a teacher joins us in 2018, by the end of today, he already experienced the 4 or 5 times of retention periods. And for a new teacher, he doesn't really have that time to grow his class scale. And for our top teachers, like I just said, we are closely monitoring their ongoing KPIs, and we also want to create a really healthy environment for those teachers, that they are teaching the class scale that they can handle, and they are feeling good about it.

So right now, we do see our top teachers, they are teaching a class scale at around like low-single-digits of thousand, like 2,000 or even like 1,200 students in the same class. And we will closely monitor our KPIs to see whether we can put that number up.

Sheng Zhong

Thank you very much, Shannon.

Operator

The next question today comes from Carson Lo with Nomura. Please go ahead.

Carson Lo

Thank you for taking my question. So congrats on the strong quarter. So I just have a few questions first to follow up about the teacher-student ratio. So based on the current KPI monitoring, how -- I just want to follow up on what was the ceiling for the top teacher-student ratio for the top teachers, based on your monitoring to determine the room for the maximum students in the same class.

And the second question is more about the cross-selling. So I want to see for a cohort of users, then how many subjects do they normally apply in our platform? Thank you.

Shannon Shen

Okay. So for the ceiling of the scale, the instructors, theoretically, there's no limit for the class because our live broadcasting technology now supports 100,000 students in the same classroom without significant latency. And in reality, we did host a class with students of over 26,000 and still without any significant latency.

But for another reason or another parameter, we are evaluating this to optimize the scale of the class, is the instructor and the tutor group, as well as the content development team, also together with the technology team and the sales team, it's a group, which means the instructors need to work closely with his group to make the class -- or to the make the learning experience better.

And when the group grows really quick, or grows into a large group, the communication efficiency might be lower, which means sometimes, there's an optimal scale of these classes. And again, we are closely monitoring all the ongoing KPIs. And right now, we did see for those top teachers, probably 1,000, 2,000; they are in a really good shape to handle that scale of class.

And also, for cross-selling, cross-selling did see different characters across high school sector, elementary school sector and middle school sector. So for instance, for elementary school, they only learn three subjects at school. And sometimes, the parents won't be that brutal to them to have them learn all the three subjects. They may just focus on the weakest one.

For high school sector, they learn six subjects at school, and basically, they have no time to do leisure or hobbies. All of their time is concentrating on all the tasks and study. So they tend to have a higher cross-selling rate.

So that's kind of different across all the sectors, and that may subject to change when our enrollments distributions across all the school segments change. So usually, right now, we did a really good job on cross-selling, like I just said, because we have good teachers evenly distributed on different subjects. So we will continue to encourage our students to register for different subjects with our platform.

Carson Lo

Thank you. So can I follow up quickly on the -- for example, on the high school students, who now at this moment on average, how many subjects will a normal high school student uses, registers on our platform?

Shannon Shen

That also shows seasonalities. Usually, that number tends to be high in the first quarter because if we take the scenario of the whole school year, the school year usually starts in the summer. And when it comes to next year's first quarter, it comes to the end of the school year, which means probably the students, they stay with the platform with a longer time. Then at that time, they tend to take in more courses because they have built a really trustworthy relationship with our platform.

And the number in summer or in fall semester tends to be low because that's usually the time the students are newly registered, and they are probably not familiar with the platform. So they tend to just try one subject and they will be expanding in the sequential semesters.

Carson Lo

Okay. Thank you very much.

Operator

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

Tip Fleming

Okay. Thank you, operator, and thank you, everyone, for joining the call today. If you have any further questions, please don't hesitate to contact us or the Company directly. Thank you very much.

Shannon Shen

Thank you.

Operator

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