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Q1 2021 Qudian Inc Earnings Call

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CORPORATE PARTICIPANTS

Min Luo *Qudian Inc. - Founder, Chairman & CEO*
Sissi Zhu *Qudian Inc. - VP of IR*

CONFERENCE CALL PARTICIPANTS

Jacky Zuo *China Renaissance Securities (US) Inc., Research Division - Analyst*
Steven Chan *Haitong International Research Limited - Executive Director*

PRESENTATION

Operator

Hello, ladies and gentlemen, thanks for standing by for Qudian Inc's. First Quarter 2021 Earnings Conference Call. (Operator Instructions)

Today's conference call is being recorded.

I will now turn the call over to our host from Qudian. Please go ahead.

Unidentified Company Representative

Hello, everyone, and welcome to Qudian's First Quarter 2021 Earnings Conference Call. The company's results were issued via newswire services earlier today and were posted online. You can download the earnings press release and sign up for company's distribution list by visiting our website at ir.qudian.com.

Mr. Min Luo, our Founder, Chairman and Chief Executive Officer; and Ms. Sissi Zhu, our VP of Investor Relations, will start the call with prepared remarks, and then we will open the call to Q&A.

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 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 20-F 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 *Qudian Inc. - Founder, Chairman & CEO*

Hello, everyone. I would like to thank you all for joining us on today's call. We kicked off 2021 with a solid first quarter. We greatly improved the quality of our assets while maintaining prudent operations of our cash credit business in light of the ongoing shift in online lending regulations. Notably, we recorded a net profit of RMB 478 million for the first quarter compared to a loss in the first quarter last year. Our net assets increased to RMB 12.4 billion, and we had approximately RMB 7.3 billion of cash, and cash equivalents and short-term investments at the end of the first quarter.

Our strong balance sheet allows us enough funding to invest in new business initiatives, which we believe will increase long-term shareholder value. We are very excited about the meaningful progress we have made with our early childhood education business, WLM KIDS.

In January, we launched our very first WLM Kids center in Xiamen, where our company is headquartered. This center occupies approximately 4,600 square meters. Early feedback has been positive. And we are forging ahead with our plans to expand our nationwide footprint in China's large, under-served early childhood extracurricular enrichment market.

Our mission for WLM KIDS club is to help Chinese kids grow up happy and healthy. We hope to help kids explore the potential in sports, arts and music cheerfully and freely, while also helping children build healthy bodies and minds parallelly.

We firmly believe in the great potential of extracurricular enrichment for young kids in China, we estimate that there are currently about 160 million kids between the age of 0 and 9 in China and we expect the penetration rate of extracurricular enrichment services as well as household spending in this area will grow WLM KIDS business in the world to defy kids' special curricular education. We consistently strive to differentiate ourselves from others and we believe WLM KIDS' value proposition for parents and kids is very clear.

Firstly, we guarantee a hassle-free refund policy as opposed to non-refundable lump sum prepayments required by many other institutions. Secondly, we provide comprehensive program offerings in one place to affordable prices, saving parents the time and money spent in taking kids to different places. Thirdly, we have well-trained instructors in each of our centers with standardized teaching procedures and we also have a centralized teaching research and development team. Last, but not least, we provide state-of-the-art high-tech facilities to create a safe and comfortable environment in each center.

With our first-mover advantages, we built strong entry barriers in 2 aspects: locations and talent. There are limited good and convenient location near core urban residential areas, and once we secure the right of use at these locations, others cannot easily find a similar location there. On the other hand, as talents are at the core of this business, we have attracted over 50 excellent entrepreneurs who have run education business with annual revenue of over RMB 100 million to join us as equity partners.

Specifically, our equity partners will actively participate in our frontline business operations. Our senior management team and employees are highly motivated and share the same vision, adding critical value to the success of this new business.

In conclusion, as we venture further into 2021, we remain cautious in our credit loan business operations, striving to develop our early childhood education business.

I'm also happy to share with you that we held our internal kickoff meeting today, attended by over 800 employees and core management teams, marking WLM KIDS' official move to the national stage for Xiamen. Backed by our shared vision, we look forward to joining hands with our core management team and employees to build a nationwide extra-curricular platform in China to help tens of millions of kids grow up happy and healthy.

Now I would like to turn the call over to Sissi for more details on our results.

Sissi Zhu Qudian Inc. - VP of IR

Thank you, Min, and good morning, and good evening, everyone. As Min mentioned, in order to navigate evolving market dynamics, we maintained our conservative approach to operate our loan business by rigorously assessing credit risks of new transactions. Consequently, we experienced an 8.4% decrease in transactions volume for our loan book business for the first quarter of 2021 compared with the previous quarter.

Our strict credit approval standards continued to pay off during the first quarter with a further sequential decrease in our delinquencies. In particular, our D1 delinquency rate for loan book business fell to less than 5% at the end of the first quarter of 2021, a normal level in our operating history.

Moreover, our balance sheet remained strong and healthy, enabling us to safeguard the interests of our shareholders. Additionally, more than 98% of our outstanding loans were funded by our own balance sheet loan transactions. And our M1+ Delinquency coverage ratio remained at 2.7x.

