Qudian Inc.
Fourth Quarter and Full Year 2017 Earnings Conference Call
March 12, 2018 8:00 AM US ET

Executives
Min Luo, Founder, Chairman, Chief Executive Officer
Carl Yeung, Chief Financial Officer
Sissi Zhu, Director of Capital Markets

Analysts
Charles Zhou, Credit Suisse
Richard Yu, Morgan Stanley
Daphne Poon, Citi
Jinjin Qian, Needham & Company
Dexter Hsu, Macquarie Securities
Binnie Wong, Merrill Lynch
May Yan, UBS
Alex Zhou, UBS

Presentation

Operator: Hello, ladies and gentlemen. Thank you for standing by for Qudian Inc.'s fourth quarter and full year 2017 earnings conference call. At this time, all participants are in listen-only mode. After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded.

I would now like to turn the call over to your host, Ms. Sissi Zhu, Director of Capital Markets for the Company. Sissi, please go ahead.

Sissi Zhu: Hello, everyone, and welcome to the fourth quarter and full year 2017 earnings conference call for Qudian Inc. The Company's results were issued via newswire services earlier today and are posted online. You can download the earnings press release and sign up for the Company's distribution list by visiting the IR section of our website at ir.qudian.com.

Mr. Min Luo, our Founder, Chairman and Chief Executive Officer, and Mr. Carl Yeung, our Chief Financial Officer, will start the call with their prepared remarks.

Before we continue, please note that today's discussion will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the Company's results may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is included in the Company's prospectus as filed with the U.S. Securities and Exchange Commission. The Company does not assume any obligation to update any forward-looking statements except as required under applicable law.

Please also note that Qudian's earnings press release and this conference call include discussions of unaudited GAAP financial information, as well as unaudited non-GAAP financial measures. Qudian's press release contains a reconciliation of the unaudited non-GAAP measures to the unaudited most directly comparable GAAP measures.

We also posted a slide presentation on our IR website providing details on our results in the quarter. We will reference those results in our prepared remarks, but will not refer to specific slides during our discussion.

I will now turn the call over to our CEO, Min Luo. Please go ahead.

Min Luo: Thank you, Sissi. Hello, everyone. I'd like to welcome all our investors and analyst friends to our earnings conference call today.

Today I turn 35 years old, so today is something of a milestone for me, but I'm still young, excited to learn and am committed to working hard to make Qudian more successful. I am sure you have heard from news today about me forgoing all compensation until the Company's market capitalization reaches $US100 billion. This is a birthday gift to myself to push myself further. More importantly, it represents my commitment and confidence in Qudian.

We have experienced many changes in the fourth quarter in the Chinese fintech industry, as the regulatory environment developed. I believe these developments pave the way that will better the long-term health of the industry. With the recent implementation of anticipated regulations, Qudian is well positioned in the industry, and in fact, we believe our competitive position has been strengthened, as many other smaller, less competitive players are forced to exit the market.

At its core, our business model successfully resolved two essential challenges in the online consumer finance industry. First, we use big data analysis and technology to determine the creditworthiness of consumers who haven't established the standard credit metrics, also known as credit underserved. These underserved consumers make up the majority of the 1.4 billion Chinese population.

The lack of access to standard credit data presents a significant challenge for traditional financial institutions to serve these underserved consumers, although many are credit worthy, which in turn presents tremendous market opportunities for us.

The demand for access to credit remains strong in this population, and we believe the newly enacted industry regulations support our disciplined approach and strengthen our competitive position. Through our strong data and technology capabilities, we will continue to lead the market to make personalized credit accessible to hundreds of millions of people in China.

Second, traditional financial institutions, and other less efficient competitors, find small-ticket, short-duration credit transactions unprofitable. And that challenge is compounded significantly under the 36% APR cap. Therefore, most players in the market offer very high interest rates.

The true power of our technology and efficient process is demonstrated by our ability to profitably initiate small-sized, high-velocity, wholly-automated transactions under strict regulatory requirements, in turn making our credit offering affordable to these consumers.

In fact, to be ready for the developing regulatory environment, we self-enforced an all-in service fee to users that translates to 36% APR or less across all our products as early as April 2017. Therefore, there is really no challenge for us to continue to offer substantially the same products and services, while most smaller or non-compliant players that cannot offer 36% APR or less are forced to exit.

Now, directly related to the evolving regulatory environment, in late 2017, as many smaller players are forced to exit, we saw reduced liquidity in online consumer finance, which in turn led to what we believe to be an industry-wide credit down cycle. As a responsible corporate, we proactively shrunk our credit facilitation volume in order to limit risk exposure during the credit down cycle.

With this action, recent data are very encouraging, as we have seen initial delinquency rates stabilize, then fall, for new transactions facilitated in January. This indicates an opportunity for us to grow on this new base again.

Carl will discuss more on our operations, financials and the regulatory impact shortly, but I'd like to take a moment and highlight Dabai Auto, a new business initiative in budget auto financing.

In light of detailed guidance issued by regulators in December, we looked for opportunities to continue to grow our business that would fit well with regulator's objectives, while at the same time, leverage our core strengths.

Among our 62 million registered users, or 26 million approved users, only about 7 million users each quarter actively drew down on credit, leaving around 19 million high-quality, credit-approved users inactive. They are either not in need for small ticket-size credit, or haven't found a suitable consumption scenario to draw down their credit. Since we don't have credit know-how to do large unsecured cash credits, it was a natural decision for us to re-engage these users through a larger ticket size, yet asset-backed consumption installment scenario.

