Sunlands Technology Group [STG]
Third Quarter 2019 Earnings Conference Call
Friday, November 22, 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

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Sunlands' third 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' third 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 fourth quarter of 2019. Following their prepared remarks, we will move into the Q&A session.

Before I hand it 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 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' third quarter 2019 conference call. During the third quarter, we continued to focus on a diversified set of student acquisition methods to attract more students to our online platform.

Driven by these initiatives, our third quarter top line reached RMB527.3 million, which was in line with our guidance and represented a 2% increase year-over-year.

We also narrowed our net loss margin to 24.6% in the third quarter versus 43.8% in the same period last year, as we continued to manage costs and expenses.

During the third quarter, we continued to advance our strategic initiatives and add new product features in an effort to promote our brands and improve the quality of courses and services we bring to our students. Our strategic initiatives also include the relentless pursuit of cutting-edge technologies, particularly with an emphasis on applying AI to education, as we strive to further differentiate our offerings.

Through data mining our vast database of learning records, and leveraging our integrated AI technology, we are able to analyze individual learning habits, and develop personalized study plans for our students, so that their learning can be more efficient and targeted. We also use AI technology to analyze our massive database of historical examination questions in order to predict the most frequent test knowledge points and optimize our test preparation materials.

Moreover, artificial intelligence plays an essential role in Sunlands' internal management to improve quality of services for student education and training, as well as protect students' rights. For example, all phone calls to our students are monitored by our AI system, which can detect sensitive words and protocol violations, and immediately sends an alert for corrective action.

Data analysis is also the foundation of our recruitment process. We have detailed data records for candidate profiling, interview results and training that facilitate recruitment and internal staff promotions.

Next, let me provide some specifics on several of our key highlights of the quarter. First, as we mentioned in previous earnings calls, we are strengthening our strategic emphasis on non-STE products with master's-oriented products growing rapidly. With an increasingly diversified portfolio of educational products, we are enjoying a more balanced revenue mix.

Our master's-oriented products continue to attract interests from students, increasing to 16.9% of gross billings at the end of the third quarter, from approximately 5.9% at the end of Q3 2018. The solid growth was attributable to favorable supply and demand dynamics for master's degree programs in China, as we elaborated during the last quarter's earnings call, and also to our efforts in developing products designed specifically to match the needs of prospective students in this segment.

It is worth mentioning that we and one of our international partnership universities hosted the first graduation ceremony of our international MBA program. Many students far away from the venue also attended the ceremony and showed how much they had enjoyed the courses, which symbolizes our first milestone and proves the effectiveness of our revolutionary OPM model.

We are more than ever convinced that continuing to expand our master's-oriented products will help more people benefit from learning, and help eliminate the information and the cognition gap resulting from historical, geographic, cultural and economic factors.

We are more than ever determined to expand our online international master programs, to bring high quality and higher education resources from Europe and the United States to students in China and share China's education resources with other developing countries.

We are confident we will continue to capture the market opportunities for higher education, as we provide programs in response to ever-evolving market needs.

Second, our mobile app, Sunlands Speed Edition, which we launched in January, continues to gain popularity among students due to its easy accessibility, fast interaction speed and minimal memory storage requirements. By the end of the third quarter, users of this app reached 6.3 million, increasing further from nearly 1 million users at the end of second quarter, and 250,000 as of the end of the first quarter.

We also continuously upgraded and diversified our WeChat mini-programs, which are designed to allow students to maximize their study time on their mobile devices. Through the efficient use of time fragments, we saw an increasing number of exam preparation questions completed by our students, which we believe will lead to higher pass rates going forward.

Lastly, while we are optimistic about the long-term growth of our gross billings and new student enrollment, we also continue to seek balanced top line and bottom line performance.

In the third quarter, our net loss narrowed by 42.6% year-over-year, to RMB129.8 million, as we prudently managed our expenses. With our leading technology, high-quality educational content and one-to-many business model, we are confident in our ability to grow and be the market leader in China's adult online education industry.

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.

For the third quarter, our net revenues were RMB527.3 million, in line with our guidance. Our gross billings and new student enrollment declined by 18.8% and 20.8%, respectively, year-over-year, as we continued to adjust marketing expenses in view of uncertainties in student acquisition costs and macroeconomic trends. However, the rates of decrease moderated from the second quarter, which shows our student acquisition efforts are gaining traction.

In addition, as Tongbo just mentioned, following the improvement in net loss in the second quarter, in the third quarter, our net loss narrowed again, year-over-year, to RMB129.8 million, compared with a loss of RMB226.3 million in third quarter of 2018, primarily as a result of reduced administrative expenses and sales and marketing expenses. Going forward, we will continue with steady execution of our five-pronged expansion and retention strategies to bring long-term returns for both our customers and shareholders.

Now, let me walk you through some of the key financial results for the third quarter. In the third quarter of 2019, net revenues increased by 2% to RMB527.3 million from RMB517 million in the third quarter of 2018. The increase was mainly driven by the growth in the number of students in the third quarter of 2019 compared with the third quarter of 2018, following new student enrollments increase over the past years.

