[DNK] - Phoenix Tree Holdings Limited ("Danke")
Q4 and Fiscal Year 2019 Earnings Conference Call
Wednesday, March 25, 2020 08:00 AM Eastern Time

Executives
Kobe Ge, Director of Corporate Finance
Jing Gao, Co-Founder, Director, CEO
Jason Zhang, Chief Financial Officer

Analysts
Tina Long, Credit Suisse
Avery Chan, JPMorgan

Presentation

Operator: Good day, everyone, and welcome to the Danke Fourth Quarter and Fiscal 2019 Earnings Conference Call. Please note that today's call is being recorded.

I would now like to turn the conference call over to Mr. Kobe Ge, the Director of Corporate Finance. Please go ahead, sir.

Kobe Ge: Hello, everyone, and welcome to Danke's Fourth Quarter and Fiscal Year 2019 Earnings Conference Call. The Company's earning results were released earlier today and are also available on the Company's IR website.

Today, you will hear from Mr. Jing Gao, Co-Founder and Chief Executive Officer of Danke, and Jason Zhang, Chief Financial Officer of the Company.

During this call, the Company will be making some forward-looking statements regarding future events and results. These statements are made under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Statements that are not historical facts, including statements about Danke's beliefs and expectations are forward-looking statements. Forward-looking statements involve inherent risks and uncertainties. Further information regarding these and other risks is included in Danke's filings with the SEC.

All information provided today is as of the date of this call, and Danke does not undertake any obligation to update any forward-looking statement, except as required under applicable law.

With respect to any non-GAAP measures discussed during today's call, reconciliation information related to these measures can be found in the earning release issued earlier today.

With that said, I would like to turn this call over to Mr. Jing Gao, Co-Founder and CEO of Danke. Jing, please go ahead.

Jing Gao: (Speaking Foreign Language).

Kobe Ge: Okay. I'll translate it.

(Translated). Thank you, Kobe. Thank you for joining Danke's fourth quarter and fiscal year 2019 earnings conference call, which is also our first earning call as a public company. After 5 years of hard work and growth, we successfully completed our initial public offering on the New York Stock Exchange on January 17 this year. The IPO was an endorsement of our successful track record, launched us onto the international stage, and raised our brand recognition.

I'd like to take this opportunity to thank all of our investors, property owners, residents, employees, and third-party service providers in our ecosystem, for their tremendous support and trust. We will continue to work tirelessly to fulfill our mission to help people live better.

Let me now turn to our performance highlights during the fourth quarter and full fiscal year of 2019. We experienced rapid revenue growth during the period. Revenues for the fourth quarter of 2019 increased by 112.5% year-over-year to RMB2,129 million. For the fiscal year, revenues grew 166.5% to RMB7,129 million.

We also experienced fast growth in operating scale. Since our inception in 2015 until the end of 2019, Danke's footprint now covers 13 cities. In addition to Suzhou, Wuxi, Xi'an, and Chongqing, which we entered in 2019, we also provide our services in Beijing, Shenzhen, Shanghai, Hangzhou, Tianjin, Wuhan, Nanjing, Guangzhou, and Chengdu. In these first and second-tier cities, we provide apartment rental solutions for numerous city residents.

The number of apartment units grew 85.4% to more than 438,000 units as of the end of 2019. Of these, the number of units in Beijing, Shanghai, and Shenzhen grew 46.6% to close to 224,000 as of the end of 2019. The number of units in other cities grew 156.1% to close to 215,000 as of December 31, 2019. These numbers demonstrated our ability to duplicate our success across cities.

Supporting this ability is our innovative new rental business model, deeply-rooted technology DNA, strong supply chain management, and our team's outstanding execution capabilities.

Now, I will highlight some of our 2019 achievements. Technology differentiates Danke from its peers. In 2019, we took a step further in applying digital decisioning in the process. We created a system named after Lu Ban, the legendary Chinese carpenter, which incorporates laser imaging and machine visualization in an innovative way to completely automate apartment configuration and status recognition. The system not only enables us to optimize renovation plans, but also greatly reduces reliance on human judgment. The system is a first in the industry and already has more than 10 patents pending.

At the same time, Danke has strong capabilities in product offering and supply chain management. In 2019, we made new improvements in product design for further standardization. We continued to iterate optimizations in product design and style, while at the same time, further improved the functionality. No matter being a small room of only 8 square meters, or being the entire apartment, each unit is designed in a way to maximize space utilization and create a warm and comfortable atmosphere. At the same time, it applies our core beliefs of making renting a simpler and happier experience, with a feeling of home.