We found auto financial leasing to be the most fitting and launched our first Dabai new retail showroom in November to test the market.

We also know China's new car transaction market is huge, but the penetration rate for financial leasing solutions in new car sales is only 5%, much lower compared with the 46% in the U.S. In addition, China's new car sales growth has been stagnant in recent years with first-tier cities saturated, while traditional dealerships find it not cost effective to further penetrate into lower-tier cities.

We make cars affordable to a large population of young people who have a strong desire for auto vehicles, but previously couldn't afford to buy one because they could not get access to the financing. We use technology to serve young consumers responsibly and in a very transparent manner, so that they can enjoy consumption without over-leveraging themselves by turning to black markets, or feeling embarrassed by turning to parents and family members.

We are creating a unique and very convenient user experience relative to traditional auto sellers. We have placed our shops in the most populated downtown areas of tier-two to tier-five cities, and created a techy and comfy environment in our showrooms with well-trained staff members.

To further differentiate our services, we don't have hidden fees for users. Our delivery times are shorter than peers, and we take care of all the complex steps in the car-buying process, such as insurance, car plate licensing, purchase tax, etc.

With a firm belief in the market opportunity and the outstanding quality and speed of our team's execution, we established 175 showrooms in 175 tier-two to tier-five cities across China by the end of January 2018.

Embracing our 62 million existing high-quality users and supported by our strong balance sheet, Dabai entered the market rapidly with a nationwide, self-owned network, which enables us to reach, stay close to, and serve our users with a seamlessly merged online and offline credit consumption experience.

We have successfully leased out and delivered over 4,800 cars as of March 10h, 2018 -- another very encouraging statistic for a newborn business.

We believe Dabai will instill new energy into the auto retail industry and transform the consumer finance experience for China's car buyers through our data technologies, and breakthroughs in consumer-focused service model. And we expect this new division to be profitable in the first year of operation.

Looking ahead, we are excited about the results of our efforts, which we will begin to see in the back half of 2018 and beyond. And we will continue to adhere to our strict internal discipline and follow regulatory guidelines to grow and explore consumption based installment scenarios.

And before I turn the call over to Carl, I want to reaffirm again my personal commitment and confidence in Qudian's future.

I want to thank the board in supporting my decision to forego all compensation until the market capitalization reaches US$100 billion. This sounds like a big goal from where we are today, but I believe it is achievable enough to make the commitment to not take any compensation until we get there.

With that, I will now turn the call over to our CFO, Carl Yeung, who will discuss our key operating metrics and financial results.

Carl Yeung: Thank you, Min, and hello, everyone. First, I'd like to touch base on a couple highlights of the quarter. We delivered strong results in the quarter with year-over-year revenue growth of 108% and net income growth of 80%, a result of the strength of our business model and the fast expansion of transaction volume.

In the fourth quarter, we recorded total registered users of 62 million, among which 26 million users have been approved of credit and 7 million users actively transacted with us in the quarter.

We cumulatively facilitated over 130 million credit transactions on our platform by the end of December 2017, which represents over 130 million actual transaction and delinquency data points, the most valuable type of data for credit assessment.

Possessing such a huge library of proprietary data, our risk management system significantly outperforms most of the other platforms that don't have such volume of data.

Before going into detailed financials, I'd like to spend a couple of minutes providing more update in three major areas regarding the new regulatory guidelines.

First, the 36% all-in APR cap. As Min mentioned, we've been self-enforcing an all-in service fee to users that translated to 36% APR or less across all our products since April 2017. Being the first in the industry to implement this requirement, we think this 36% all-in APR cap will force many players to exit, and it did. Since December, we believe many players have exited, which leaves us with a bigger opportunity, but there are short-term trade-offs in a rise of short-term delinquency that I will discuss further.

Second, the new regulatory guidelines discourage lending activities without a consumption scenario and specific purpose, and promote scenario- and purpose-based consumption installment businesses. We are fully committed to grow and explore more consumption-based installment scenarios, demonstrated by the launch of Dabai Auto, our budget auto financing business. I will provide more details on Dabai as well.

Third, new regulatory requirements also outlined the financial institutions are not allowed to outsource credit assessment or accept guarantees from lending platforms. Third-party platforms are also not allowed to charge interest or transaction fees from borrowers directly.

In light of the above, we have been in the process of adjusting our funding arrangements so that Qudian is only the facilitator during the process. We have complied with the requirement of ceasing cash credit funding collaborations with Financial Asset Exchanges. These requirements will essentially mean our consumption credit business will migrate more and more from a principle-based model to an agency model. It will also mean potential increases of funding or guarantee costs across the market.

Now, with these changes, we have noticed an industry-wide credit decline since December 2017 and an increase in the delinquency rate. In an effort to manage credit risk responsibly, we swiftly implemented a conservative strategy of reducing credit volumes since December of 2017 to protect our credit quality. This action was effective as the initial delinquency for new credits facilitated in January stabilized, providing us a new basis for credit volumes to grow again after Chinese New Year.

In addition, our team's strong execution capability is evidenced by the successful launch of 175 retail locations supported by over 600 newly hired, high-quality staff by end of January 2018 from the exploratory stage in November 2017; building, over a very short time, what we believe to be one of the most competitive auto distribution channels that offering financing in China today.

