

Yiren Digital (ADR)
Q2 2024 Earnings Conference Call
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Executives

Keyao He, Investor Relations
Ning Tang, Founder, Chairman, Chief Executive Officer
Na Mei, Chief Financial Officer

Analysts

Ethan Yu, First Trust Group
Bruce Oren, Black Lab Fund
Dylan Paul, Private Investor

Presentation

Operator: Good day, and welcome to the Yiren Digital Second Quarter 2024 Earnings Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note this event is being recorded.

I would now like to turn the conference over to Keyao He, Investor Relations Officer. Please go ahead.

Keyao He: Thank you, operator. Good morning and good evening, everyone. This call features the presentation by our Founder, Chairman, and CEO of CreditEase, our CEO, Mr. Ning Tang, and our CFO, Ms. Na Mei. Our new CFO, Mr. Yuning Feng, will also attend the Q&A session after the prepared remarks.

Before beginning, we'd like to remind you that discussions during this call contain forward-looking statements made under the Safe Harbor provision of U.S. Federal Security Litigation Reform Act of 1995. Such statements are subject to risk, uncertainties, and factors that can cause actual results to differ materially from those contained in any such statements.

Further information regarding such risk, uncertainties, or factors is included in our filing with the U.S. Securities and Exchange Commission. We do not undertake any obligation to update any forward-looking statements as required under the relevant laws.

During the call, we will be referring to certain non-GAAP financial measures and supplemental measures to review and assess our operating performance. These non-GAAP financial measures are not intended to be considered in isolation, or as a substitute for the financial information prepared and presented in accordance with U.S. GAAP. For information about those non-GAAP measures and reconciliations of GAAP measures, please refer to our earnings press release.

I will now pass it on to Ning for opening remarks.

Ning Tang: Thank you all for joining our earnings conference call today. Despite the evolving market environment, we are pleased to report another solid quarter with strong unit economics, reflecting the resilience of our business structure and operational strategies, as well as our commitment to quality growth over mere expansion.

Additionally, our strategic investments in AI and the seamless integration of technological innovations into our operations have fostered dual growth in both technological advancements and operational efficiency. Our strategic direction positions us well to evolve into a leading AI-driven platform, paving the way for groundbreaking solutions and setting new industry standards.

Now I would like to go through our business highlights for this quarter. First, our financial services business, the second quarter of 2024 saw a steady growth, with total loan volume reaching RMB 12.9 billion, marking a 59% increase year-over-year, and maintaining a resilient consecutive quarterly growth despite an industry slowdown. The momentum is largely driven by the concrete growth of our new customers with higher credit quality, as we continue to optimize our asset quality of loan portfolios.

Since the second half of 2023 when the entire industry experienced substantial credit risk fluctuations, we started to proactively upgrade our customer mix and diversify our online acquisition channels. The strategy has proven effective, leading to secure growth and improved asset quality. Meanwhile, we have refined our proprietary RTA credit model for borrower acquisition, which has notably enhanced our overall credit approval efficiency.

In this quarter, the number of borrowers served increased by 47% year-over-year to 1.5 million. Moreover, our loan facilitation platform continued to gain popularity, with monthly active users rising by 88% year-over-year to 4.5 million in the second quarter of this year, showcasing strong customer engagement and loyalty. As we maintain our focus on attracting high-quality borrowers and note that existing high-value borrowers repeatedly use our revolving loan products, we expect this growth momentum to continue throughout the year.

Meanwhile, our international business is showing exciting progress. The total loan volume overseas nearly doubled in the second quarter of 2024 compared to the prior quarter. In the Philippines, monthly loan volume facilitated exceeded RMB 20 million milestone, with the growth rate remaining robust as we move into the second half of the year.

Moreover, as our business continues to grow, we are benefiting from economies of scale, with customer acquisition costs decreasing by 18% quarter-over-quarter. In June 2024, our business in the Philippines achieved a positive net profit margin.

It's worth mentioning that our rapid growth is closely tied to our AI development and integration. Our proprietary Large Language Models have been implemented across various operations, including customer acquisition, customer service, risk management, and asset management. For instance, in our international operations, our anti-fraud AI models have processed over 10 different types of identification documents this quarter, achieving a 93% accuracy rate and significantly enhancing our risk management efficiency.

