[DNK] - Phoenix Tree Holdings Limited ("Danke")
Q1 2020 Earnings Conference Call
Wednesday, June 10, 2020 08:00 AM Eastern Time

Executives
Kobe Ge, Director of Corporate Finance
Derek Shen, Chairman
Jason Zhang, Chief Financial Officer

Presentation

Operator: Ladies and gentlemen, welcome to Danke’s First Quarter 2020 Earnings Conference Call. All participants will be in listen-only mode during management's prepared remarks, and there will be a question-and-answer session to follow. Today's conference is being recorded.

At this time, I would like to turn the call over to Mr. Kobe Ge, Director of Corporate Finance at Danke, for opening remarks and introductions. Please go ahead.

Kobe Ge: Thanks, Operator. Hello, everyone, and welcome to Danke’s first quarter 2020 earnings conference call. The Company's earnings results were released earlier today and are available on the Company's IR Website at ir.danke.com.

Please note that the discussion today contains forward-looking statements made under the Safe Harbor provisions of the United States 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 statements, 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 earnings release issued earlier today.

Now, allow me to introduce the management team on the call today. Mr. Derek Shen, Chairman of Danke, will discuss business updates for the quarter. Mr. Jason Zhang, our CFO, will provide financial highlights. Following management's prepared remarks, we will open up the call to the questions.

With that said, I would now like to turn the call over to Mr. Derek Shen, Chairman of Danke. Derek, please go ahead.

Derek Shen: Thank you, Kobe, and thank you all for joining us on our first quarter 2020 conference call.

Thanks to the hard work and dedication of our team, we continued our strong execution during the quarter despite the challenges of COVID-19. We operated approximately 420,000 apartment units as of March 31, 2020, and our revenue for the quarter increased 63% year-over-year. In addition, we continued to see improvements in our margins, and Jason will discuss these financial improvements later in greater detail.

Similar to many companies around the world, our business was adversely impacted by the COVID-19 outbreak. Our apartment units in Wuhan, and our local operations in the city, were adversely impacted when various travel restrictions and quarantine measures were implemented, starting from an unexpected and unprecedented lockdown of the City of Wuhan on January 23, 2020. With the spread of COVID-19 pandemic throughout China, our business and operations in other cities were also challenged.

As a result, the occupancy rate of our apartment units decreased during the quarter, as many residents delayed their return to work, which in turn, had a negative impact on our revenues.

We took measures to counteract some of the adverse impacts from the decrease in occupancy rate, including reducing the rate of sourcing and renovation of additional apartment units, and negotiating with property owners for early termination of certain leases. As a result, the number of apartment units we operated decreased sequentially.

At the same time, the health and safety of our residents and employees is of paramount importance, and we implemented various preventative and control measures during the quarter. For example, we are providing best-in-class services to help residents stay clean and healthy as part of the Company's commitment to deliver high-quality, one-stop services that allow a hassle-free living experience.

Our in-house cleaning and maintenance services team allows us to respond in a timely way, and provide superior and consistent services to our residents. During the COVID-19 pandemic, Danke has taken quick action to make sure that its sales teams, housekeepers, and maintenance staff all take the necessary precautions to provide safe services to its residents.

With the pandemic outbreak seems to be under control in China, we have started to see an early sign of recovery recently. As the Chinese government began relaxing its travel restrictions and quarantine measures in recent weeks, more residents have begun to return to the cities where they work. As a result, our recent data indicates that both the rate of renting out our apartment units and our occupancy rate have shown improvements since the COVID-19 outbreak.

Throughout the challenging environment, we remained focused on our strategic growth priorities and made a few more achievements. First of all, I am excited to say that we are the first co-living platform in the world to obtain international industry recognition for the high quality of a co-living project.

The International WELL Building Institute awarded the WELL Building Standard for our Model Room Center in Beijing. The WELL Building Standard is a global benchmark for healthy communities. Its rating system consists of more than 100 evaluation standards in 7 categories, including air, mind, nourishment, comfort, light, water, and fitness. It has always been a priority for us to provide safe, healthy, and comfortable living environments for our residents, and we are proud that our efforts have been recognized on an international level.

