Sunlands Technology Group [STG]
First Quarter 2019 Earnings Conference Call
Tuesday, May 28, 2019, 7:30 AM ET

Company Participants:
Yingying Liu; IR Director
Tongbo Liu; Chief Executive Officer
Steven Yipeng Li; Chief Financial Officer

Analyst Participants:
Alex Xie; Credit Suisse
Timothy Zhao; Goldman Sachs

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Sunlands' first quarter 2019 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 call over to your host today, Yingying Liu, Sunlands' IR Director. Please go ahead.

Yingying Liu: Hello, everyone, and thank you for joining Sunlands' first quarter 2019 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 second 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 in any forward-looking statement. 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' first quarter 2019 conference call. During this first quarter, we continued to advance our strategic initiatives to elevate our program offerings and strengthen our brand equity, with a keen focus on diversifying student acquisition methods, increasing accessibility, and enhancing user-friendly marketing techniques.

During the first quarter, we advanced each of these initiatives, including launching a new mobile app that broadens our subject domains and deepens our content offerings. This is a milestone and a starting point for Sunlands to build up our own free learning community and a self-developed traffic pool.

We successfully delivered revenue of RMB564 million for the first quarter, which is in line with our guidance and represents a 39% increase year-over-year. We also narrowed our net loss margin to 20%. Students are also spending more time on our platform. The average time spent on live-streaming classes grew 39.2% year-over-year for the first quarter.

As we discussed in the last earnings, we are working to further expand our free trial offerings to reach out to a wider population of prospective students. To realize that goal, more specifically, in Q1 we kicked off a free learning plan along with an independent mobile app, providing free short courses across professional domains and industries.

Launched in the end of January, the app is aimed to attract more students to our professional education and skills courses and, more importantly, to expand our own active students pool for future conversion in the long term. Since the launch of the app in late January to the end of the first quarter, Sunlands' new mobile app had registered users of 250,000.

As we know, for an adult online free learning platform to achieve scale and activity at the same time is not an easy task, but with our one-to-many live streaming model, we can attract students more easily and add courses and content more easily.

Currently, we provide more than 20 free short course offerings that target an expanded student demographic, while utilizing our existing infrastructure and maintaining a low-cost structure. This key demographic of professionals who are already in the workforce, along with those looking to obtain a university degree, represent an opportunity for us to further grow our business.

As we have discussed in the past, one of the main ways we are attracting new students to our program is through free introductory seminars and free trials of common subjects among the 18 STE majors we provide. We continue to add to this selection to deepen our connections with those prospective students looking for support to upgrade their degree and education credentials.

By providing potential students with an overview of our course offerings, along with a way to experience selected introductory courses at low or no cost, they are able to see if our program is a good fit for them. This method allows us to not only build a base of committed students, but also improve the way our brand and courses are perceived.

Thanks to this change in outreach, we are seeing a shift in our relationships with our students.

We are beginning to be viewed as more collaborative, acting as partners with our students rather than holding a role as a vendor.

When we became a listed company, we stated that our business focused on three main categories -- STE, master degree offerings, and professional certification offerings. As of the end of the Q1 2019, we can see that the popularity of our master-oriented products is growing rapidly.

The percentage of gross billing for master-oriented products is up significantly to more than 10% by the end of Q1, comparing to 3.2% of gross billing in 2017 and 5.5% of gross billing in 2018. This clearly shows there is a ready market for this offering.

The synergies of our proprietary AI technology and the industry-leading adult online education programs are paving the way for sustainable growth over the longer term. Many of the programs that began last year are showing early signs of traction. While we are not yet realizing the financial benefits of these newer initiatives, we believe once they take hold, they will help us build an even broader base of paying students, gaining us faster recruiting cycles, directly increasing student enrollment numbers, and positively impacting our gross billings.

Our expansion and retention plan for 2019 follows a five-pronged approach. First, we are continuing to enrich and upgrade our existing trial programs. We are adding STE courses, and we are building out our professional certificate programs to reach a high-quality constituency.

