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Q3 2021 Yiren Digital Ltd Earnings Call

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CORPORATE PARTICIPANTS

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Ning Tang *Yiren Digital Ltd. - Executive Chairman & CEO*

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Yiren Digital Third Quarter 2021 Earnings Conference Call. (Operator Instructions)

Please be advised this conference is being recorded. (Operator Instructions) I would now like to hand the conference over to your first speaker today, Ms. Keyao He. Please go ahead. Thank you.

Keyao He

Thank you, operator. Good evening, everyone. Today's call features a presentation by the Founder, Chairman and CEO of CreditEase, and our CEO, Ms. Ning Tang; and our CFO, Ms. Na Mei; Ms.Xiao Shang, our SVP; Mr. George Liu, our CRO; and Mr. Raymond Fung, COO of Yiren Wealth , who will also join the presenters in the Q&A session.

Before beginning, we would like to remind you that discussions during this call contain forward-looking statements made under the safe harbor provision for the U.S. Private Securities Litigation Reform Act of 1995. Such statements are subject to risks, uncertainties and factors that can cause actual results to differ materially from those contained in any such statements.

Certain information regarding the potential risks, uncertainties or factors is included in our filings with the U.S. Securities and Exchange Commission. We do not undertake any obligation to update any forward-looking statements as required under relevant law.

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 the U.S. GAAP.

For information about the non-GAAP financial measures or reconciliation to GAAP measures, please refer to our earnings press release. I will now pass it over to Ning for opening remarks.

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

Hello, everyone. Thank you for joining us today.

We are delighted to announce a solid quarter with visible increase in profitability and a healthy growth in business scale amid a muted macro environment.

At the beginning, I would like to reiterate our strategic positioning as a user-centric personal digital financial management platform as our business models continue to integrate and expand.

In the third quarter, we saw growing interactions and synergies between business lines. For example, the total number of investors who purchased the Hexiang's long-term insurance products on Yiren Wealth's platform this quarter increased by [67%] (corrected by company after the call) compared with the second quarter this year, while the number of borrowers cumulatively served with our insurance product as of September 30 grew 33% compared with the end of last quarter.

So by "personal digital financial management", we mean to serve our customers in the long run and meet their comprehensive financial management needs, including liquidity management, income generation, financial protection and value enhancements, which correspond to our credit-tech and wealth management services.

Now I will go through our business updates on wealth management first. As of September 30, 2021, total client assets exceeded RMB 17.4 billion, representing a 19% growth from last quarter and about 250% growth from prior year. Total number of active investors grew 11% quarterly to about 428,000.

More specifically, on Yiren Wealth's platform, we saw accelerated growth in both new investors as well as average client asset due to our "precise targeting" acquisition strategy and optimized the services and products.

In the third quarter, the number of new investors on the platform reached nearly 10,000, representing a [93%] (corrected by company after the call) increase quarter-over-quarter.

Excluding insurance products, average client asset per investor reached RMB 259,000, representing a 125% annual growth. Particularly, the number of investors with client assets over RMB 500,000 grew almost 3 times compared with last year, and the trend continues going into the fourth quarter, a clear reflection of our enhanced capabilities to serve a higher segment of our investor spectrum.

Moreover, as our investor education further penetrates and the concept of "balanced asset allocation" is becoming increasingly accepted, the number of investors holding at least 2 different asset classes on Yiren Wealth's platform grew 168% year-over-year.

Talking about "precise targeting" acquisition strategy. Our "finance plus life" initiative is worth mentioning. Two years of operation, we found common needs in our investors in 4 specific scenarios. Namely, health and sports, study and self-improvement, lifestyle and leisure, child education and parenting. To better serve our investors and target these common needs, we recently started offer selective life services and products tailor-made for investors.

These non-financial services are proven effective to both attract new investors and to enhance our existing users' LTV. Through "finance plus life" strategy, we are building up a broader Yiren Wealth community, consisted of high-quality users who have the common pursuit for better wealth, better selves and a more positive life spirit, which is translating into comprehensive growth in Yiren Wealth, and we expect more promising results to come in the following quarters.

Next, onto our Hexiang Insurance Brokerage business. We are pleased to deliver a better-than-expected growth this quarter. Hexiang contributed RMB 735 million in total premiums, up 29% quarter-over-quarter. And its commission revenue reached RMB 199 million, up 31% compared with last quarter and up 95% from prior year.