Secondly, we launched our Co-living Apartment Indoor Air Quality Control Standard, which is the first in China's residential rental industry. Our standard consists of 5 components, including sourcing and design, procurement of materials, renovation and furnishing, inspection, and maintenance. Developed in conjunction with the China Environmental United Certification Center, a state-owned enterprise affiliated with the Ministry of Ecology and Environment of China, the standard was evaluated and approved by experts from across China's leading real estate and standardization institutions.

This standard further reflects our commitment to our residents' safety, health, and comfort, and we hope to enhance consumers' trust and satisfaction with Danke, as well as lead the co-living rental industry towards greener and more sustainable development.

Lastly, to improve our brand awareness, we have gained Guo Ailun, a popular player in the Chinese Basketball Association, as the brand ambassador for our Starling Project. The Starling Project, which we launched in 2016, aims to help college graduates find affordable apartments in their desired cities. Through the program, we have helped more than 1 million graduates from over 2,000 colleges and universities in the past 5 years. Guo Ailun's positive personality, energetic attitude, and confidence will set an optimistic and reassuring tone for our program this year, as a record 8.74 million college graduates will need to find suitable housing during this challenging time.

We are confident in the long-term outlook of our industry and our Company. We will remain focused on our core mission and growth strategies, which include improving our technology, products and services, ecosystem, and brand awareness. Our goals also include leveraging technology to better serve our residents, such as by improving our housing matching system and responding to residents' needs more accurately and in a more timely manner. In addition, we will further improve our management team's efficiency, as well as recognize, identify, and deploy more talent.

We believe our team, resources, and ability to execute will enable us to navigate through the pandemic and macro headwinds to develop long-term, sustainable value for our shareholders.

Meanwhile, we will also leverage our strengths to help alleviate the impact wrought by the epidemic, such as through our Starling Project to help college graduates.

Last, but not least, on behalf of Danke's management team, I want to thank our employees who continue to work hard to serve our customers and the communities. Even in the face of adversity, their dedication to our Company and our mission is unwavering, and we couldn't be more proud of them.

Now, please allow me to turn the call over to our CFO, Mr. Jason Zhang, who will discuss the financial results of our first quarter. Jason, please go ahead.

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

As Derek stated just now, despite the impacts of the COVID-19 outbreak, we delivered solid financial results and continued to see margin improvements on a year-over-year basis.

Our revenues during the quarter reached RMB1,940 million, representing an increase of 63%, and which is primarily due to the increase in opened apartment units.

In terms of expenses, our operating expenses were RMB3,102 million, representing an increase of 59%. And of these expenses, the rental cost increased 68% to RMB1,956 million. The increase was primarily due to an increase in the number of the opened apartment units that we operated.

As we increased the number of apartment units renovated and opened, our depreciation and amortization expenses increased 67% to RMB328 million.

In addition, our other operating expenses increased 106% to RMB251 million, and this was due to the 3 -- mainly because of the 3 drivers below.

The first is a loss on the early termination of the rental agreements due to the -- as we mentioned before, that adjusted over our asset portfolio, the early termination of the certain leases with the property owners, and to connect to the adverse impact from the COVID-19 pandemic. And because of that, this resulted in a loss for the related leasehold improvements and the deposits to the property owners for the first quarter of 2020.

And second is the cost of -- the increase in the cost of services as we operated more apartment units because of business increase. Third is the increase in incentives for apartment sourcing because as we have more and more open apartment units and recorded more amortized commissions and lead generation fees for sourcing such apartments.

For our pre-opening expenses, and it decreased by 89% to RMB9 million in the first quarter of 2020 because we proactively slowed down the rate of sourcing new apartments in response to the COVID-19 pandemic. As a result, there were fewer pre-opening apartment units during the quarter, and compared to the same quarter last year. We do have some new apartments, which we sourced in last year and toward the end of last year, which are in the renovation stage during the first quarter of 2020.