Cost of revenues increased by 22.7% to RMB113.7 million in the third quarter of 2019 from RMB92.7 million in the third quarter of 2018, which was primarily due to the insurance premiums related to online education services with insurance coverage since late in 2018.

Gross profit decreased by 2.5% to RMB413.6 million from RMB424.4 million in the third quarter of 2018.

In the third quarter of 2019, operating expenses were RMB546.9 million, representing a 21.5% decrease from RMB696.3 million in the third quarter of 2018.

Sales and marketing expenses decreased by 20.8% to RMB429.2 million in the third quarter of 2019 from RMB542 million in the third quarter of 2018. The decrease was mainly due to reduced marketing spending, reflective of disciplined, prudent cost management, and the decrease in the expense of sales and marketing personnel.

General and administrative expenses decreased by 30.4% to RMB91.3 million in the third quarter of 2019 from RMB131.1 million in the third quarter of 2018.

Product development expenses increased by 14% to RMB26.4 million in the third quarter of 2019 from RMB23.2 million in the third quarter of 2018. The increase was primarily due to an increase in the number of employees and compensation paid to Sunlands' product and technology development personnel during the quarter.

Net loss for the third quarter of 2019 was RMB129.8 million, compared with RMB226.3 million in the third quarter of 2018.

Basic and diluted net loss per share was RMB19 in the third quarter of 2019.

As of September 30, 2019, the Company had RMB1,569.4 million of cash and cash equivalents and RMB208.8 million of short-term investments, compared with RMB1,248.8 million of cash and cash equivalents and RMB1,028.6 million of short-term investments as of December 31, 2018.

As of September 30, 2019, the Company had a deferred revenue balance of RMB3,214.6 million, compared with RMB3,286 million as of December 31, 2018.

Capital expenditures were incurred primarily in connection with purchases of buildings and IT infrastructure equipment necessary to support Sunlands' operations. Capital expenditures were RMB11.8 million in the third quarter of 2019, compared with RMB10.3 million in the third quarter of 2018.

And in terms of the key financial results for the first 9 months of 2019, let me walk you in the details too. In the first 9 months of 2019, net revenues increased by 17% to RMB1,644.2 million from RMB1,405.2 million in the first 9 months of 2018.

Cost of revenues increased by 17.1% to RMB294.8 million in the first 9 months of 2019 from RMB251.9 million in the first 9 months of 2018.

Gross profit increased by 17% to RMB1,349.4 million from RMB1,153.3 million in the first 9 months of 2018.

In the first 9 months of 2019, operating expenses were RMB1,658.3 million, representing a 15.9% decrease from RMB1,972.9 million in the first 9 months of 2018.

Sales and marketing expenses decreased by 18.9% to RMB1,316.2 million in the first 9 months of 2019 from RMB1,622.7 million in the first 9 months of 2018.

General and administrative expenses decreased by 12.1% to RMB264.7 million in the first 9 months of 2019 from RMB301.1 million in the first 9 months of 2018.

Product development expenses increased by 57.8% to RMB77.4 million in the first 9 months of 2019 from RMB49.1 million in the first 9 months of 2018.

Net loss for the first 9 months of 2019 was RMB255.6 million, compared with RMB743.3 million in the first 9 months of 2018.

Basic and diluted net loss per share was RMB37.36 in the first 9 months of 2019, compared with RMB121.93 in the first 9 months 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 RMB15.1 million in the first 9 months of 2019, compared with RMB255.3 million in the first 9 months of 2018.

For the fourth quarter of 2019, Sunlands currently expects net revenues to be between RMB520 million to RMB540 million, which would represent a decrease of 5.1% to 8.6% year-over-year.

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

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

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Alex Xie of Credit Suisse.

Alex Xie: So my observation is that in Q3 compared with Q2, we have Q-on-Q growth in terms of gross billings and new student enrollments. But at the same time, our net loss also increased Q-on-Q. So will management share your thoughts on what will be your priority in the future, are you still going to boost the gross billings growth, or to continue to narrow the loss?

Steven Yipeng Li: Thank you for the question. Yes, like you mentioned, the gross billings for the third quarter, we see an increase compared to the second quarter. Also, the loss is bigger for the third quarter and that's primarily due to the additional spending on the sales and marketing expenses. As you may know, most of the sales and marketing expenses are recorded at once right after the gross billing, but most of the gross billings will be deferred, and be recognized as revenue in the future periods. So that's the reason why the loss for the third quarter is bigger than the loss for the second quarter.

But as we mentioned during the call, the Company, for the past few quarters, we continue to try out different ways to control our costs, control the general and administrative expenses, control the sales and marketing expenses, and we have seen some results from our actions. So in the future, I think our number one priority is still to get more market share. That's our number one goal, but at the same time, we believe we can still control our costs and all the expenses and continue to narrow our loss.

Alex Xie: Thank you.

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

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

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