Additionally, to standardize our services, our Large Language Models are used in our overseas call centers to translate local languages, detect sensitive words, and analyze service quality and assurance, thereby boosting customer satisfaction. As more data are processed, we expect continued enhancement of our models in both accuracy and their applicability to a wider range of scenarios and uses.

Turning in to asset quality, delinquency rates continue to show an encouraging trend as assets from upgraded borrowers increase. Specifically, the 15 to 89 day delinquency rate for the second quarter of 2024 declined to 3.8%, down 10 basis points. The FPD 30+ delinquency rate decreased for the third consecutive quarter, and the M1 collection rate for the second quarter of 2024 increased by 290 basis points quarter-over-quarter to a historic high. We expect a sustained improvement in asset risk performance in the second half of this year as we continue to optimize our customer mix and re-tune our credit risk models.

Now on funding cost, our effort in building an efficient funding management system is showing results. In the second quarter of this year, our funding cost decreased by 82 basis points quarter-over-quarter, reaching a historic low and exceeding our internal target. The downward trend will continue in the third quarter. Moreover, given the current market funding conditions, we are strategically increasing our loan volume under the risk-taking model to better balance risk management and profitability.

Regarding our insurance brokerage business, we have focused more on property insurance and expanded our customer acquisition channels to hedge against the ever-changing regulatory environment and uncertainties in the life insurance sector. In the second quarter, gross written premiums totaled RMB 1.1 billion, reflecting a year-over-year decrease of 20% and a quarter-over-quarter increase of 16%. The annual decline was primarily due to the impacted life insurance business, which experienced limited sales of first-year premiums as a result of product changes under new regulations.

The quarter-over-quarter growth in premiums is largely attributable to the property insurance business, where premiums reached 557 million, marking a 19% increase from the previous quarter and setting a new record high.

Going forward, we will continue to focus on three key areas in our insurance business: First, strengthening channel partnerships and expanding the scale of property insurance, optimizing our product mix, and continuously increasing the proportion of high-profitability products, such as liability insurance.

Second, in life insurance, we will focus more on high-net-worth clients, addressing their comprehensive protection needs for retirement and savings. Thirdly, we will enhance online customer acquisition by utilizing AIGC tools to improve market outreach and boost sales volume.

In our consumption and lifestyle service segment, our GMV increased by 40% year-over-year to RMB 554.6 million. However, due to the high penetration rate of these services among our current customer base, we are observing a moderation in growth rates. Moving forward, the

company will focus on acquiring new customers and refining customer profiles to better understand and address their comprehensive needs.

Moreover, with the aim to enhance shareholder returns and boost market confidence, we are pleased to announce that the Board has approved a new dividend policy. Under this policy, the Board plans to declare dividends amounting to no less than 10% of the Company's anticipated net income after tax for each half-year, starting from the first half of this year.

The cash dividend for the first half of 2024, set at USD0.2 per American depositary share, is expected to be paid on or about October 15, 2024 to holders of the Company's ordinary shares and ADSs of record as of the close of business on September 30, 2024, Hong Kong time and New York time, respectively. We would like to express our gratitude to our shareholders and investors for their ongoing support.

Finally, we have a management change to announce. First, let me introduce our newly-appointed CFO, Mr. Yuning Feng. Yuning possesses over a decade of experience in venture capital investment, investment banking, and financial control. Before joining us, he was a partner at CE Innovation Capital, where he led investments in fintech, enterprise solutions, and AI sectors.

Prior to that, Yuning was also served as an investment banker at China Renaissance, and a financial controller at Goldman Sachs and UBS. We are confident that Yuning's extensive experience and proven track record will enhance our global strategy and AI focus, and we look forward to the positive impact this will bring.

Also, on behalf of the Board, I would like to extend our deep gratitude to Na for her significant contributions and outstanding work during the past years.

With that, I will pass it to Na, who will go through the financial performance for this quarter. As this marks her final earnings call with us, we once again thank her for her leadership and wish her continued success in her future endeavors.