Also in 2019, we prioritized control of apartment air quality and took the industry lead. In April 2019, we raised the quality of the sheet materials used in our apartments, from the national standard of E1 to the highest E0 standard, and established strategic partnerships with the country's most well-known sheet material suppliers.

In July 2019, Danke formally launched an innovative intelligent ventilation system, which can effectively improve the air quality of newly-renovated apartments, a first in the industry as well. To date, we have installed more than 20,000 systems in cities including Hangzhou, Shanghai, Nanjing, and Wuhan.

We were also able to expand our financing channels in 2019. Working with many financial institutions, we launched several innovative financial products, including supply chain financing. These innovative products are the first in the industry, and can further improve our cash flow and financial product mix.

At Danke, we highly value our people. In 2019, we welcomed Michael, our COO; Jason, our CFO; Lillian, our CPO; and Bing, our CTO, to the senior management team. With decades of expertise in their respective fields and extensive leadership experience, they bring professionalism and global vision to the Danke team. In addition, their arrival has accelerated the construction of the Company's overall talent pool, continued the optimization of our talent discovery and development mechanism, and further improved the Company's corporate culture and operation efficiency.

Recently, we have collaborated with local government in developing co-living apartment business. As announced in our press release on March 18th of 2020, we entered into investment and cooperation agreements with the local government of Huaqiao Economic Development Zone in Kunshan, Jiangshu Province, China. Danke will make a capital contribution of RMB625 million in exchange for 51% equity interest in the joint venture, while Kunshan Yinqiao, an investment entity of the local government, will make a capital contribution of RMB600 million in exchange for the remaining 49% stake. The joint venture will use all the capital contributions to develop the co-living apartment business.

The local government expects to provide certain benefits and support to the local Danke entities, including but not limited to, assist with bank financing, offer talent retention incentives, and provide government awards.

Our path forward is not without its challenges, among which is the recent coronavirus, or the COVID-19 outbreak. Upon receiving news about the outbreak, we immediately implemented prevention and control measures to ensure the health and safety of our residents and supported the government's efforts to combat this virus.

On the first day of the Chinese New Year, we provided 800 apartment units in Wuhan for medical workers, free of charge, to provide them with a place to rest. In addition, we provided safety notifications and preventative guidelines to residents through multiple channels, immediately launched online travel detail registrations, and assisted residents with applying for neighborhood entry permits.

In addition, leveraging our online platform, we publicized various online facilitation services including launching an online, zero-contact apartment viewing and selection function. We are also the first in the industry to offer partial rental waivers to certain affected residents.

In response to the government and industry initiatives, we also discussed with property owners to offer a certain period of rent support so that we can overcome the present difficulties, together.

We expect adverse impacts on our business and financial performance from the COVID-19 outbreak. The delayed return of workers and the strict management of most cities and neighborhoods will present short-term impacts to our business growth. Since the outbreak, we also adjusted the number of apartment units we operated to counteract some of the adverse impacts on the occupancy rate.

In addition, we have been taking proactive actions to control our costs and expenses, including significantly slowing down the rate of sourcing and renovating additional apartment units.

Furthermore, our management team has volunteered for a pay cut during this difficult time.

We currently expect the impact of the outbreak to be short-term given some early signs of recovery in China, and remain confident in the long-term outlook of the industry and growth perspective. We will continue to monitor the rapidly-evolving situation in order to ensure the safety of our residents and employees.

Looking forward into 2020, we will continue to focus on our growth strategies, namely, enhancing our technological capabilities, further expanding our scale, expanding and enhancing product and service offerings, promoting our brand awareness and industry influence, as well as strengthening and expanding our ecosystem. As we continue to execute on our strategy and grow, we are confident in our ability to deliver long-term, sustainable value for our shareholders.

Now please allow me to turn the call over to our CFO, Mr. Jason Zhang. Jason, please go ahead.

Jason Zhang: Thank you, Kobe and Jing. I will now provide an update on our financial performance during the reporting quarter and the fiscal year. Please note that all numbers provided are in RMB terms, and that all comparisons are made on a year-over-year basis.

In the fourth quarter 2019, our revenues were RMB2,129 million, representing an increase of 113% year-over-year growth. The growth was primarily driven by an increase in the number of opened apartment units as a result of the continued expansion of our business, and also to a lesser extent, by the acquisition of Aishangzu in March 2019.

Operating expenses were RMB2,967 million, representing an increase of 96%. The components of operating expenses included rental costs, which increased 124% to RMB1,950 million. This growth was primarily due to an increase in the number of opened apartments units as a result of the business expansion.