This effort will position us more favorably in the developing consumption credit regulatory environment, and at the same time, open up the large opportunity in the emerging auto finance space.

We also believe, compared to traditional auto distribution, the significantly lower operating cost of running a nimble showroom-type distribution channel will mean increase of CapEx in 2018, but as we quickly ramp sales, Dabai Auto will turn profitable in the first year of operations.

Before reviewing the financials, I would like to provide an update on our relationship with Alipay. In response to announced APR policy limitations by Alipay last year, or at the end of last year, we implemented measures to promote the use of our mobile applications. These marketing efforts have been very successful, with now the absolute majority of transaction orders occurring on our APP directly.

We are pleased by this trend with the use of our APP since the additional APR flexibility provided by those transactions broadens the base of the credit-invisible population we can profitability serve. Today, we remain one of the most innovative yet regulatory compliant players on the Alipay consumer-facing interface.

We continue to believe Alipay is the most far-reaching, secure online payment mechanism in China with the best user experience, and our relationship with Alipay remains unchanged. We are committed to this ecosystem with its vibrant services and continue to utilize their unmatched capabilities to make transactions seamless. As such, Alipay remains our sole accepted payment and disbursement partner for consumption credit transactions, regardless of where a user chooses to initiate a transaction.

With the above, we are more confident with our position today from what was frankly a more unsteady operating environment in the last few months. Based on this current information, we expect consumption credit to return to a stable growth track in 2018, and anticipate Dabai Auto to turn profitable within the first year of operation, establishing a strong case for the Company to initiate full year 2018 guidance, which I will offer after discussing fourth quarter results.

Now, I'd like to walk you through our detailed financial results in the fourth quarter of 2017.

Total revenue for the quarter increased by 108% to RMB1.5 billion from RMB716 million in the prior-year period, primarily due to the increase in financing income as a result of the substantial increase in the number of transactions we processed in the quarter.

Financing income totaled RMB1.1 billion for the quarter, increasing 73% from RMB612 million for the fourth quarter of 2016, representing the fast growth of our on-balance sheet transaction volumes.

Loan facilitation income and others increased to RMB149 million for the quarter, up 587% from the prior-year period, as the result of the substantial increase in off-balance sheet transaction volume.

Sales commission fees increased to RMB251 million for the quarter. Now, that's a 212% increase from the same period a year ago. The significant year-over-year growth in sales commissions was driven by an increase in merchandise credit utilized by borrowers to purchase merchandise on our marketplace. We believe that one of the factors contributing to the strong year-over-year growth was the expansion of products we were offering on the marketplace.

Revenues from sales-type leases was RMB26.1 million, representing revenue generation in the first quarter of launching Dabai Auto.

The total operating cost and expenses increased by 164% to RMB943 million for the quarter, from RMB357 million for the fourth quarter of 2016.

Cost of revenues increased by 173% to RMB305 million for the quarter from RMB112 million for the fourth quarter of 2016. This year-over-year increase was primarily the result of higher interest expenses on borrowings because of increased use of funds from institutional funding partners.

Sales and marketing expenses increased by 39% to RMB94 million for the quarter from RMB68 million for the fourth quarter of 2016. This increase was primarily a result of higher expenses associated with the establishment of a nationwide network of showrooms for Dabai Auto, as well as higher borrower engagement fees compared with the same period last year.

G&A expenses declined by 25% to RMB64 million for the quarter, from RMB86 million for the same period last year. The decline was primarily attributable to the decrease in salaries and benefits expenses, which was partly offset by the increase in administrative service fees paid to trust companies as a result of increased use of trust funding in the fourth quarter of 2017.

Research and development expenses increased by 36% to RMB37 million for the quarter from RMB27 million for the fourth quarter of 2016. This increase was primarily due to higher salaries and benefits expense for such staff. We have increased our spending on R&D with the goal to further enhance our data analytics and risk management capabilities.

Provision for loan principal, financing service fee receivables and other receivables increased by 435% to RMB338 million for the quarter from RMB63 million for the fourth quarter of 2016. The increase was primarily due to an increase in the M1+ overdue loan principals and financing services fees receivables, which we intend to provide sufficient allowance to cover.

We have cumulatively provided RMB519 million allowances for principal and financing service fee receivables, 1.3x covering the M1+ actual overdue loan balance.

Our M1+ delinquency by vintage for the new credit transactions facilitated in the first 3 quarters of 2017 still stayed less than 0.9% as of December 31, 2017.

Therefore, income from operations for the quarter was RMB559 million, representing a 52% increase from RMB368 million during the same period last year.

Income tax expenses declined by 71% to RMB19 million in the quarter from RMB64 million in the prior-year period, primarily due to the increase of tax refund.

Now, because of all this above, net income totaled RMB540 million for the quarter, up 80% from RMB300 million for the fourth quarter of 2016.

Net income attributable to the Company's shareholders per diluted share was RMB 1.67, compared to RMB0.99 in the prior-year period.

Adjusted net income attributable to the Company's shareholders, which excludes share-based compensation expenses, increased by 74% to RMB559 million from RMB322 million in the prior-year period.

Adjusted net income attributable to the Company's shareholders per diluted share increased to RMB 1.73 from RMB 1.06 in the same period last year.

As of December 31, 2017, the Company had cash and cash equivalents of RMB6.8 billion, compared to RMB786 million as of December 31, 2016.