Na Mei: Thank you, Ning, for all the kind words and support. Hello, everyone. On this call, I will only focus on our key financial highlights, and Yuning will join us for the Q&A session after the prepared remarks. First of all, we are glad to deliver a solid quarter with a healthy profitability. In the second quarter of this year, our total revenue reached RMB 1.5 billion, 13% increase year-over-year.

In the financial services segment, total loan facilities continued to grow steadily, reaching RMB 12.9 billion, up 59% year-over-year. This is mainly driven by the growing number of new borrowers and the strong demand of our small revolving loan products. Revenue from financial service business increased to 46% year-over-year to RMB 851 million. The momentum remains strong throughout the year.

In the insurance sector, our gross written premiums were RMB 1.1 billion, a decrease of 20% year-over-year, but an increase of 16% compared with the prior quarter. The year-on-year decline was driven by a substantial drop in our life insurance sales following local regulatory changes. During the same period last year, sales of life insurance products with a capped 3.5% interest rate, surged before being withdrawn from the market due to the new regulations.

Therefore, the premium in the second quarter of 2023 was [exceptionally] high, making a sharp contrast to the decline of the second quarter this year.

Meanwhile, the quarterly growth in our total premium was mainly driven by the expansion of our property insurance business. Consequently, the proportion of our property insurance in our overall premium mix increased, translating into a lower average revenue take rate due to the lower commission fee rate compared with life insurance products.

In the second quarter this year, revenue from our insurance segment reached RMB 91.5 million, down 77% year-over-year. Going forward, we expect continued growth in our property insurance business in the foreseeable future, and a gradual recovery of our life insurance product along with the market trend.

In the consumption and lifestyle segment, the total GMV for this quarter reached RMB 555 million, an increase of 40% year-over-year, but a decline of 11% quarter-over-quarter. As mentioned by Ning, as the penetration rate of services and products in this segment grows into a substantial level, we expect the growth rate of this segment will continue to moderate.

On the expense side, sales and marketing spend increased 91% year-over-year to RMB 285 million. This growth was mainly fueled by the swift expansion of our financial services segment and enhanced marketing efforts focused on attracting new and high-quality customers, as we continue to refine our customer base. Research and development expense increased 69% year-over-year to RMB 56 million, due to our ongoing investment in AI enhancements and technological advancements.

Origination and the service cost decreased 29% year-over-year to RMB 247 million. This is primarily attributed to the declined insurance business volume, especially the sharp decrease in the first premium for our life insurance products, which led to lower channel rebates and relevant settlement costs.

Moreover, G&A costs increased to 8% year-over-year to RMB 68.7 million, remaining largely stable. The allowance for contract assets and receivables was RMB 123 million for this quarter, a 152% year-over-year increase and 20% quarterly growth. The increase was mainly driven by the growth in loan volume facilitated

Moreover, provision for contingent liabilities this quarter increased to RMB278.9 million from RMB12 million in the same period of 2023. This is due to a rapid ramp-up in loan volumes facilitated by our risk-taking model, which leads to significant upfront provisions under current accounting principles. However, over time, these provisions will be periodically transferred to guarantee service fees. Actually, in the second quarter of this year, the revenue from guarantee services reached RMB68.9 million, more than 4x of that in the same period last year.

Now on the bottom line, our net income decreased 22% year-over-year to RMB 410 million this quarter due to three reasons: Firstly, overall profitability in the insurance business declined, as mentioned above. Secondly, marketing expenses increased due to our ongoing investment in attracting new high-quality borrowers for our financial services business. Thirdly, substantial upfront provisions have been accrued as we ramp up our loan volumes under the risk-taking models. Currently, our profit margin reached 27.4%, still a healthy level in the industry.

Regarding cash flow, we generate approximately RMB 369 million net cash from our operations in this quarter, remaining healthy and strong.

On the balance sheet side, our balance sheet remained strong with RMB 5.5 billion in cash and cash equivalents as of the end of this quarter, and we are exploring diversified ways to enhance our shareholder returns. As Ning just introduced, we are pleased to announce a semi-dividend plan with no less than 10% of our after-tax income for the prior 6 months distributed to our shareholders.