Depreciation and amortization expenses increased 138% to RMB348 million as we increased the number of apartment units renovated and opened.

Other operating expenses increased 91% to RMB205 million. This was due to, first, an increase in cost of services as we operated more apartment units; and second, the increase of incentives for apartment sourcing, which resulted from additional commissions and lead generation fees; and third, an increase in payroll cost, primarily due to business expansion.

Pre-opening expense decreased 58% to RMB38 million. This was a lower number of pre-opening apartment units during the quarter compared to 2018, we strategically sourced a larger number of apartment units.

Sales and marketing expenses increased 34% to RMB245 million. This increase was due to, first, the increase of incentives for apartment renting as additional commissions and lead generation fees were incurred for renting out apartment units; and second, the enhancement of our advertising efforts; and third, an increase in payroll cost because of the business expansion.

G&A expenses increased 77% to RMB132 million due to the hiring of additional personnel, as Jing mentioned just now, for general corporate functions at the Company’s head office and also the regional managerial roles.

Technology and product development expenses increased 26% to RMB50 million. We expanded our technology team with additional and a more experienced research and development personnel to develop our technology system and to improve our product and service offerings.

As a result of the above, operating loss was RMB838 million compared to RMB509 million in 2018. Operating loss, as a percentage of revenues, improved by 12 percentage points.

Interest expenses were RMB99 million, representing an increase of 62%. The increase was attributable to additional bank loans and interest expenses related to rent financing, which was driven by the number of residents who opted for rent financing as more apartment units were rented out.

Net loss was RMB921 million compared to RMB557 million for the fourth quarter of 2018. Adjusted net loss, which represents net loss before share-based compensation and incentives for apartment sourcing, was RMB892 million compared to RMB543 million in the fourth quarter 2018. Both net loss margin and adjusted net loss margin improved by 12 percentage points.

EBITDA was negative RMB490 million compared to negative RMB363 million. EBITDA represents net loss before depreciation and amortization, interest expenses, interest income and income tax benefit or expense. Adjusted EBITDA was negative RMB461 million compared to negative RMB349 million. Adjusted EBIDA represents EBITDA before share-based compensation and incentives for apartment sourcing. Both EBITDA margin and adjusted EBITDA margin improved by 13 percentage points.

Now, let me provide an overview of full year 2019 results. Our full year revenue reached RMB 7,129 million, representing an increase of 167%.

Operating expenses were RMB10,280 million, representing an increase of 164%.

And the breakdown for operating expenses is as follows. Rental costs increased 195% to RMB6,400 million.

Depreciation and amortization expenses increased 205% to RMB1,138 million.

Other operating expenses increased 157% to RMB758 million.

Pre-opening expense decreased 17% to RMB224 million.

Sales and marketing expenses increased 120% to RMB1,038 million.

G&A expenses increased 159% to RMB527 million.

Technology and product development expenses increased 75% to RMB194 million.

As a result of the above, operating loss was RMB3,151 million compared to RMB1,221 million. Operating loss, as a percentage of revenues, improved by 2 percentage points.

Net loss was RMB3,437 million compared to RMB1,370 million in 2018. Adjusted loss was RMB3,347 million in 2019 compared to RMB1,333 million in 2018. Net loss margin and adjusted net loss margin both improved by 3 percentage points.

EBITDA was negative RMB2,013 million in 2019 compared to negative RMB853 million in 2018. Adjusted EBITDA was negative RMB1,922 million compared to negative RMB816 million in 2018. EBITDA margin and adjusted EBITDA margin both improved by 4 percentage points.

We had RMB3,455 million or approximately US$500 million in cash and restricted cash as of the end of 2019.

Our cash position remains strong, helped by the completion of our Series D financing in October 2019, and also our IPO on the New York Stock Exchange in January. We received US$190 million in Series D round, and also another US$128 million in our IPO.

Looking forward, we expect the revenue for the first quarter of 2020 to be between RMB1.9 billion and RMB2 billion.

This forecast reflects our current and preliminary views, which is subject to change.

This concludes our prepared remarks. Operator, we are now ready for questions.

Questions and Answers

Operator: Thank you. (Operator Instructions). Tina Long, Credit Suisse.

Tina Long: (Speaking Foreign Language). So I'll translate briefly. I just want to get updates because the COVID-19 situation in China is getting better every day. So I want to check if there's any updates on improvement, especially in March in major cities.

Jing Gao: (Speaking Foreign Language).

Kobe Ge: Yes, I'll get it translated.