The Company additionally also had restricted cash of RMB2.3 billion, compared with nil as of December 31, 2016. Now, restricted cash mainly represents the cash in consolidated trusts that can only be used to fund credit drawdowns or settle these trust obligations.

As of December 31, 2017, the Company had short-term amounts due from related parties of RMB551 million, compared with short-term amounts due from related parties of RMB586 million as of December 31, 2016. Such amounts include RMB550 million and RMB405 million deposited in our Alipay accounts as of December 31, 2017 and December 31, 2016, respectively. Such amount is unrestricted to withdrawal and use, and is readily available to the Company on demand.

As of December 31, 2017, the total balance of outstanding principal for on-balance sheet transactions for which any installment payment was more than 30 calendar days past due was RMB404 million. Yet, the balance of allowance for principal and financing service fee receivables at the end of the period was RMB519 million, indicating an M1+ delinquency coverage ratio of 1.3x.

Net cash provided by operating activities for the fourth quarter of 2017 was RMB742 million.

To be mindful of the length of this earnings call, for the full year 2017 financial results, I'd like to ask the listeners to refer to our earnings press release that was recently disclosed.

Looking forward, for the full year 2018, we currently expect adjusted net income to be more than RMB2.5 billion and the number of vehicles leased out for this 2018 to be more than 100,000 cars.

This outlook is based on current market conditions and reflects the Company's preliminary estimates of regulatory, market and operating conditions, as well as customer demand, which are all subject to change.

Now, this concludes our prepared remarks, and we'd like to open the call to questions. Operator, please.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). For the benefit of all participants on today's call, if you wish to ask your question to management in Chinese, please immediately repeat your question in English.

Charles Zhou, Credit Suisse.

Charles Zhou: (Speaking Chinese). So my question is I think Mr. Luo said something very shareholder friendly that he will not receive any compensation from Company before the market cap reaches US$100 billion. However, we also know the Company has to make some changes in its business priorities. We know that during the listing process, the Company was talking about small credit, big data, about the cash flow and now we also see a new, very fast growing auto financing.

So my question for Mr. Luo is do you think that the two sectors are big enough for you to achieve this growth? If not big enough, do you expect that you may also enter other industries, say maybe just another sector next year, and etc.? And how long do you think until you can achieve this goal?

(Speaking Chinese). So my second question is about the auto financing side. Based on my understanding, the funding cost on auto financing is about over 8%, and they also charge net interest yield around 10%. So roughly speaking, QD does not make too much money from the spread business, and the majority of the earnings come from the sales commission of the cars.

So for me, I think this requires two capabilities. The first thing is about selecting the right model because we all know that in the auto industry, the new models -- or when the new model comes, the old model may become less popular. And it may also become very difficult to sell because Qudian does not apply all the pre-ordering model. So some of the cost may also become, say for example, if auto becomes inventory, which may also become impaired on your balance sheet.

And the second thing is also about how can you get a car if, so for some car models which are very, very popular, so because if you cannot get enough cars, this may also limit your expansion for your business in the future as well. So just to summarize, so can you just tell us about your key competitive advantages in selecting the car and also getting the popular cars?

(Speaking Chinese). My last question is so how about your share buyback in the Q4 last year and also Q1 this year? Thank you.

Min Luo: (Speaking Chinese).

(Translated). Let me briefly summarize what Min just said. So regarding your second question, Min himself has over 10 years of e-commerce experience, and we believe that e-commerce has a lot of similarities with auto new retail business that we are engaged in right now. So it's not that we started this new business without any experience, but we have already accumulated a lot of experience in this area. And achieving a sales number over 100,000 vehicles this year, comparing to the total new car sales in China of over 20 million is still a small percentage, so this is quite achievable.

And then regarding your first question, the two sectors, the online consumer finance, as well as the auto loans, are already two very huge sectors that will help us achieve over US$100 billion market cap, as long as we can perform well in these two sectors.

And regarding the question relating to whether we will have a third or fourth other business, so in order to become a large company, a large tech platform, we will find the right time to explore outside our boundaries. We won't rest on our foot; we will find other, battlefields in the right time.

Carl Yeung: And this is Carl, the CFO of the Company. Charles, thank you for the questions. If I may just supplement regarding answering your third question on share buyback, the Company has yet to disclose our share buyback amounts, but we have been buying in the market last year. And we will continue to enter the market at what we believe to be the right price at the right time. So we didn't just issue a plan; we actually issued the plan and did buy a meaningful number of shares.

Charles Zhou: Thank you.

Operator: Richard Xu with Morgan Stanley.

Richard Xu: Thank you for the opportunity for the question. I've got two questions, first of all, I guess on the cash loan business. So we've seen some pickup on M1 overdue loans, and then there's some already slowdown in the industry loan balance. So I guess the question is where is management seeing the industry is trending? Are we seeing stabilization already with the overdue loans, or are we expecting still some more pressures over the next few months and then stabilizing after that?

And at the same time, given the industry trends, what was the loan balance allocation? How much capital will be deployed to the cash business in 2018? Any changes from the previous plans after we started the auto business?

And the other question is on the auto business. Could you share a little bit of breakdown in terms of profitability so far on the auto business in terms of cost? And then what is the plan provisions? Obviously, there's commission fees and there's spreads, so some rough estimates, or rough guidance on the overall profitability of the auto business? And that'll probably help us to understand the breakdown of RMB2.5 billion profit guidance for 2018 and how we break into different business segments. Thank you very much.