A cash dividend of USD0.2 American depositary share is expected to be paid on or about October 15, 2024 to holders of the Company's ordinary shares and ADS of record as of the close of business on September 30, 2024.

Moreover, we are still doing share buybacks. In the second quarter of this year, we allocated USD4 million to repurchase shares in the public market, bringing our total deployment for the share repurchase program to USD13.5 million by June 30, 2024.

Lastly, on our business outlook. based on our assessment of current business and marketing conditions, we expect our revenue for the second quarter 2024 to stand between RMB 1.4 billion to RMB 1.5 billion, with a healthy net profit margin. This represents our current and preliminary assessment, which may be subject to changes and uncertainties. This concludes our remarks.

Operator, now we are open for questions. Thank you.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). The first question comes from Ethan Yu with First Trust Group Inc.

Ethan Yu: Congrats on a really solid quarter. My first question is about your AI development. As disclosed in your ESG report, the company has developed a range of AI systems. Regarding your AI strategy, have there been any notable advancements in AI applications or research? Can you share more details about any specific investments in AI sector? And also, have there been any significant (indiscernible) our AI product commercialization?

Operator: Excuse me, Ethan, I'm sorry, you're not coming through clearly. Is it possible to move the microphone closer to you and repeat, please?

Ning Tang: I got the majority of the question, and it's about the AI development, investment, commercialization, right, yes?

Operator: Okay. He accidentally disconnected. Just a moment. He must have pressed something accidentally. So would you like to go to the next question and have him come back?

Ning Tang: Hello, (indiscernible).

Operator: Would you like me to have the next questioner ask, and then when --

Keyao He: (Inaudible) go to the next question.

Operator: Thank you. Okay. The next question is from Bruce Oren with Black Lab Fund.

Bruce Oren: I'd like to express appreciation to the Board for the new dividend. That's a good move. I'd also like to congratulate and thank Ms. Na Mei for helping to build an extraordinary company under circumstances that were often difficult. Thank you.

I have two questions. The first is could you add some insight into the large second quarter increase in net cash used in investing activities and net cash used in financing activities? And my second question is, where is most of the international business growth?

Ning Tang: And Na, please cover them first.

Na Mei: Yes, as my -- in my script for our cash flow for our operation business, we can (indiscernible) nice income of about (inaudible) as we mentioned before, so the purpose, our financial service segment, the management is from a financial leasing opportunity to pick companies in the (inaudible).

Ning Tang: I cannot hear you very clear now.

Na Mei: Now it's better? I'm close to the phone now.

Ning Tang: (Inaudible) yes, it's better now, yes.

Operator: Thank you. Yes, please repeat. Thank you.

Na Mei: (Inaudible).

Unidentified Company Representative: (Inaudible) items and also our international business market.

Na Mei: Yes, I'm explain on the -- explain our investment cash flow, the reason why we increase so much in the first quarter. And as I mentioned, as you remember that last year, we purchased a new financial guarantee company, Chongqing Jintong, to our financial service segment purpose. For this year, the management is still going on to [provide] a financial license to purchase for our financial service business, like the AMC Assets Company and micro-small lending companies and other financial guarantee companies for this development purpose.

So for this financial license companies before the (indiscernible) come to the formal operations, and repurchase process based on the communication status, we should replace some investment amount to our partners to lock the acquisition target. So you can see our investment cash flow remains [catch-out], that most of our investment payment to our potential financial lease target. I hope my question is answer -- my question and my answer has answered your question.

Bruce Oren: Yes. Do you see the cash used plateauing or continuing to grow greatly?

Na Mei: Yes, I think you can see for the cash from the operating will keep healthy and stable cash flow. And also, we have used the cash to other investment opportunity, no matter the internal financial license, or the international overseas business development also in our AI strategy. We also have many cash advantage, but in our forecast, we still have the confidence in our cash and cash equivalent balance with even strong status in the next quarter, yes.

Bruce Oren: Thank you.