In the beginning of November, Hexiang had already completed our full-year internal targets in both premium and revenue. Hexiang is positioned as a national comprehensive customized insurance service provider, and it stands out in its strong capabilities in product innovation and customization.

For instance, its innovative annuity product launched in May enjoyed an immediate popularity with premium of RMB 285 million as of end of third quarter. Moreover, Hexiang's high-standard services also gain market recognition.

In the third quarter, long-term insurance renewal rate stood at 98%, much higher than the common industry standard of 85%. Moreover, Hexiang's unique 2B2C business model has proven effective in market expansion. By working with 2B channels with a considerable customer base, Hexiang has embedded their tailor-made insurance products into these 2B platforms and scenarios.

This is a win-win solution for both Hexiang and our channel partners. For Hexiang, we have effectively acquired 2C consumers at minimal cost While for 2B channel partners, we help them realize additional revenue streams and enhance their customers' LTV.

Hexiang is currently cooperating with over 100 insurers and brokers nationwide, offering more than 510 products. With new products going to hit the shelves in the coming days, we expect a further growth in the quarters to come.

Now I will outline some highlights for our credit business. In the third quarter, our total loan facilitation volume maintained a strong growth trajectory reaching RMB 6.8 billion for the quarter, representing an increase of 30% quarter-over-quarter and 117%

year-over-year.

Total number of borrowers served this quarter was 548,000, increasing 26% from prior quarter. On loan products, Yxianghua, our small revolving loan product witnessed a continued rapid growth and a clear increase in borrower base due to our enhanced digital operating capabilities and improved the servicing standards.

In the third quarter, loan volume of Yixianghua stood at RMB 3.4 billion, accounting for close to 50% of total loan volume and representing almost 5 times growth compared with prior year. Meanwhile, monthly active users on our Yixianghua APP, reached 1.1 million as of September 30, jumping 82% quarter-over-quarter.

Further increase in customer activity is expected as we start to embed more diversified consumption scenarios on the platform and to scale up our own traffic pool. Moreover, as our repeat borrowing rate continues to rise, and our consumption traffic base start to convert into new loans, we have managed to keep our customer acquisition cost at a low level, translating into healthy product unit economics.

Furthermore, I want to share with you our progress on SME loans, which we started to focus on in the second half of this year. We are pleased to see robust growth in SME loan business with its volume increasing by over 431% quarter-over-quarter, now accounting for 25% of total loan volume. It's worth mentioning that small and medium enterprise loans are priced under 24% APR, and as we are on the full wing to dive into this SME market, we expect the SME loan volume continues to grow in the coming quarters, further optimizing our product mix and paving the way for us to accomplish compliance transitions.

And talking about compliance and APR cap requirements, we have been executing 3 concrete strategies to ensure effective transitioning while maintaining profitability. First, like I just mentioned above, we are scaling up SME loans to better support real economy and to respond to regulatory directions.

Second, we have been proactively offering lower-priced evolving revolving loans to our existing customers with higher credit quality.

Thirdly, we have been improving our customer mix and acquiring new customers with better credit performance through our diversified online consumption scenarios. Through the combination of these 3 efficient strategies, we are very confident to be able to complete our progressive adjustment by the second quarter next year.

Moreover, for the new guidelines related to credit scoring, we have been in close communications with regulators and are exploring different options to ensure our compliance. So far, we have already signed an agreement with the licensed credit rating agency, and we are in the stage of testing detailed cooperation models, which will take some time due to the complexities surrounding operational flow as well as tech capabilities.

We expect to finish the connection within the guided space grace period, and the relevant cost will be manageable. We will continue to pay close attention to regulatory guidance as well as industry standards and make timely adjustments as needed. Last but not least, as we refine our risk management systems and enhance our asset quality, our 15 to 89 days delinquency rate remained low at 2.4%, and we expect our credit performance to remain stable during the transition, and then to experience an overall improvement in the long run as we continue to optimize our customer mix.

Going forward, we will continue our efforts to drive up our business scale and create stronger synergies, not only within our wealth management ecosystem, but also within the whole Yiren Digital ecosystem. Meanwhile, as our investors are showing growing demand for higher investable amounts, we will serve them with more diversified products with bigger ticket size, further driving up our profitability.

Additionally, as our credit-tech business continues to move toward higher-quality customer segment, there will be growing synergies and overlap between credit and wealth management businesses in the long run. Now I will pass it on to Na, who will provide this quarter's financial updates.