Second, we are hiring and training live-streaming teachers suitable for our adult students. We believe we have a talented pool of educators who are attracted to our competitive compensation structure, which will also help us to retain this talent.

Third, we are cultivating a unique online learning community. We actively encourage our students to interact with our teachers, mentors and each other. Building these important relationships reinforced our students' commitments to our programs, improved referrals, and helps solidify our leading reputation.

Fourth, we are enhancing our technology in order to improve our students' ability to learn efficiently, reduce study time, and support their overall success.

Finally, we are continuing to expand our range to cover more attractive course offerings that help our students achieve their post-secondary and professional education goals. At the same time, we are offering more diverse trial programs and deploying more effective after-sales services, all in an effort to attract more students and strengthen our position as a market leader.

With our best-in-class technology, high-quality educational content and one-to-many business model, we believe we are well-positioned to seize the tremendous growth opportunity before us.

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

Steven Yipeng Li: Thank you, Tongbo, and hello, everyone. Thanks for joining us.

We are pleased to report revenue in line with our guidance for the first quarter. While the seasonal slowdown due to Chinese New Year, softer marketing tactics and our expanded trial programs negatively impacted student enrollments and gross billings, we are confident that our upgraded free trials, introductory seminars and free short courses for graduates, post-graduates and professionals can increase average gross billings, conversion rates and sales efficiency over the long term.

Let me walk you through some of the key financial results for the first quarter. In the first quarter of 2019, net revenues increased by 38.8% to RMB564.2 million, from RMB406.4 million in the first quarter of 2018. The increase was mainly driven by the growth in the number of students in the first quarter of 2019 compared to the first quarter of 2018, following a continuous increase in new student enrollments over the past years.

Cost of revenues increased by 20.9% to RMB85.5 million in the first quarter of 2019, from RMB70.7 million in the first quarter of 2018, which was primarily due to the increase in the compensation for faculty members. Gross profit increased by 42.6% to RMB478.7 million, from RMB335.7 million in the first quarter of 2018.

In the first quarter of 2019, operating expenses were RMB612.7 million, representing a 4.2% increase from RMB588.3 million in the first quarter of 2018. Sales and marketing expenses were RMB497.3 million in the first quarter of 2019, compared to RMB499 million in the first quarter of 2018.

General and administrative expenses increased by 13.8% to RMB88.4 million in the first quarter of 2019, from RMB77.7 million in the first quarter of 2018. The increase was mainly due to the increase in compensation, mainly as a result of hiring more R&D talent to strengthen our IT infrastructure and R&D capabilities.

Product development expenses increased by 132.7% to RMB27 million in the first quarter of 2019, from RMB11.6 million in the first quarter of 2018. The increase was primarily due to an increase in the number of employees and the compensation paid to our course and educational content professionals and technology development personnel during the first quarter.

Net loss for the first quarter of 2019 was RMB112.9 million, compared with RMB245.2 million in the first quarter of 2018. Basic and diluted net loss per share was RMB16.48 in the first quarter of 2019.

As of March 31, 2019, we had RMB1.3 billion of cash and cash equivalents and RMB836.8 million of short-term investments. These compared to RMB1.2 billion of cash and cash equivalents and RMB1 billion of short-term investments as of December 31, 2018. Our deferred revenue balance as of March 31, 2019, was RMB3.4 billion.

Capital expenditures were RMB1.1 million in the first quarter of 2019. This compares to RMB147.7 million in the first quarter of 2018. Capital expenditures were incurred primarily in connection with purchases of buildings and IT infrastructure equipment necessary to support our operations.

For the second quarter of 2019, we currently expect our net revenues to be between RMB550 million to RMB570 million, which would represent an increase of 14.2% to 18.3% year-over-year.

