

**Sunlands Online Education Group [STG]  
Q4 and Full Year 2018 Earnings Conference Call  
November 23, 2018 7:30 AM**

Executives

Yingying Liu, IR Director  
Tongbo Liu, CEO  
Steven Yipeng Li, CFO

Analysts

Alex Xie, Credit Suisse

**Presentation**

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Sunlands fourth quarter and full year 2018 earnings conference call. At this time, all participants are in a listen-only mode. After prepared remarks by the management team, there will be a question-and-answer session. Today's conference call is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the conference over to your host today, Yingying Liu, Sunlands IR director. Please go ahead.

Yingying Liu: Hello, everyone, and thank you for joining Sunlands fourth quarter and full year 2018 earnings conference call.

On the call, our CEO Tongbo Liu will provide an update on our operational performance as well as our strategic initiatives. Our CFO Steven Yipeng Li will give you an overview of our financial performance and also provide our guidance for the first quarter of 2019. Following their prepared remarks, we will move into the Q&A session.

Before I hand over to the management, I'd like to remind you of Sunlands' safe harbor statement in relation to today's call. Except for the historical information contained herein, certain of the matters discussed in this conference call are forward-looking statements. These statements are based on current trends, estimates, and projections, and therefore, you should not place undue reliance on them.

Forward-looking statements involve inherent risks and uncertainties. A number of important factors could cause actual results to differ materially from those contained any forward-looking statements.

For more information about the potential risks and uncertainties, please refer to the Company's filings with the Securities and Exchange Commission.

With that, I will now turn the call over to our CEO Tongbo Liu.

Tongbo Liu: Thank you, Yingying. Hello, everyone. Welcome to Sunlands fourth quarter and full year 2018 earnings call. 2018 was a memorable year for us. Coincidentally, today is the 1-year anniversary of our listing on the NYSE. Thank you for joining our Q4 and full year earnings call.

In 2018, we made a number of substantial changes to our Company. In addition to our U.S. public listing, we fine-tuned our business, enhanced our brand, served even more students and launched more courses. Throughout the year, we worked to support and enrich our industry-leading brand by focusing on user experience and course offering development.

First, we continued to bring students our best-in-class STE programs. We also introduced new, proprietary AI technology designed to help students develop better study habits and support our unrivaled pass rates. Importantly, we refined our marketing tactics, by offering a broader variety of free trial of selected course offerings. By adding more free course offerings, including graduate, post-graduate and professional classes, we believe we can support our growth over the longer term.

We ended the year growing our total annual net revenues by nearly 104%, or RMB2 billion, with fourth quarter net revenues of RMB569 million RMB, at the high end of our guidance, demonstrating an increase of 65%. The increase was mainly driven by the growth in the numbers of students in the year of 2018 compared to 2017, following new student enrollments' continuous increase over the past years.

During the year, we continued to introduce the market to the benefits of online STE, and more specifically, to our high-quality, post-secondary education on our technologically advanced platform. In April, we reached a considerable milestone initiating our free trial program. We began working diligently to gain the interest of new students with increasingly versatile courses, on both mobile and PC.

We have a talented pool of teachers that support our online offerings, and our platform is now equipped with customized AI technology designed to make personal selections for our students. We now offer free introductory seminars, which enable prospective students to see firsthand how our course offerings work, as well as select free short courses to provide our students with free introductory learning opportunities.

We believe our upgraded free trials with introductory seminars and free short courses can, over time, increase average gross billings, conversion rates and sales efficiency.

These initiatives also support our emphasis on enhancing the overall user experience, including how students perceive our marketing and sales.

Previously, our primary challenge had revolved around bringing in more students through soft marketing tactics. With our upgraded free trials in place, we see an opportunity to familiarize a broader population with Sunlands platform and our extensive education services.

As awareness of our brand grows, we believe we can reach a larger prospective pool of students. While it will take time to achieve the long-lasting effects we are looking for, we are seeing early signs of the benefit of these programs.

Empowered by our one-to-many live streaming model, we are able to continue to broaden our course offerings to serve a larger number of students. At the same time, we can leverage our premier AI technology and industry-leading online education platform to build a positive user experience that creates a base for future learning and a [virtual cycle] of recurrent users.

In 2019, we will be focused on attracting more students by upgrading our free trials with even more offerings, as well as further enhancing the user experience.