Na Mei ***Yiren Digital Ltd. - CFO***

Thank you, Ning. Dear analysts and investors, good evening. For this quarter's financial update, I will focus on key financial highlights only. For further details on our financial performance, you can refer to the detailed financial results in our earning release and deck that has been posted on our IR website.

I'm very happy to share with you another solid quarter with strong growth achieved gross revenue, profit and transaction volume on a year-on-year basis, as we continue to see strong consumer demand for our financial management service.

Total revenue in the third quarter was RMB 1.2 billion, increased 20% year-over-year. This quarter, revenue from wealth management services accounted for close to 30% of our total revenue, becoming a significant revenue driver.

On the credit side, total loan facilitated this quarter was RMB 6.8 million, up 117% year-over-year, and the revenue from loan facilitation service increased 48% from prior year accordingly. Loan facilitation revenue take rate decreased year-on-year due to shifts to shorter [tenure] (corrected by company after the call) loan products as well as due to pricing cuts as we adjust our loan portfolio to below APR 24%.

Q3 operating expense decreased by 10% year-on-year to RMB 0.8 million. Sales and marketing expense decreased by 16% from prior year to RMB 407 million, driven by increased consumer acquisition efficiency. Our origination, servicing expense decreased 22% from prior year to RMB 187 million, mainly due to the improved collection efficiency.

Allowance for contract assets,receivable and others with RMB 83.6 million this quarter, equivalent to 1.2% of loan volume as compared to 1.8% last quarter.

The decline was largely driven by improved asset quality and the change of product mix. Net income grew 3 times year-on-year to RMB 0.3 billion, reflecting a net income margin of 26%, mainly due to our continued efforts in cost control and increasing operating efficiencies.

Despite planned APR cuts in our loan pricing, we are confidence in being able to maintain healthy growth and profitability in the transitional year of 2022 and a return to a more robust profitability growth upwards.

Turning to our balance sheet. We ended the quarter with RMB 2.3 billion cash and cash equivalents, up 6% from prior quarter, leaving us with sufficient reserves to seek any new opportunity.

This concludes our closing remarks. Operator, now we are open for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from the line of [Boyd Haynes] from Equinox Capital.

Unidentified Analyst

A very nice quarter. I have a number of questions. What was the APR for loans initiated in the quarter? And what was the average loan tenor?

Na Mei ***Yiren Digital Ltd. - CFO***

Yes. Hello. This is Na. I will answer your questions. Our average -- the tenor of the loan is about 28 months, but we suppose, in line with that, the tender will be shortened to about 10 to 12 months by the year of this end. And our total -- the 24% APR account for about 30% in the quarter, this quarter, and were close to about 50% by the year of this end.

Unidentified Analyst

Okay. And can you discuss how your business has been progressing so far in the fourth quarter? I see that you did not provide much guidance for that. You did say that the economy has been muted. So if you could discuss that, that would be great.

Na Mei ***Yiren Digital Ltd. - CFO***

Yes. As we mentioned, there is no -- for our revolution cap, it is not the [diamond] of this year. But as I mentioned, our CEO piece in the script, you can notice that our SME loan is increasing significantly. In last year, there is only below the 1% for that year SME loan. But for this quarter, it accounts for about 24%.

And actually, for all of our SME loans is -- the pricing is below the 24% [APR] (added by company after the call), even below the 18%. So we think that in line with the portion of the SME loan increased, the [overall APR will be much lower and lower than in -- and another reason is that we think our purpose is to pay attention to our planned policy as we are moving towards higher credit quality customer segment. And I think that with our continuously improved risk performance, we should actively lower our price to serve more higher quality clients] (corrected by company after the call).

So i think that we can increase our APR 24% potential partners. But as we mentioned, the regular guideline is next year. So we will focus on the regulation improvement and we'll adjusting our strategy planning if that makes sense. So that's all. Yes.

Unidentified Analyst

So given that the competition for higher-quality borrowers is increasing, can you -- and also with the interest rate cap kicking in additionally. Can you talk about what your outlook is for pretax or operating margins given those pressures?

Na Mei ***Yiren Digital Ltd. - CFO***

Yes, for the -- for our -- for currently, our gross revenue is about 20%, and our acquisition cost is 2% or 3%. Our other operating cost is 1% to 3%. And we hope that all our operating costs will be decreased about 1% or 2% in the first quarter. And we will also enhance our cost efficiency in the next year.

I think this is another driver for our profitability, yes.