Carl Yeung: Hi, Richard, this is Carl again. Thanks for the questions. We are glad that you asked the cash credits trend in the market. We have seen a quite sharp increase in delinquency rates as soon as the regulation came out on December 1 and it highlights the strength in the nature of our business - It’s a very short duration, very small credit backed by large data analytics. Therefore, we're able to quickly adjust and shrink our outstanding balance to not get exposed while this external credit cycle was happening.

We did get affected a little bit. So therefore, you’ve seen the Q4 delinquency pick up. And the way we do our accounting actually will mean, this pickup will continue into Q1. But if you look at as we operate the business, as we look at the underlying vintage delinquencies of the new transactions happening in January and February, it is extremely encouraging.

Because of the strong execution of our data analytics, we have been able to avoid a lot of the risk that’s going on in the market, and the initial vintage delinquencies for the January and February cohorts have actually returned to pre-regulatory environment rates. And these data gives us tremendous encouragement and confidence to really now give us the opportunity to grow our loan volume as well as loan balance again. And this visibility gives us further confidence to support really why we are initiating a full year guidance this time.

Although we are a young public company, this is really the first time we are giving full year guidance, and it's this raw data that is turning and telling us information firsthand that gives us this encouragement.

Now regarding autos, we believe, as we just mentioned, that in the first year of operations, this unit should be profitable. We have done a lot of discussion internally and calculations and modeling on why it could become profitable.

Now, if you just look at 100,000 units of cars, based on varied industry benchmark statistics, it will generate approximately 5%. Well, 100,000 unit of car sales volume translates to just about RMB10 billion of transaction dollar volume. And as the standard industry commission provided by OEMs at 5%, that would give us about approximately RMB500 million in revenues just for sales commission alone.

This RMB500 million in revenues from commission alone will well cover the 175 retail locations plus the staff that we have built for running this, this year. And this is a very nimble new retail model which is very low cost at city centers, so that covers that. And any additional financing revenues we can charge on usage on the loan outstanding balance in the vehicle itself will essentially mean profit to us. That’s why we have confidence this unit is profitable, again, building the case for us to really provide a full year 2018 guidance for the first time.

Richard Xu: I see. I have just a follow-up question on the cash loan a little bit more. Certainly, that trend is encouraging; that it's picked up a little bit, has returned to the pre- regulation delinquency ratio again. So I remember when we discussed previously, there is probably, I guess at the time, a planned slowdown. It seems like that plan has changed a little bit. We're going to re-accelerate the growth in cash loan again.

Any sort of outlook or guidance in terms of the growth? Certainly, probably not the same as our regional guidance on the cash before all the regulations started, but things like better than some of the guidance or expectation during the peak of uncertainty during the financial regulatory (inaudible) in the sector. So where are we now in terms of our plan for the cash balance or volume for 2018?

Carl Yeung: Thank you for the question, Richard. Unfortunately, we only provide bottom line guidance. But just in terms of the rough shape of things, as you can do the calculation, last year's loan balance on average was about RMB10 billion. We are sitting here at this stage where we can see a significant growth from that in terms of average loan balance we can achieve this year.

In fact, we are already at above -- currently, our current outstanding loan balance that generates revenues is already above last year's average at this stage. So we are quite comfortable with growth. Anything further in terms of specific numbers, unfortunately, we don't guide.

Richard Xu: Okay. Got it. Thank you.

Operator: Daphne Poon with Citi.

Daphne Poon: So my first question is about the funding side. So can you provide us an update in terms of the funding situation for your cash loan business, in particular the funding partnership with banks and trust companies after the new cash loan rule has came out? And how has the funding mix and also the funding cost been changing?

And my second question is about the auto finance business. So regarding your full year guidance of 100,000 car sales this year, but we also look that the runway in the first quarter of 2018 so far is only 4,800 cars. So this (inaudible) a little bit aggressive. So would you explain to us more about how would you achieve this full year target, for example, in terms of your sales and marketing efforts? And also will there be any further store opening plans going forward? Thank you.

Carl Yeung: Thanks, Daphne. Regarding the funding side, I think the first objective is to get regulatory compliance. So with respect to funding that are prohibited by the regulators such as financial asset exchange. We essentially now have a zero balance with financial asset exchanges.

We have actually increased significantly the amount of balance sheet. Right now, it contributes approximately 25% of our actual loan book, which is significant growth from last year. This is beyond -- this is currently in February.

So as of today, I want to remind you that the regulations issued in December actually had no time table. We are doing this all proactively to get ourselves ahead of actual regulatory so-called enforcement.

So our current loan book essentially looks like this -- a portion that is self-funded, which is going to our licensed small loan company; a portion which is going through our financial asset exchanges; and a portion that is going through our off-balance sheet arrangements.

Sorry, I don't have anything going to financial asset exchanges. It's actually through trusts. So trust, essentially banks do off-balance sheet arrangements, as well as our own small license. So that's all regulatory compliant.

In terms of costs, we expect that maybe for the rest of this year, the actual cost will increase by a very little bit, maybe 0.5% to 1% over what the overall funding cost we would've gotten last year. But that's all we are expecting, so there shouldn't be any big impact. So that's the funding side.

And then regarding 100,000 cars as a target for us in this guidance, we announced that we sold 4,800 cars by essentially just 2 days ago from the launch of essentially building that network by January end. It's actually a very, very fast run rate that we achieved, 4,800 car sales essentially with just 2 months of operation.