(Translated). So basically, except for Beijing and Wuhan, we actually see early signs of good recoveries in China in terms of the overall coronavirus. As a result, we also see some level of improvement in terms of our business operations in all the other cities. And then but in Beijing and Wuhan, I think basically, especially in Beijing, there are some like import cases of the coronavirus. But other than that, I think we do see the signs of improvement.

Jason Zhang: And actually, and can see that in cities like in Beijing and Wuhan, that employees still quite strict (inaudible). And other cities, we can see that people are back to work and back to their normal life. And our business in the city, that in all units and are improving and increasing, but is still not as good as we expected, and -- yes.

Tina Long: (Speaking Foreign Language). So despite the imported case now in those tier-one cities, especially in Beijing and probably Shanghai, but all the other cities are seeing -- seen already, more or less, resume to work at a very fast speed. So the base case that we previously had was actually to have everything back to normal only in May. But given the current situation, will there be any chance that this base case will move forward?

Jing Gao: (Speaking Foreign Language).

Jason Zhang: Actually, we agree that if the conditions continue to improve and turns better, and except for Beijing and Shanghai, those couple of cities; and also Beijing, some other cities, and we're back to the normal life as well. And if the trend continues to be -- to a better direction, yes, we will look forward like our plan, and also like the expansion plan. But we'll keep monitor the changes.; and [if] the conditions change, and be ready to do that.

Tina Long: (Speaking Foreign Language).

Operator: (Operator Instructions). Avery Chan, JP Morgan.

Avery Chan: (Speaking Foreign Language). My first question is about kind of a follow on the COVID-19 impact. I was wondering whether management had any numbers that could quantify the recovery that we're seeing? And how does that revise our expansion plan in 2020?

And the second question is about any of the government is giving a subsidy on the Company, on the back of the virus situation?

And my third question is on the financial side, which is what's the upcoming maturity profile like for the offshore, and whether Danke can raise onshore corporate bonds from the business?

Jing Gao: (Speaking Foreign Language).

Jason Zhang: And actually, in terms of the virus impact to our business, as Jing mentioned just now, and there was a couple of metrics that shows, one, that the impact, including the occupancy rate, and of course, and because people slow down their pace back to cities, back to work, so the occupancy rate will impact by the slow.

And second, which is kind of the flow control by the communities in the big cities, and there are lots of check before you enter into the building and into the community, which will cause some of kind of actual work for us. And that's one thing.

And secondly, in terms of the growth rate, which means that our new source of apartment (inaudible) growth rate, and to keep our occupancy rate at reasonable and healthy kind of rate. So we will slow down and actually, we have already stopped the [first] new apartment until we see that the whole situation turns better, and which is we -- everything on the right track. And so the new source of apartment growth rate (inaudible), as Jing said just now, it slows down. And that's two kind of metrics that shows that the [net] impact to our business.

Second, in terms of the signs of recovery and what I can tell you that the data is (inaudible) apartment unit number. And in February, and since end of February, and in March, we can see that as (inaudible) data our business will improve quite a lot and keep at quite good kind of a level. So which -- that's why Jing mentioned just now that we have seen that the recovery is coming.

Jing Gao: Okay. (Speaking Foreign Language).

Jason Zhang: Okay. In terms of the -- for question two, yes, and during the virus, the period, and actually, the China government has offered a serious kind of benefits, or a federal policy to support the companies. And actually, we believe we are qualified to apply some of the benefit supports, and actually, we have a series of dialogs with local government and central government (inaudible) to apply for relevant to the benefits and supports. But actually, it's still in the process, so we will let the market know that how it goes, and when everything is like completed and finalized. Yes, but the dialog is in the process.

And second, in terms of the cooperation with the government, as Jing mentioned, we have the government collaboration with Huaqiao (inaudible) and we think that this is a right action and strategy for Danke. But as of now, we don’t have other kind of dialogs with other local government, and once we have any kind of a movement, we'll let you know.

And the fourth question was about the offshore maturities, and I think that Jing has already just outlined, it will mature after the [fourth] quarter of 2021, yes. We don’t think that will have an impact (inaudible) to our business. Okay.

Avery Chan: Thank you.

Operator: And there appear to be no further questions. I'd like to turn the call back over to management for closing remarks.

Kobe Ge: Thank you again for joining us on today's call, and we appreciate your ongoing support. If you have any questions or concerns, please do not hesitate to reach out to the Investor Relations team. That concludes the call. Thank you, and have a good day.

Operator: Thank you. This concludes today's conference. You may now disconnect your lines. And have a wonderful day.