Our sales and marketing expenses decreased by 10% to RMB204 million. This decrease was due to our proactive actions to control the costs and expenses, particularly on advertising expenses. The decrease was partially offset by an increase in incentives for apartment renting, and an increase in payroll cost as a result of the recognition of the share-based compensation, the SBC, expenses upon the completion of our IPO in January 2020.

At the same time, our G&A expenses increased by 142% to RMB274 million, mainly due to the recognition of a substantial amount of SBC expenses, which are primarily allocated to the G&A expenses. Excluding the effect of the SBC expenses, our G&A expenses would be RMB133 million, and the G&A expenses, as a percentage of the revenue, would decrease by 2.6 percentage points as compared with the first quarter of 2019.

Our R&D technology and product development expenses increased by 26% to RMB61 million, and also primarily due to the SBC expenses, which were partially offset by our proactive cost and expense controls.

So I would like to spend a little bit more time here to explain our SBC expenses for the first quarter of 2020. Because the exercisability of the share options that we granted was conditional upon the completion of our IPO, actually, we did not recognize any SBC expenses relating to the share options granted before the IPO.

Upon the completion of the IPO, we immediately recognized a substantial amount of the SBC expenses associated with the vested options towards in the first quarter of 2020. The total SBC expenses were RMB206 million during the first quarter of 2020 compared to RMB1.5 million same quarter last year, and which RMB141 million allocated to G&A expenses, RMB32 [million] allocated to technology and product development R&D expenses, RMB19 million to sales and marketing expenses, and RMB14 million to other operating expenses.

Our last operating expense relates to the impairment of the long-lived assets, which amounted to RMB19 million. And the recognition of the impairment was due to the underperformance of certain apartment units relative to their projected operating results during our impairment test in the first quarter of 2020, during the quarter. Their underperformance was primarily due to the impact of the COVID-19. So as a result, the operating loss was RMB1,162 million during the quarter compared to RMB763 million, same period last year.

Our interest expenses were RMB85 million, representing an increase of 15%. And the increase was due to the interest expenses related to the rent financing and also the additional bank loans.

Our net loss was RMB1,234 million compared to RMB816 million same quarter last year. Adjusted net loss, which represents net loss before the SBC, incentives for apartment sourcing, and the impairment of the long-lived assets, was RMB979 million compared to RMB799 million last year, same quarter last year. We are pleased that the net loss margin improved by around 5 percentage points, and that the adjusted net loss margin improved by over 16 percentage points.

EBITDA, which represents the net loss before the depreciation and amortization, interest expenses, interest income, and the income tax benefit and expenses, was negative RMB834 million compared to negative RMB567 million last year.

Adjusted EBITDA was negative RMB578 million compared to negative RMB550 million the first quarter 2019. Adjusted EBIDA represents EBITDA before SBC, incentives for apartment sourcing, and impairment of the long-lived assets. EBITDA margin improved by around 5 percentage points, and the adjusted EBITDA margin improved by over 16 percentage points.

Finally, our cash position remains strong. As of end of first quarter 2020, and our cash and restricted cash position totaled RMB4,226 million, approximately US$600 million roughly.

Overall, and despite the challenges during the quarter, we are pleased with our implementation of the disciplined financial control policies and the progress on the continuing improvement of our operational efficiencies gained from the economies of scale.

Looking forward, as Derek mentioned just now, we expect that the second quarter revenue to be -- showed early sign of the recovery. And the second quarter revenue will be between RMB1,850 million and RMB1,950 million. The forecast reflects the management’s current and preliminary views, which is subject to change based on the market conditions.

This concludes my prepared remarks. Thank you.

Operator: I would now like to turn the conference back over to management for any closing remarks.

Kobe Ge: This concludes today’s call. Thank you again for joining us. We appreciate your ongoing support. If you have any questions, please do not hesitate to reach out to the investor relations team. See you next quarter.

Operator: The conference has now concluded. Thank you for attending today's presentation. And you may now disconnect.