Ning Tang: Our international business covers the Philippines and Mexico, and we're also looking to expand, yes, to certain other markets in Southeast Asia and other parts of the world.

Operator: Thank you. (Operator Instructions).

Ning Tang: Is the first, yes, gentleman back?

Operator: Yes, we have him now.

Ning Tang: Okay.

Operator: Please go ahead.

Ning Tang: (Inaudible) that we cover, yes, the AI investment implementation part, yes?

Ethan Yu: Yes, yes, hi, Ethan again. Can you hear me now?

Ning Tang: Yes, I can hear you very clearly, and actually, as I reported, yes, the beginning, we use AI extensively in our operations. And we also try and, yes, leverage the technology capabilities developed internally for potential like external like opportunities. Like we have fintech partners, financial institutions that are interested in our solutions, and yes, I hope we'll see some results later this year or, yes, first half next year.

At the same time, we try and build, yes, a strategic investment and partnership infrastructure like ecosystem and so we've made a couple of small, but in my view, hopefully, yes, very promising investments in the AI space, but their contributions are very tiny. And as I -- yes, going back to our like the AI, like the use cases internally, for example, like we use AI in customer like acquisition, customer service; like we use robots like, yes, and the large language models, yes, for like incoming, out-bounding calls.

Like, say, when we detect a customer like emotions, yes, change, it's time to switch to like a human like operator, we will do that. And also, yes, the machine can interact with a customer up to the right point to switch to the human, and so on, and of course, we use like voice recognition like the technology. And also, I gave the example, like we -- our large language models used in the Philippines, right, can do like a great visual recognition algorithm because in the Philippines, like IDs, personal identification, like paperwork is really paper. So it's not very digital and it takes quite some skills to detect the risk. So AI plays a key role there and so on.

So yes, basically, yes, we use AI extensively in our own operations and some like technologies are really welcomed by outside partners, prospects, like buyers, yes, so customers. So we will try to monetize these technologies as well.

Ethan Yu: Okay. (Inaudible). My second question is there is a continued rise in your R&D costs. Could you share us more color about how these costs have been used?

Ning Tang: Yes, so for our like AI like large language model development, yes, we take like open source, like a model combined with our own data and business algorithm to develop our proprietary models. And we purchase hardware and, yes, develop software and so on. And so in the second quarter, I believe it was about RMB 56 million, yes. So I think this is money well spent and yes, so I think our investment in AI has been prudent, but strategic for the future.

Ethan Yu: Thank you. I have another question about your -- can I ask one more question about your overseas business?

Ning Tang: Sure.

Ethan Yu: Can I know what is the total loan volume facilitated overseas in second quarter 2024? I'm impressed with the growth rate achieved in the Philippines. And also you have mentioned that you have made another progress in Mexico. And what is the driving rate achieved in Philippines?

Ning Tang: (Inaudible) say it again, sorry, the last part?

Ethan Yu: What is driving this growth? And what's your outlook for the revenue generated from overseas business and profit in, let's say, second half 2024 or the coming 2025?

Ning Tang: I see. Well, yes, the growth rate has been phenomenal largely because the base is too small. So we really hope to grow the base. And so, yes, the second quarter like loan volume was RMB 63 million and we expect to do like over RMB 100 million in this quarter. We hope to maintain a relatively high growth rate for the foreseeable future just because the base is still small.

And also, you asked about the growth driver. The Philippines and some other countries in Southeast Asia and also in Latin America, they are large countries with population of over like 100 million. And also, the target customer base is very young, which we like very much, and so they have really strong demand for like convenient credit, yes, but the market certainly lacks such opportunities, yes, means.

So we are there to, yes, leverage the capabilities we've developed in Mainland China. And so I think this is a very, very big opportunity, frankly speaking, for us to do credit tax outside of Mainland China in these large population, young markets like where digital finance is still in very early days and booming.

Ethan Yu: Okay. Understood. May I know the current customer acquisition cost for these countries, especially in Philippines?

Ning Tang: Na, you have this number?