Echoing Min on our early childhood quality education business, we are actively progressing towards our goal of becoming a comprehensive one-stop service provider for early childhood extracurricular enrichment program. Our WLM KIDS project offers numerous top quality sports, arts, music enrichment programs for children from ages 0 to 9, such as swimming, basketball, football and dancing, et cetera. Following the effective opening and operation of the Xiamen Caizihui activities center, our first endeavor in the early childhood education market. We are designing more than 80 additional activity centers to replicate its success. Boasting solid financial strength and a superior team of education industry veterans, we plan to broaden our early childhood education services across the country with a mission to help Chinese children grow up happy and healthy.

The incremental spending in our WLM KIDS business may put pressure on our profitability in the near term, but we believe we are well equipped to tap into the opportunities in the fast-growing extracurricular enrichment market in China. Following the completion of loss-making ramp-up period, we anticipate that the Unit Economics, or UE, for the WLM KIDS club business will be very attractive. The UE will be superior to that of many other offline businesses because: number one, being large long-term traffic generating tenants, we can enjoy lower rents compared with smaller institutions; number two, we can enjoy lower user acquisition costs due to the variety of SKUs being offered and because of strong word-of-mouth referrals, as evidenced by the fact that over 50% of our traffic for the first center were from referrals and natural walk-ins.

Having said that, we have a concrete plan to expand across China this year, and hope our investors could stay with us and enjoy the great journey ahead. Going forward, we will keep a close eye on regulations in the online lending industry and proactively take adaptive measures in the rapidly changing environment. Supported by our adequate cash resources and strong financial position, we believe we can continue to grow our overall business and deliver sustainable value to our shareholders over the long term.

Now let me share with you some key financial results. In the interest of time, I will not go over them line by line. For a more detailed discussion of our first quarter 2021 results, please refer to our earnings press release.

Our total revenues were RMB 515.7 million, or USD 78.7 million, representing a decrease from RMB 958 million for the first quarter of 2020.

Our financing income totaled RMB 362 million, representing a decrease from the RMB 623 million for the first quarter last year as a result of the decrease in the average on-balance sheet loan balance.

Loan facilitation income and other related income decreased by 97% to RMB 12 million from RMB 422 million for the first quarter of 2020 as a result of the reduction in transaction volume of off-balance sheet loans during this quarter.

Our transaction services fee and other related income increased to RMB 50.6 million from a loss of RMB 150 million for the first quarter last year, mainly as a result of the reassessment of variable consideration.

Sales income and others increased to RMB 62.5 million from [RMB 17.1 million] (corrected by company after the call) for the first quarter of 2020, mainly due to the sales related to the Wanlimu e-commerce platform.

Our sales commission fee decreased by 68% to RMB 10.7 million from RMB 33.7 million for the first quarter of 2020 due to the decrease in the amount of merchandise credit transactions.

Our total operating cost and expenses also decreased by 97% to RMB 63.3 million from RMB 2 billion for the first quarter last year.

Our cost of revenues decreased by 4.8% to RMB 91 million from RMB 95.6 million for the first quarter last year, primarily due to a decrease in funding costs associated with the on-balance sheet loan book business, partially offset by the increase in cost of goods sold related to Wanlimu e-commerce platform.

Sales and marketing expenses decreased by 36% to RMB 37.6 million from RMB 58.8 million for the first quarter last year, primarily due to the decrease in third-party service fees and marketing promotional expenses.

General and administrative expenses decreased by 12.9% to RMB 66.7 million from RMB 76.6 million for the first quarter of 2020 as a result of the decrease in staff salaries.

Research and development expenses decreased by 28.4% to RMB 39.2 million from RMB 54.7 million for the first quarter of 2020 as a result of the decrease in staff salaries.

Our provision for receivables and other assets was a reversal of RMB 106.8 million compared to a loss of RMB 1 billion for the first quarter last year, mainly due to the decrease in past due on-balance sheet outstanding principal receivables compared to the first quarter last year.

Our income from operations was RMB 464.8 million as compared to a loss of RMB 961.1 million for the first quarter of 2020. Our net income attributable to Qudian's shareholders was RMB 478.4 million or RMB 1.81 per diluted ADS.

Our non-GAAP net income attributable to Qudian's shareholders was RMB 488.3 million or RMB 1.85 per diluted ADS.

With that, I will conclude my prepared remarks. We will now open the call to questions. Operator, please continue. Thanks, Annie.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And your first question is from the line of Jacky Zuo of China Renaissance.

Jacky Zuo *China Renaissance Securities (US) Inc., Research Division - Analyst*

(foreign language)

So let me translate my questions. Congrats for the solid results. I have 2 questions. Number one is about our credit business. We observed that our risk level continued to decrease year-to-date. So just want to check what is our loan balance outlook for this year. And in terms of the credit business model, my understanding is we continue to use the interested lending model for our on-balance sheet loans.