Mind you, that we actually experienced Chinese New Year, essentially a whole 1 ½ weeks in China where nobody does anything and we still sold 4,800 cars. So 100,000 unit cars is something that we have done to ramp analysis on, and we believe, number one, 175 locations will sufficiently satisfy about 100,000 unit car sales this year.

Let me remind you that we do have 62 million registered online users on our platform, of which approximately 19 million have not drawn down on their approved credit. So in the context of 100,000 unit of 19 million people, just in terms of the raw probabilities, is likely achievable. That's why we are showing these numbers up. While we do have plans to continue to explore additional distributed channels, if it allows us to sell more than 100,000 cars at a reasonable profitability, we will do so.

Daphne Poon: Okay. Thank you. Just a follow-up on the funding side. So I'm aware that earlier this year, or when the regulation rule first came out, there has been some funding cost change in terms of the partnership from banks and trust committees. So I just want to check whether there has been some -- any improvement in the funding situation with banks and trusts.

And also regarding that because new regulations, they require basically everything to be off-balance sheet, while treating with (inaudible) pure platform. So do you have any update in your progress of moving the loans off-balance sheet, for example, by providing -- partnering with any third-party guarantees? And if there is any, what would be the pricing on that?

Carl Yeung: Thank you, Daphne. Again, to follow up on this, essentially, what we saw in September last year, in December last year, in terms of the players that we work with have continued to work with us today. We really haven't seen drop-offs from the number of funding partners that work with us. The only drop-off is the financial asset exchanges, which was directly, say, mentioned by the regulations that we cannot work with them anymore, so we don't. And then that's kind of a funding partner.

In fact, we are seeing more and more of potential interest to join our platform, as we are currently offering an asset package, or access to these credit-underserved users, that no other platform can offer in this scale, in this cost structure, in this with the data attached. So there will be additional platforms with funding partners such as banks that will join this platform and that's the funding in terms of partnership side.

In terms of cost, when we put in guarantees, our quoted market rate so far is about 0.5%, 1 % annualized on top of what the funding partners will ask for. So roughly around 8.5% to 9% or what our external funding partner is asking for, it will become 9% to 9.5% I guess, so not much impact there as well.

Daphne Poon: So this is including the credit we expect the funding partner will bear, right?

Carl Yeung: That’s right, that’s right, yes.

Daphne Poon: Okay got it. Thank you.

Operator: Jinjin Qian with Needham.

Jinjin Qian: My question is, first could you share or give us an update on your user acquisition strategy since the Alipay policy change? We see kind of the user growth slowed a little bit in Q4. What are you planning to do to re-accelerate user growth in 2018 and beyond?

And second question is on the auto loan 100,000 car target, what is your strategy? Are you primarily planning to achieve the target through your existing 60 million users, or what is your marketing strategy for 2018? Are you planning for any large scale branding campaign as you did earlier this year?

And then lastly on the housekeeping, could you share the growth rate on the merchandise credit, or maybe the take rate on the merchandise credit business? Thank you.

Carl Yeung: Okay. So thank you for the question. Number one, user acquisition, as a platform as a whole, it's just announced we now have 62 million registered users. Not many platforms in China have this kind of user scale. Based on just this number alone, we should be happily achieving this guidance that we're providing of the RMB2.5 billion net income. We are only -- we only have to serve 6 million to 7 million users a quarter to get to RMB2.5 billion of net income, and 62 million is just a very, very large user pool.

We don't have intentions to expend a significant amount of marketing dollars to drive that registered user growth. We have enough users, period. Obviously, we will continue to see user growth backed by, number one, we offer the most user-friendly user experience and affordable credit you can find today in the market. So this 62 million should naturally grow whether we're on whatever platform.

We continue to exist on the Alipay platform and our app continues to grow its traffic naturally, not at the same high rates as last year. We will continue to grow. So just given these, we believe the guidance we're providing should be well achieved.

Yes, the second question regarding 100,000 units of cars -- based on our internal user registration base, plus some natural traffic associated with having that offline presence in these retail populated retail locations should get us to 100,000 units without significant marketing spend.

And thank you for following us. We did have a test; we did implement a test marketing campaign with an online questions game. We actually stopped that. We didn't spend much money at all. In the context of the grand scheme of things, we spent about RMB1 million, RMB2 million, which was essentially nothing. But sometimes media likes to blow things up as usual, as you all know. So it wasn't a big spending at all.

Your last question is the merchandise growth rate and sales commission. Now, as we're all familiar with our model, the merchandise credit exists because we have very, very large database from cash transactions. And recently in the last couple of months, industry delinquency has increased. Therefore, we reduced our credit for cash transactions. Therefore, we had become more cautious about merchandise volumes overall because we have to extend a larger credit to these users.

And because data is changing the underlying situation, we had to pull back on the credit that we offer to users. So merchandise volume is affected, and it will continue to have an affect at least in the first or second quarter of 2018.

And as our transaction volume for cash credit continues to improve and stabilize, and credit quality increases, we could see merchandise volume grow again. But Dabai Auto is different; when we sell a merchandise credit, for example, like a laptop or cell phone, that's an unsecured credit, a user is delinquent, they are delinquent. But auto is an asset-backed asset; that's why it will actually, as we do more and more volume of autos, it would drive down overall delinquency.

In terms of take rates, our 2017 average take rate for the fourth quarter was approximately 17%. So it’s consistent with what was happening basically in the third quarter.

Jinjin Qian: Thank you, Carl.