Na Mei: Yes, for our Philippines business, due to the acquisition cost, is based on our new customer acquisition strategy. And based on the current data in this quarter, about 1% is around \$5 or \$10 one-unit person. But I think in the second half year of this year, as Ning mentioned about, we want to -- we hope and look for our development growth, our Philippines business, and other wholesale business.

So in the second half of the year, for our business development, we will primarily [change] to our new customer acquisition. So we plan the acquisition rate (indiscernible) will be a bit increased in the third and fourth quarter, but in this quarter, it's about \$5 or \$10 one person, yes.

Ethan Yu: Again, (inaudible) and thanks again.

Na Mei: Okay.

Ethan Yu: (Inaudible) again.

Operator: Dylan Paul at Dylan Paul, MD.

Dylan Paul: Yes, can you hear me?

Ning Tang: Yes.

Dylan Paul: I'm going to switch off speaker like you recommended. This is Dylan Paul here, a private investor. Myself and my friend, Dale [Tiongsen], who's very sorry he can't be here, have been following and invested in the company for a couple of quarters now along. And we want to thank you all for the strong result. We'd like to -- and also mention that we'd like to hear from any people listening to the call who are interested in sharing bidirectional insights. So please reach out to us via email or social media, which is easily found online.

We have two questions. The first is related to the guarantee business, and I will say that these questions actually, that Dale is the one who's most talented in understanding and insights on the business. So I won't be able to ask any further follow-up, but I wanted to get them out there for his sake.

The first is related to the guarantee business. It seems like this is becoming a growing part of the business, and we are interested in some additional color. Maybe you could speak towards how the guarantee contracts work in terms of sharing of credit risk, and what that means for a return relative to the default rate on the underlying loans.

And we also understand the accounting to be atypical for provisions. Could you maybe explain just how the accounting works or provide additional color? And would it be helpful to show progression of loss provisions to write-offs in the quarter similar to how you do for contract receivables in the 10-K?

And then the second or the final component, which again, maybe I should be separating. Well, actually, let me stop right there and it sounds like -- sorry, this is my first time doing a call

before. It sounds like I can come back and ask that second question. I won't have any follow-up on the first because your answers, I won't be able to adequately process in the way Dale does when he's listening to them. So let me just stop right there with that first question there, or question.

Ning Tang: Yes, so Na can -- yes, we can please -- we'll try to cover that. Maybe I can suggest that, yes, we can have a follow-on call to go into some of the details with your friend.

Dylan Paul: Okay. Got you. All right. That's fine. And then let me see then whether you have the same recommendation for the second question then, which is it's related to the parent controlling shareholder structure, which I guess we can, or Dale in particular, but we have continued to be confusing for us. And I know we have asked about it before. But just wondering, is there any further color you can provide regarding CreditEase and how the relationship works with Yiren, which again, I've been involved in that question before. And so I know you've addressed it.

And then he's mentioned this before, that he knows there's a large transaction in 2019. And this is maybe the new part that can be addressed and nothing has happened since. But are you expecting any related party transactions coming up here, if you're able to speak to that? And thank you.

Ning Tang: Not as substantial as like the one you mentioned several years ago, not even close, yes.

Dylan Paul: Okay. All right. Well, that's all of our questions or Dale's, more specifically. And again, most importantly, thank you for that tour that you guys gave me while I was in China, and answering questions at that time, and all your efforts that you've done with both myself and Dale to help understand the company. And we are currently very bullish and excited about everything you guys have accomplished so far.

Ning Tang: Thank you. You are more than welcome to come back, see us.

Dylan Paul: Okay.

Ning Tang: And so yes, we'll book a follow-up call to cover, yes, all the detail.

Dylan Paul: Details, yes. And again, Dale is the technical guy. That stuff confuses me too. I can't follow him.

Ning Tang: No problem. (Inaudible) thank you.

Operator: This concludes -- go ahead, please.

Na Mei: Okay. Thank you for listening to our company, and I hope you will come in again later. Okay. Thank you.

Operator: And then this concludes our question-and-answer session, and concludes the Yiren Digital conference call. If you have any further questions, please contact the Investor Relations team at Yiren Digital. Thank you for attending today's presentation. You may now disconnect.