Do you see any regulatory pressure for this type of model? Are we planning to switch to, let's say, license lending, for example, using the micro loan license? And second question is about our new business, WLM KIDS. So just trying to understand the unit economics for this new business. Can you give us some details of breakdown? And Also, we mentioned we will increase the spending for this new business in terms of the nationwide expansion. So what will be the investment scale and pace going forward?

Sissi Zhu *Qudian Inc. - VP of IR*

Thank you, Jacky. I'm happy to see you on the call. So let me answer your questions one by one. Regarding our credit business, as we also observed at our D1 delinquency rate and as well as our vintage charges have been improving over the past quarters. But in the long-term future, the demand for small credit will always exist. However, in China, such demand in the long term, we believe, will be highly likely started by large financial institutions as opposed to nongovernment-backed technology companies like us. So the regulation risks in this sector should not be ignored as we observed that the tone from regulators have been on the tightening side.

So in our point of view, including things like interest rate cap, leverage restriction, information disclosure requirements, credit guarantee restrictions, et cetera. Therefore, not many positive updates in the regulation in the first quarter or the second quarter. As such, we chose to maintain our prudent strategy, and which means we will maintain our similar credit assessment, rigorously credit assessment rules and similar volumes. However, our loan balance for our loan book business will still be decreasing in the second quarter.

With regards to the on-balance sheet loan channels from the interested loan model to other regulated models -- license models. Yes, we have already changed that to license trend. So the risks pending the interest-to-loan model is not with us.

Regarding your second question on our UE we expect the UE to be superior to that of many of other offline businesses. Although it is our company's policy not to give guidance since 2019, we surely will incur some Capex for the renovation of activity centers and operational expenses for staff costs and rents. The unit economics, although I couldn't give out concrete guidance, I could help guide the market to think and make reference to other offline businesses.

Our UE will be superior to many traditional education businesses as we do not need to incur abnormally high user acquisition costs or high rents. And also, our UE could be a bit similar to that of offline catering business as well. Just need to take out the large amount of food and consumable expenses of the offline catering business. So UE will be very attractive.

And with regards to our Capex and the ramp-up speed, as we mentioned in our call and presentation, we currently have over 80 centers in the designing process and renovation process. So we expect to do a big ramp-up and expansion nationwide this year. There will be certainly Capex expenditures, but we expect, in the steady state, our UE will be very attractive.

Operator

(Operator Instructions)

Our next question is from the line of Steve Chan of Haitong International.

Steven Chan *Haitong International Research Limited - Executive Director*

(foreign language)

Let me translate it into English. I have 2 questions. First of all, I think Sissi just mentioned about the loan balance of the credit business will likely to reduce in Q2, and we will maintain a conservative approach in the credit business. So does that imply that in the medium term Qudian is likely to gradually transform from loan facilitation or credit lending business towards more like an early education company. That's the first question.

And secondly, 2 sub-questions. One from the accounting point of view, where did you put the revenue and expenses of WLM KIDS in the P&L account? And do you have any target revenue or target return for this business, say, in 3 years time?

Sissi Zhu *Qudian Inc. - VP of IR*

Thank you, Steven. Good to meet you over the line and let me address your questions one by one. First of all, our balance dropping and rate. As a matter of fact, the unit economics of our credit business is still very profitable. We charge at 36% annual interest rate and our annualized delinquency defer rates is less than 10%. So this business is still very lucrative. So, as long as we're making profit on this business, we will keep a similar level of loan volume and similar level of risk assessment procedures.

In the mid- to long term, from an investment point of view, as we were seeing today, the investors, who invest in both credit business and WLM KIDS business, if the payoff from WLM KIDS business is better than our cash credit business, we will allocate more resources into WLM KIDS business for sure. And from a regulatory standpoint, we believe the WLM KIDS quality education business is safer from the regulatory point of view. Although, it is still very small at this stage as we only have a full quarter of 1 school, 1 center only in the first center.

So relating back to your second question. In accounting terms, our revenues and costs for the first WLM center is quite minimal, and it is inside the sales income as well as the cost of goods sold. In 2 to 3 years, the return on WLM KIDS business, we expect that the unit economics of this business, after the ramp-up period, will be very attractive. If we look at the offline catering business, the unit economics of net profits will be around 10% net profit margin. And for some other offline education business, the UE for net profit will be around 10% to 20%.

So as we have experimented our strategy in our first and second school, we anticipate the UE of our WLM KIDS business will be superior to that of the offline catering and traditional offline education business. I hope that answers your question. Thank you, Steven.

Operator

(Operator Instructions)

All right. There are no further questions now. I'd like to turn the call back over to the company for closing remarks. Please continue.

Sissi Zhu Qudian Inc. - VP of IR

So thank you all once again for joining today's conference call. We warmly invite investors to visit us in Xiamen, and very soon in other major cities in China as well. If you come see our centers in person, I'm sure you'll be impressed by the new species of Qudian's quality education that we are developing.

And if you have any further questions, please don't hesitate to contact our IR team and visit our IR website. Thank you once again very much.

Operator

Thank you. This concludes the conference call. You may now disconnect your lines. Thank you.

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