We strive to bring our students inclusive, effective and efficient learning opportunities, and we are at the forefront of technological advances for enabling this ease-of-use and seamless platform integration.

Students are spending an increasing amount of time on our platform, demonstrating that our programs work, and students are utilizing them to their full potential.

The total number of students engaged in live streaming classes grew 45.8% in Q4 2018 compared to Q4 2017. And more importantly, the average time spent on live streaming classes continued to grow 26.6% year-over-year for the fourth quarter.

Our users are also becoming more engaged and are showing increased passion toward studying on our platform. There is even more of a leap if we look at the gains we made over the course of this year. Students took in total of more than 2 billion quizzes online in 2018, compared to just 200 million quizzes in 2017.

In return, for 2018, our pass rates continue to be well above the industry average, and these have increased consistently on an annual basis. Our highest average pass rates continue to be among students taking STE exams in the Jiangsu province. For 2018, our pass rate in this province was 76.8%, up from 71.9% in 2017, and we are pleased to maintain this exceptionally high level of education for our students.

As we move through 2019, new student enrollment will be key. We believe the initiatives we have put in place to improve our user experience throughout the front and back end of our business, our advanced technology and expanded course offerings will prove attractive to new students.

The online post-secondary and professional education market is massive and continues to evolve. We are dedicated to providing a complete online continuing education ecosystem that is tailored to each student's learning patterns. We believe these initiatives will help develop

online learning habits for more students, transferring them from offline to online, and enhance a stronger brand for Sunlands over the longer term.

Our innovative approach to online learning, paired with our one-to-many live-streaming model is ideally suited to support our future growth.

With that, I would like hand over the call to our CFO Steven to run through our financials.

Steven Yipeng Li: Okay. Thank you, Tongbo, and hello, everyone. Thanks for joining us. We are pleased to report that we delivered revenue at the higher end of our guidance in the fourth quarter, reflecting the effectiveness of our initiatives to strengthen brand awareness and attract more students to our platform.

Let me walk you through some of the key financial results for the fourth quarter and full year 2018. All comparisons are year-over-year and all numbers are in RMB.

In the fourth quarter of 2018, net revenues increased by 65% to RMB568.8 million from RMB344.7 million in the fourth quarter of 2017. The increase was mainly driven by the growth in the number of students in the fourth quarter of 2018 compared to the fourth quarter of 2017, following new student enrollments' continuous increase over the past years.

Cost of revenues decreased by 1.1% from RMB79.4 million in the fourth quarter of 2017 to RMB78.5 million in the fourth quarter of 2018.

Gross profit increased by 84.8% to RMB490.3 million from RMB265.3 million in the fourth quarter of 2017.

In the fourth quarter of 2018, operating expenses were RMB699.7 million, representing a 0.2% increase from RMB698 million in the fourth quarter of 2017.

Sales and marketing expenses increased by 2.5% to RMB530.1 million in the fourth quarter of 2018 from RMB517.3 million in the fourth quarter of 2017. The increase was mainly due to increases in spending on branding and marketing activities, including investments in broadening Sunlands' search engine and mobile application channels.

General and administrative expenses decreased by 15.5% to RMB142.6 million in the fourth quarter of 2018 from RMB168.7 million in the fourth quarter of 2017. The decrease was mainly due to significant share-based compensation expenses recognized in the fourth quarter of 2017.

Product development expenses increased by 125.6% to RMB27 million in the fourth quarter of 2018 from RMB11.9 million in the fourth quarter of 2017. The increase was primarily due to an increase in the number of employees and compensation paid to Sunlands' course and educational content professionals and technology development personnel during the quarter.

Net loss for the fourth quarter of 2018 was RMB183.7 million compared with RMB427.8 million in the fourth quarter of 2017.

Basic and diluted net loss per share was RMB26.68 in the fourth quarter of 2018.

As of December 31, 2018, the Company had RMB1,248.8 million of cash and cash equivalents and RMB1,028.6 million of short-term investments, respectively, compared to RMB559.5 million of cash and cash equivalents and RMB353.1 million of short-term investments, respectively, as of December 31, 2017.

As of December 31, 2018, the Company had deferred revenue balance of RMB3,286 million.