Operator: Dexter Hsu with Macquarie Securities.

Dexter Hsu: I have a question actually on -- your Company has already been bring about 175 branches at the end of January. And I’m wondering what is the trend of the per-store daily sales for your stores in January and after the Chinese New Year? Thank you.

Carl Yeung: Thanks for the question. The per-store unit sales is --how can we --

Dexter Hsu: Each day, your information?

Carl Yeung: Yes, how can I give you information without disclosing something unnecessary? So yes, (inaudible), in fact, you see we really only launched this with 175 stores at the end of January. And into January, we quickly ramped to approximately 80 units of new car sales every day, which is a significant achievement, given that it’s newly set-up distribution network.

So at the Chinese New Year, our volumes had to come down because we couldn’t actually sell cars as people go on holidays. But we are recently back to approximately 80, 90 units of daily volume again, so the trends are pretty good. And --

Dexter Hsu: Sorry to interrupt.

Carl Yeung: That's all right.

Dexter Hsu: How about the trend, the sales, day sales of the outlet opened in last year? And how to they perform right now?

Carl Yeung: So okay, we were selling average per-day in December, where it was like 0.04 new cars sold every store a day, and now, we are doing 10 times that.

Dexter Hsu: Okay.

Carl Yeung: Okay. Actually, our CEO would like to add.

Min Luo: (Speaking Chinese).

(Translated). So in the first quarter, we launched our auto business. We were doing some testing. We haven't aggressively ramped up our business yet because we want to focus more on user experience before we ramp up this business. So Q1 is testing period and in Q2, the sales will be much, much better.

Carl Yeung: And let me put things also in context. If you are familiar with the Chinese auto leasing industry, there are other players that have been doing this for 2, 3 years, and I'm sure you know the statistics. They're probably selling about 100 to just under 200 cars a day. So they've been doing this for 2, 3 years. We did achieve these kind of numbers in basically 2 months.

Dexter Hsu: Understand. (Speaking Chinese). Thank you.

Operator: Binnie Wong with Merrill Lynch.

Binnie Wong: My question here is that how do you see in terms of the auto -- how do you see in terms of your strategy compared to some of the auto verticals extending into auto financing versus your current strategy? How do you see your competitive edge in terms of previous user acquisitions or in terms of credit risk assessment? Any color on that in terms of how you think your competitive advantages will compare with the existing auto verticals? Thank you.

Carl Yeung: Thank you, Binnie. This is a really good question because we have re-invented the user experience. We built 175 retail locations, which are in the center to shopping centers. Really, we brought the purchase experience, the service experience, to the users, rather than having users go out 5, 10 kilometers away to these 4S distribution centers. This gives us tremendous access and basically a much better user experience.

We have the capital. As you see, we have over RMB9 billion of cash sitting on our balance sheet today, which I don't think any of the other auto verticals have. We have exceptional local execution power. We built these 175 stores essentially in around 80 days. I don't see any others players doing this.

Min Luo: (Speaking Chinese).

(Translated). So if you are familiar with our history, we are not the first one who entered into the campus consumer finance sector, but we are the number one in the sector within 1 year of launch. And then we were not the first ones in the online consumer finance sector. So it took us only 1 year to become the number one in that sector as well. So now, we think that after 2 months of launching, we are already in the tier-one player group in the auto financial leasing sector. And in the future, we will be the number one, not only in the online auto financing, but also in the overall cars sales and distribution.

The key to success is our team. We have a quite a lot of talent and capital, and we have not forgotten about our genes, about our DNA, that is moving very fast. Thank you.

Binnie Wong: May I just have a quick follow-up here? How about in terms of credit assessment and also in terms of the quality of the loans, how would you compare to your competitors? Thank you.

Carl Yeung: Thanks, Binnie. The credit assessment is actually something that we would actually have a slight advantage because we have 130 million actual transactions and delinquencies that no other players have. In addition, we will do the standard offline stuff like bank credit checks that all of our peers would do. So our advantage lies in actually in the additional data that that we have.

In terms of performance of delinquency, having sold 4,800 cars, we have only seen 10-late payments, and they haven't really gone to bad debt anyway. So the delinquency rate is what we expect because of the asset-backed situation, we would see it to be significantly better than standard unsecured cash credit or merchandise.

Minnie Wong: Okay. Thank you. That's very helpful. Thank you.

Operator: May Yan with UBS.

May Yan: (Speaking Chinese). Okay. I will translate briefly. So basically, an update on the Alipay relationship and since now with the banking, the setup of a banking credit company by the government, it seems like individual credit companies are not allowed to provide services on credit to clients. So how is the relationship with Ali?

And then secondly, on the cars, on the profit breakdown, what is the contribution from the car business, the car loan business? And what's the contribution expected from the cash loan or the credit side of the business into 2018? Thank you.

Carl Yeung: Thanks, May. Very quickly in terms of the cash credits, we are operating in a fully regulatory-required compliant way. So for example, we require users to put in a purpose when they apply for credit. And once these credits are formed, we actually are basically either going through our small loan license company, or off-balance with banks and trusts, which all these arrangements are reviewed by the appropriate regulators, so these are all okay.

36% is an all-in one service fee that we charge. We actually do something that is very conservative, called an average reducing balance rate. So we actually target one of the most conservative places in the market. There is only one fee, nothing else, very, very user friendly as well.