Unidentified Analyst

Just last question, and this is about a possible share repurchase or dividend. Do you have cash that's offshore that could be used right now to repurchase shares, given that the ADS is trading well below book value and at very, very low valuations?

This must be -- it just would seem to make a lot of sense here to start aggressively repurchasing shares.

Na Mei ***Yiren Digital Ltd. - CFO***

Yes. Yes, I can suggest something, and if there is something other than the planned (inaudible) we can for our (inaudible). Yes, as we mentioned, we have keep the deposits about RMB 2.3 billion on hand. However, our market value is much lower than our cash. So as common sense, we should repurchase [ourselves].

Actually, in the second quarter, after our -- we yes, we have performance done on [little more] repurchased share in the market. But I -- better for the -- considering our future business strategy. I think there is still [certain uncertainties in the industry] (corrected by company after the call). So we still think we should keep some -- enough cash back on hand for our future business development.

Of course, as you mentioned, we still internally discuss about any other strategies such as the repurchase of share or pay the dividend. But I think that the first of all, for that to keep our strategy and pick our performance to development. So I think considering the uncertainty, we think we have keep sufficient cash deposits but we have some plans about your suggestion. Thank you.

Operator

(Operator Instructions)

Your next question comes from the line of [Allan Young] from [Gold Dragon].

Unidentified Analyst

Congratulations on the good results. We've discussed the topic about the shift to lower pricing earlier. Can you elaborate a little bit more on the pace of pricing shift towards '24% in 2022? I know by -- you are targeting around 50%, 24% loans by the year-end.

And the second question is what is the take rate outlook in 2022 as we complete the shift of pricing? And how do we arrive at such take rate? For example, credit funding? Yes.

Na Mei ***Yiren Digital Ltd. - CFO***

Yes. Thank you. We will now answer your -- the question. For the first question, the pace of lower APR pricing. Actually, as I mentioned in the presentation, I -- we're performing some reclamation from the account pricing to the 24%. You also mentioned that our -- currently, our gross revenue is about a 20%. And for the 24% price capital, we still have confidence in our product profitability consider better asset quality, lower fund costs, lower acquisition costs, keep on operating cost savings.

For example, compared to the 20% gross revenue currently, 24% cap rates gross run rate will increase about 4% to 5% but to also impact the risk, the funding cost and the -- acquisition cost will decrease to 3%, 1% and 1%, respectively. So that we still have the confidence that the net revenue margin will still keep stable. Yes, compared now. Yes. Okay? Did that answer your question?

Unidentified Analyst

Yes.

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

And this -- yes, and this is Ning. I'd like to add that our business model is quite differentiated.

We have a credit-type business. We also have insurance and wealth management business, which is a significant part of our revenue and value. And my sense is it's really like much safer business model. We talked about like the regulatory uncertainty and so on. My view is the monoline business is very risky in such uncertain environment. But you can think of us as a kind of a -- 3 pillars, so much more stable.

And the good thing is, as far as I can see, each business line represents a very big market opportunity, growing very fast, with high quality. So I think that's a really differentiated strategy.

And we don't do these 3 things just for the sake of doing more things. It's because there is strong synergy among the businesses, between credit tech and wealth management and insurance.

So as I highlighted in the first part of my presentation, this synergy is becoming more and more obvious. All that makes our customer acquisition cost, relatively speaking, probably the lowest, and the LTV, the highest. I think that's how my colleagues and I look at our business. Thank you.

Unidentified Analyst

And one more question is on the funding side, about our funding strategy as we shift to lower APR. What would be that -- about funding sources?

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

We continue to work the -- yes, Na, can -- please? Yes.

Na Mei ***Yiren Digital Ltd. - CFO***

Okay. Sorry. Yes, I think as we mentioned that, I think with our client, quality is better for the 24%. We think that there is still significant space for funding [price] (added by company after the call) to decrease. In 2021, our main funding partner is including banks, trust or microfinance companies and the financial lease company. And we suppose we will get more relationship with our funding partner, and we suppose they were about 1 or 2 at least percent [space] (added by company after the call) to lower funding [cost] (added by company after the call). Yes.

Operator

(Operator Instructions)

As there are no further questions at this point of time, this concludes our conference for today. Thank you all for participating. You may all disconnect now. Thank you, everybody joining.

Ning Tang ***Yiren Digital Ltd. - Executive Chairman & CEO***

Thank you.

Na Mei ***Yiren Digital Ltd. - CFO***

Thank you.