

**Sunlands Online Education Group [STG]
Q2 2020 Earnings Conference Call
August 14, 2020 7:30 AM**

Executives

Yuhua Ye, IR Representative
Tongbo Liu, CEO and Director
Selena Lv, CFO and Director

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Sunlands' Second Quarter 2020 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, Yuhua Ye, Sunlands' IR Representative. Please go ahead.

Yuhua Ye: Hello, everyone, and thank you for joining Sunlands' second quarter 2020 earnings conference call. The Company's financial and operating results were issued in a press release via newswire services earlier today and are posted online. You can download the earnings press release and sign up for our distribution list by visiting our IR website.

On the call, our CEO Tongbo Liu will provide an update on our operational performance, as well as our strategic initiatives. Our CFO Selena Lu will give you an overview of our financial performance, and also provide our guidance for the second quarter of 2020. 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 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, Yuhua. Hello, everyone. Welcome to Sunlands' second quarter 2020 conference call.

While the COVID-19 pandemic in China was effectively contained during the second quarter, due to the varying work resumption requirements in different regions, the average resumption rate of our Wuhan campus and the headquarters in Beijing was about 80%. Against this backdrop, we are pleased with maintaining steady growth in the second quarter, thanks to our self-developed collaborative online office system, efficient operation management and rigorous execution.

We achieved satisfactory financial results for the quarter. Our net revenues reached RMB512.5 million, in line with our guidance.

Additionally, we are proud to say that our more than 8,000 employees in 4 cities are all safe and sound.

Our gross billings achieved year-over-year growth for the first time in 5 quarters, increasing by 21.3% to RMB531.5 million compared with the prior-year period.

In addition, new student enrollments increased by 10.2% year-over-year. The increases were mainly driven by our strategy to diversify product and service offerings, continuous expansion in training course categories, improved efficiency of our sales team, as well as tremendous efforts from all of our employees.

Next, let me provide highlights at the business segment level. Our business mainly focuses on 3 categories: STE, Master's degree-oriented programs, and professional certification and skills programs. Our STE programs have maintained a solid market position and market share, and the Master's degree-oriented programs have become our strong new growth driver.

According to Ministry of Education, the number of applicants for postgraduate programs are expected to reach a record high of 3.41 million, representing an increase of 510,000, or a 17.6% year-over-year from 2.9 million in 2019. In response to the strong growth of applicants, the Ministry of Education made an announcement in February to expand the number of admissions in 2020 by 189,000 from last year's level.

The ever-expanding number of people taking the Postgraduate Admission Test comes from the rising pressure of employment in China and the increasing demand for talents with higher education from enterprises.

According to China Education Online, former students, mostly working professionals, accounted for 45% of those taking the Postgraduate Admission Test in 2018. Leveraging our student acquisition experience and service advantages for this group of people, we focus on providing the Postgraduate Admission Test preparations for working professionals and have achieved remarkable results.

Our Master's degree-oriented programs have grown year-over-year for 8 consecutive quarters. Gross billings of Master's degree-oriented programs for this quarter reached a new high of RMB135.2 million, up 58.7% year-over-year and accounting for 25.4% of total gross billings.

This proportion was significantly higher than 2019 and 2018, during which our Master's degree-oriented programs accounted for only 17.9% and 5.5% of gross billings, respectively.

At the same time, based on student demands and new market trends, Sunlands is also actively expanding our course offerings in multiple categories, including professional certifications and trainings related to new occupations, as well as new skills and hobbies training catering to persons' diverse interests. This segment reached RMB59.5 million in gross billings this quarter, up 58.4% year-over-year, accounting for 11.2% of total, compared with 6.9% in 2019.

We expect continued robust growth for this segment, as its ASP is relatively low at approximately RMB3,000. And we are in the process of adding more courses for our new and existing students to experience on our live teaching platform. We are pleased to see that as these new categories of courses are much shorter than degree courses, students are stickier and have a higher repurchase rate, which we expect to contribute positively to our profitability improvement.

In the future, we will continue to take advantage of the STG platform and our teachers' rich teaching experience, constantly develop more online short-term courses suitable for adults, in order to expand our target user base and promote cross-selling.

Lastly, due to the postponement of the national STE exams from April to August, gross billings of STE programs, our largest business segment, also increased by 6.8% year over year in the second quarter, as both new student enrollments and ASP increased.

In the second quarter, our students, including those taking trial and free classes, showed greater enthusiasm to study during the pandemic period, as we continuously optimized our three-teacher system. This system refers to our comprehensive solution that combines live streaming lecturers, after-class mentors and AI-powered personal tutors.

In this quarter, total time spent on online classes on our learning platform was 22.3 million hours, increasing 64% year-over-year and 25% quarter-over-quarter. The total number of online class attendees reached 758,000, and the average time spent this quarter for each student was almost 30 hours.