Capital expenditures were incurred primarily in connection with purchases of buildings and IT infrastructure equipment necessary to support Sunlands' operations. Capital expenditures were RMB263.1 million in the fourth quarter of 2018, compared to RMB307.2 million in the fourth quarter of 2017.

Now I will go through some financial results for the full year of 2018.

For the year of 2018, net revenues increased by 103.5% to RMB1,974 million from RMB970.2 million in the year of 2017. The increase was mainly driven by the growth in the number of students in the year of 2018 compared to 2017, following new student enrollments' continuous increase over the past years.

Cost of revenues increased by 94% from RMB170.3 million in the year of 2017 to RMB330.4 million in the year of 2018. The increase was primarily due to the increase in compensation for our faculty members, which mainly included teachers and mentors, as we continued to retain our existing faculty members and attract new faculty members.

Gross profit increased by 105.5% to RMB1,643.6 million from RMB799.9 million in the year of 2017.

For the year of 2018, operating expenses were RMB2,672.5 million representing a 54.7% increase from RMB1,727.6 million in the year of 2017.

Sales and marketing expenses increased by 59.3% to RMB2,152.8 million from RMB1,351.8 million in the year of 2017. The increase was mainly due to increases in our sales and marketing compensation; and spending on branding and marketing activities, including investments in broadening our search engine and mobile application channels.

G&A expenses increased by 29.4% to RMB443.7 million from RMB342.9 million in the year of 2017.

Product development expenses increased by 131.3% to RMB76 million from RMB32.9 million in the year of 2017. The increase was primarily due to an increase in compensation for our course and educational content professionals and technology development personnel during the quarter.

Net loss for the year of 2018 was RMB927 million, compared to RMB918.7 million in the year of 2017.

Basic and diluted net loss per share was RMB147.27 in the year of 2018.

Capital expenditures were incurred primarily in connection with purchases of buildings and IT infrastructure equipment necessary to support Sunlands' operations. Capital expenditures were RMB518.4 million and RMB398.9 million for the years ended December 31, 2018 and 2017, respectively.

For the first quarter of 2019, Sunlands currently expects net revenues to be between RMB550 million to RMB570 million, which would represent an increase of 35.3% to 40.3% year-over-year.

The above outlook is based on the current market conditions and reflects the Company's current and preliminary estimates of market and operating conditions and customer demand, which are all subject to substantial uncertainty.

With that, I'd like to open up the call to questions. Operator, please?

## **Questions and Answers**

Operator: Yes, 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). Alex Xie, Credit Suisse.

Alex Xie: So the first question is about our outlook for 2019, what are management expectations for the growth in 2019? And what are our key initiatives to drive growth?

And my second question is about GP margin of this quarter. I think the GP margin of fourth quarter is higher than the previous 3 quarters. Could management provide some explanations about it?

Steven Yipeng Li: Yes, for the first question, in terms of our guidance or outlook for the entire 2019, as of now, I don't think the Company has a very clear guidance or outlook for the entire year of 2019. As I mentioned during the call, our guidance for the first quarter of 2019 in terms of net revenues will be between RMB550 million and RMB570 million. I think that's what we can give right now in terms of the guidance.

However, for the year of 2019, as our CEO mentioned during his call, I think the most important thing for the Company is we will continue to offer more courses through our free trials, introduction seminars, and knowledge open programs, in order for our potential students to have more experience in terms of online learning, in terms of all the course offerings, the content, and the quality. I think those are the primary goals for the Company. We want to build up better brand awareness, offer better content to the students, but not really transfer those students into our paid students advance. Yes, so I think in terms of the strategy for 2019, we will continue to expand our course offerings from those perspectives.

For your second question, in terms of the gross profit margin for the fourth quarter of 2018, I believe that's only a little bit higher compared to previous quarters. Firstly, it is because our net revenues for fourth quarter actually continued to increase. Secondly, in terms of controlling the cost of the teachers and mentors for the fourth quarter of 2018, yes, the Company sees some progress from that regard too. So that's why our GP margin is just a little bit higher compared to previous quarters.

Alex Xie: Thank you.

Operator: Thank you. (Operator Instructions). All right. Showing no further questions, this will conclude the question-and-answer session. At this time, I'd like to turn the conference back over to Yingying Liu, Investor Relations Director, for closing remarks.

Yingying Liu: Once again, thank you, everyone, for joining today's call. We look forward to speaking with you again soon. Good day and good night.

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