Before opening the call to your questions, I want to mention that in order to enhance user experience, we have recently changed certain terms of our refund policy, which are applicable to new student orders. We believe that this will enhance our branding and reputation by enabling a more flexible and smoother refund process. We expect that as a result of the new terms, our annual refund rate for 2019 will be higher than 2018.

With that, I would like to open up the call to questions. Operator?

Questions and Answers

Operator: (Operator Instructions) Alex Xie, Credit Suisse.

Alex Xie: So my first question is about regulations. I noticed that the Beijing government just conducted inspections of Sunlands' operations in April. I'm wondering what are the results of government reviews and what the government required Sunlands to change. And my second question is about our OpEx. I noticed a significant quarter-over-quarter decrease in our G&A expenses. Can management share more color on the reason behind such a decrease? And what about our headcount change in this quarter? Thank you.

Steven Yipeng Li

Okay. Regarding the first question, yes, you may have read from the recent public news that we did have some conversations with the government, and as of now, there is no final decision made by any party yet. Basically, one of the major topics we had a discussion with the government is regarding the user experience and refund process. Actually, that's part of the reason why we had this change of new terms, and we believe with our new refund terms, that will both enhance the user experience and satisfy the requirements from the government.

Regarding your second question, the decrease on the G&A expense quarter-over-quarter, this was mainly due to the higher efficiency of our employee, and also we -- like you mentioned, the number of our employees, especially the R&D team, we did see some decrease over there, since we -- right now we work in a more effective manner.

Operator: Timothy Zhao, Goldman Sachs.

Timothy Zhao: There are two questions from my side. First question is that, I think in this quarter, we see a big hike in the ASP, or the average gross billing per student, either on a year-on-year or quarter-on-quarter basis. Could you share more color on what is behind this price increase and how should we think about this trend going forward? And the second one is with this higher ASP trend and also the higher refund rate that you mentioned, can you talk about the trend of the gross billings and student enrollment for the rest of this year, or when shall we expect them to return back to growth? Thank you.

Steven Yipeng Li: Okay. For the first quarter, I think our CEO, Tongbo, mentioned just now that right now the master-oriented products, as a percentage of our gross billings, has been increasing a lot for Q1. Right now, the master-oriented products -- the gross billings for the master-oriented products right now account for more than 10% of our total gross billings. That's up from only 3% from 2017 and 5% from 2018. And those master-oriented products currently have a much higher ASP compared to the STE course. I think this is one of the major reasons why we have a higher ASP for Q1.

And as for the trend, we expect as we diversify our course offerings, as we expand our course offerings, the percentage of master-oriented products and professional certification offerings will continue to increase in the future. Yes, so we are very confident the -- our average -- the price -- our average gross billings will continue to increase as well.

And for your second question, as for the trend for the rest of this year, since right now this is only the beginning of the year, we are still expanding our free short courses, our free trials, introduction seminars, and also expand our course offerings. As of now, we are not entirely sure what this trend will be, but we are pretty confident as we offer more course offerings, as we -- along with the change of refund policy, as we continue to enhance the user experience, we will see a continuous increase new student enrollments and gross billings for the rest of the year.

Timothy Zhao: Just a quick follow-up. So another follow-up question is if we look at the sales and marketing cost per enrollment, this number seems a bit higher for this quarter. Could you share a little more color on what is behind this cost increase?

Steven Yipeng Li: I think for this quarter, the sales mark -- sales and marketing expense per student is roughly the same as the last quarter. While I think, as you may know, the traffic (inaudible) cost has been increasing for the past year or two. I think this is not just an issue for us, but is an issue for -- this is a challenge for everyone. And that's the reason why we have those new short courses. I think Tongbo, our CEO, also mentioned we want to establish our own traffic pool so that in the future -- I think we believe this will be a very efficient way for us to decrease the sales and marketing expense per student.

Operator: I'm showing no further questions. This will conclude our question-and-answer session. At this time, I would like to turn the conference back over to Yingying Liu, Investor Relations Director, for any 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: This concludes the earnings conference call. You may now disconnect your line. Thank you.