An interesting fact was that, of total time spent on live streaming classes during this quarter, nearly 5.5 million hours or about 24.5% were driven by students spending time on pre-sale trial or free courses, including various new courses and mini tutorials. This was 8 times higher compared to the level in the same period last year and 7 times higher versus last quarter.

In addition, trial class students accounted for 27% of total students attending classes this quarter. Through the trial program, we enable prospective students to experience our course contents and teaching services in advance, which not only improves the retention rate of new students and expands our potential user pool, but also helps us develop a deeper understand of student interests and realize additional cross-selling potentials.

Looking forward, we are confident to maintain the market-leading position of our existing service categories and continuously improve the learning effectiveness of our students through

technical and operational advancement. We are also optimistic of the market opportunities and the possibilities of cross-selling as we develop new contents and execute on our efficient student acquisition strategy.

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

Selena Lv: Thank you, Tongbo, and hello, everyone. During the second quarter, our net revenues declined 7.3% year-over-year due to the decrease of gross billings last year. However, we are pleased that even against the backdrop of pandemic and severe macroeconomic environment, our gross billings achieved a more than 20% year-over-year growth, reaching an important inflection point, and giving us confidence in its continuous growth in the future.

We also noticed a greater change in the product mix of our gross billings. The proportions of Master's degree-oriented programs, and professional certification and skills programs within our total gross billings, both further increased. Since the service periods of these 2 categories are much shorter compared with our STE offerings, their increasing proportions will accelerate our revenue recognition and reduce the time gap due to mismatch between revenue recognition over time and expenses booking upfront.

On the expense side, we continued our pursuit of cost structure optimization, achieving 33.9% and 33.6% reductions in administrative expenses and R&D expenses respectively compared with the same period last year.

Going forward, our focus remains on the diversification of our online courses and the improvement of our technology and operational capabilities. More product offerings translate to bigger addressable market for us and higher cost leverage, as well as increasing repurchasing potential from our students, whereas technological and operational improvement provides our students better experiences, which will further strengthen our brand image and reputation, and ultimately improve our referral rate.

We will also continue diversifying our student acquisition strategy and upgrading our conversion model, all in an effort to further improve our sales conversion rate and efficiency, and drive sustainable long-term growth.

Now, let me walk you through some of the key financial results for the second quarter of 2020. All comparisons are year-over-year and all numbers are in RMB.

In the second quarter of 2020, net revenues were RMB512.5 million, decreased by 7.3% year-over-year, mainly due to the decrease of gross billings last year.

Cost of revenues increased by 4.1% to RMB99.6 million in the second quarter of 2020 from RMB 95.7 million in the second quarter of 2019, which was primarily due to an increase in expenses related to service fees to educational institutions.

Gross profit decreased by 9.7% to RMB412.9 million from RMB457 million in the second quarter of 2019.

In the second quarter of 2020, operating expenses were RMB560 million, representing a 12.3% increase from RMB498.7 million in the second quarter of 2019.

Sales and marketing expenses increased by 25.2% to RMB487.9 million in the second quarter of 2020 from RMB389.7 million in the second quarter of 2019. The increase was mainly due to increases in, number one, compensation paid to our sales and marketing personnel, and number two, spending on branding and marketing activities, including investments in broadening our diversified student acquisition channels.

General and administrative expenses was RMB56.1 million in the second quarter of 2020, decreased by 33.9% year-over-year mainly due to the decrease in compensation expenses.

Product development expenses decreased by 33.6% to RMB16 million in the second quarter of 2020 from RMB24 million in the second quarter of 2019. The decrease was primarily due to a decrease in the compensation incurred related to our product and technology development personnel during the quarter.

Other income increased to RMB17.5 million in the second quarter of 2020 from RMB9 million in the second quarter of 2019. The increase was primarily due to the value-added tax exemptions offered by the relevant authorities in an amount of RMB15 million during the COVID-19 outbreak.

Net loss for the second quarter of 2020 was RMB126.1 million, compared with RMB12.9 million in the second quarter of 2019.

Basic and diluted net loss per share was RMB18.70 in the second quarter of 2020.

As of June 30, 2020, the Company had RMB1,079.4 million of cash and cash equivalents and RMB288.6 million of short-term investments.

As of June 30, 2020, the Company had a deferred revenue balance of RMB3,066.6 million, compared with RMB3,228.8 million as of December 31, 2019.

Capital expenditures were incurred primarily in connection with IT infrastructure equipment and leasehold improvement necessary to support Sunlands' operations. Capital expenditures were RMB1 million in the second quarter of 2020, compared with RMB2.2 million in the second quarter of 2019.

For the third quarter of 2020, Sunlands currently expects net revenues to be between RMB500 million to RMB520 million, which would represent a decrease of 5.2% to 1.4% 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?

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (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 management for any closing remarks.

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