Alipay and Qudian's relationship remains the same as our last discussion in the last quarter. We are one of their partners, or one of the ecosystems partners. There are many, many, many other players so that relationship is basically still the same. QuCampus is still there. We generate -- I already mentioned that for transactions originated from the Alipay platform itself, there is a 24% APR cap.

And then for our own app, our originated transaction is 36%, compliant to current regulatory requirements. Currently, the overwhelming majority of transactions are happening on our app. Therefore, we see very little, in fact, immaterial impact to the average rate that we can charge.

So in terms of credit data, we are participating in the newly formed government-required credit system. In fact, we are one of the very few players with 130 million transactions. We don't need to rely on external credit data. The actual users transacting and delinquent is more valuable than any single credit score out there. We know these users better than any other data provider out there.

So we don't need to rely on a credit scoring system per se; we have our own, and it works. It works because we are the first in the market to react to a credit down-cycle, and we are the first that will recover and grow again through this credit down-cycle.

In terms of cars, how much it will contribute to the RMB2.5 billion, I obviously have a number, but unfortunately, we only disclose that RMB2.5 billion of that profit is our 2018 guidance.

May Yan: Thank you. Can I ask a follow-up? So on the fees, all-in charges of 36% or 24%, how is it being collected by the partner financial institutions that you work with, or these are through your micro loan companies, and so you basically use your own micro loan company to charge? When you partner with the other financial institutions, who collects fees and how they actually pass the fees to you, and how much do they keep? I guess that's the financing cost.

Carl Yeung: So the arrangement is really the same as what we were practicing in September with regards to off-balance sheet arrangement. They are specifically off-balance sheet because the fees are first collected by our funding partners. Then they distribute the fee to us. So for example, if the interest fee all-in is 36%, our funding partners will first collect 36%. And then for that fee to finance it, for example, that their cost is, say, 8%, they would take away 8%. They will keep 8% and then remit the remaining 28% to us. So that's kind of how off-balance sheet funding works in the first place, and it's been the same since essentially we initiated off-balance sheet arrangements since as early as August last year. So that hasn't changed.

And then if it's a loan that's originated, or credit that's originated through our small loan license, then we collect everything. We don't need to pay anyone anything.

May Yan: So the banks have no -- I guess the banks are willing to collect 36% on the loans?

Carl Yeung: Yes.

May Yan: There are no objections? Yes, so there is no sort of negative view or actions on charging too high by bank of 36%?

Carl Yeung: In fact, banks have been charging service fees plus interest for a very, very long time, so it's worked this way. Credit cards charge additional annual fees based on top of APR. What we have done is we let the banks work with an APR that make sense for them, and they can charge additional service fee, but all-in, it has to be under 36%.

May Yan: Thank you.

Operator: Alex Zhou with UBS.

Alex Zhou: I'll be quick since we are running out of time. So my first question is that, can you give us a quick update on the approval rate in the fourth quarter? So my question is that are we still targeting 80% approval rates in the future, and especially given the recent credit cycle and regulatory changes?

The second question is a quick follow-up on May's question regarding credits. Our understanding is that because of the establishment of (speaking Chinese) financial is no longer allowed to provide consumer credit to third-party lenders such as Sesame. So my question is currently, are you still using consumer credit, and if so, when would the current contract expire in the future?

And how do you think it will affect your credit assessment process, especially for new users which haven't borrowed from the platform yet?

And the third quick question is regarding tax rates. Can you give us more detail on why there has been such a significant tax refund in the third and fourth quarter this year? And what is the outlook going forward? Basically, what is the baseline effective tax rate should we put in our models? Thanks.

Carl Yeung: Thanks. Those are really good questions. First of all, our actual user approval rates in the fourth quarter were 55.8%. So in fact, it was higher in October and November, but once we saw December 1, credit quality decline, we quickly shrunk back to give an average of 55.8%. So we were actually achieving close to 70%, 80% in October, November, but we reacted very quickly. And this is the beautiful nature of small credit consumer market data.

So we no longer have an 80% approval rate. This only works if the market liquidity and the market situation favor that. So we will continue to adjust these targets as long as it makes sense for us. So hopefully, as the industry stabilizes, we will get back to these approval rates to offer more inclusive credit to more underserved users. Okay. So that's kind of that.

In terms of the Sesame credit score, I'm not at a position to disclose the specific relationship arrangement regarding the contract with Alipay. But I can assure you that without external credit scoring, we have complete capability in serving our users as evidenced by what you see in terms of actually us getting the credit volume controlled in January, February and now in March in a position to grow our credit volume again.

I can tell you none of the external data credit score per se plays a very strong role in our credit model anymore. We just have so much data ourselves.

Tax rate, yes, the tax rate in fourth quarter of 2017 is not high. We have been able to negotiate several favorable long-term tax refund arrangements with local municipal governments, which are supportive of technology and things like that. So we believe over the next year or two, a conservative tax rate of around 10% is probably a good kind of guideline.

Alex Zhou: Thanks. I appreciate it.

Operator: Thank you. And as the Q&A session is over, I would like to return the call back to the Company for any closing comments.

Carl Yeung: Ladies and gentlemen, thank you very much for sticking with us for almost 1.5 hours. We really have to let Min go for his birthday. So thank you for your interest and support in the Company. We look forward to talking to all of you again in our next update on earnings. Thank you very much, Operator.

Min Luo: Thank you. Thank you very much.

Operator: Thank you. This concludes today's conference call. Thank you for attending today's presentation. You may now disconnect.