[NYSE: YRD] - Yirendai Q3 2016 Earnings Conference Call

8:00a.m. U.S. Eastern Time, November 16, 2016

Presenters

- Mr. Matthew Li, Director of Investor Relations
- Ms. Yihan Fang, Chief Executive Officer
- Mr. Dennis Cong, Chief Financial Officer
- Mr. Huan Chen, Director of Yirendai & Chief Strategy Officer of CreditEase (Q&A only)
- Mr. Yang Cao, Chief Operating Officer & Chief Technology Officer (Q&A only)

Analysts

- Eric Wen, Blue Lotus
- Mayank Tandon, Needham & Co.
- Julie Ho, Morgan Stanley

Presentation

Matthew Li – Director of Investor Relations

Thank you and welcome to Yirendai's third quarter 2016 earnings conference call. Our earnings press release and supplemental presentation slides are now available on our website. Hope you had the chance to review the materials by now.

Today's call features presentations by our Chief Executive Officer Ms. Yihan Fang, and our Chief Financial Officer Mr. Dennis Cong. Mr. Huan Chen, Director of Yirendai and Chief Strategy Officer of CreditEase, and Mr. Yang Cao, our Chief Operating Officer and Chief Technology Officer will 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" provisions of the U.S. Private Securities Litigation Reform Act of 1995. Such statements are subject to risks, uncertainties and factors that may cause actual results to differ materially from those contained in any such statements. Further information regarding potential risks, uncertainties or factors is included in Yirendai's filings with the U.S. Securities and Exchange Commission. Yirendai does not undertake any obligation to update any forward-looking statement, except as required under applicable law.

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

With that, I will turn the call over to our CEO. Yihan, please begin.

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Yihan Fang – Chief Executive Officer

Thanks Matthew and thank you all for joining the call today.

The third quarter of 2016 was a landmark quarter for the online lending industry in China with the issuance of the *Interim Measures for the Administration of Business Activities of Online Lending Information Intermediary Institutions* by the Chinese government on August 24th. These measures seek to address the most critical issues in the China online lending market. We believe these measures will benefit consumers while promoting the healthy development of China's online lending industry. We are well positioned to expand and strengthen our industry-leading position and are confident that we will be able to provide better services to more customers across China.

We continued to gain growth momentum during the quarter by focusing on technology-driven product development, partnership expansion and risk management. We provided products and services to approximately 264 thousand borrowers and investors with total loan facilitation volume reaching RMB 5.6 billion, an increase of 24% from the previous quarter and 120% from the same period last year. This brings our cumulative loan volume to RMB 25.7 billion.

In addition to the overall growth in the scale of our business, we continue to expand our online operations. 59% of our borrowers during the quarter were acquired through online channels which accounted for 40.5% of our loan volume. Our mobile application generated 39.8% of our total loan volume and accounted for 98.3% of all loans generated online, demonstrating just how important our mobile solution is for us to effectively serve our customers.

We continue to expand the geographic coverage of our existing products and are leveraging our technology to develop new ones. We expanded the coverage of our Housing Provident Fund Product to more than 50 cities during the quarter and recently launched a revolving loan product for our existing borrowers who have a proven track record of monthly payments. In addition, we are testing our new FastTrack 3.0 product which is designed to improve user experience and enhance risk control.

We have been exploring partnership opportunities with consumption-oriented industry verticals as an important customer acquisition channel. We recently enhanced our cooperation with a leading cosmetic surgery platform in China to finance the needs of select customers. We believe this type of cooperation will enable us to further improve our customer acquisition efficiency and enhance our risk management.
We also continued to enhance our risk management model by adding new data sources, fine-tuning our processing algorithms and introducing more stringent anti-fraud measures. For example, we are changing the way we acquire credit card statements. Instead of receiving them from loan applicants, we are going directly to the bank online system to ensure the credibility of the statements. We also added several new front-end anti-fraud mechanisms based on user behavior data. We believe these efforts will enhance our risk management capabilities and support our business growth in the long run.

During this quarter, we continued to see strong investor demand and improved customer stickiness. We facilitated a total investment amount of RMB 6.0 billion from about 171 thousand investors, 83.2% of which was done through our mobile application. Average tenure of our investors' investment portfolio exceeded 13 months in Q3. While demand from individual investors is strong, we have been actively seeking opportunities to cooperate with financial institutions to diversify our funding sources and reduce our funding costs.

To address the overwhelming demand from investors, we began transforming our marketplace to a more integrated financial services platform. We recently established Yiren Financial Information Services (Beijing) Co., Ltd., which will enable us to distribute third-party wealth management products on our platform and provide our investors with diversified investment opportunities and value-added services.

Turning to the regulatory environment, we are delighted to see the CBRC and 3 other government entities issued the *Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions* on August 24th. We see this as an important milestone for China's online lending industry and the government's recognition of the value that it creates. It also demonstrates the government's efforts in addressing the most critical issues in the rapidly-developing market to protect the interests of consumers. We believe that the implementation of these *Interim Measures* will promote the healthy development of China's online lending industry and benefit consumers.

Among all the measures, we believe the requirement for fund custodians is essential for customer protection and sets a very high industry barrier to entry. It requires online lending platforms to separate their own funds and the funds of lenders and borrowers, which should be managed by a qualified banking financial institution. Yirendai has been operating under bank custodian with China Guangfa Bank for over a year.

The rules also set upper limits for borrowers. Each personal borrower may only receive a maximum of 200 thousand RMB from any one online lending platform with the upper limit for total balance of all loans for each personal borrower on different platforms set at 1 million RMB. Currently only less than 5% of the loans originating from Yirendai are above the 200 thousand RMB limit and we are in the process of adjusting the loan size accordingly. On September 9th, the National Association of Internet Finance launched the Internet Financial Industry Information Sharing Platform and Yirendai is one of the first 17 members to join the effort. We began uploading our monthly operating results to the information sharing platform in this month and will be able to look up data soon. This is a significant progress for the China online lending industry which could lead to an industry wide credit reporting system that help to reduce multiple platform borrowing risk and increase default cost for borrowers.

In addition, the regulation prohibits illegal fund raising and requires data disclosure and transparency among many other very important rules.

As the regulatory and business environments continue to improve, we are confident that Yirendai is well positioned to continue gaining strong growth momentum. We remain focused on ensuring our full compliance as well as enhancing our financial technology capabilities and expanding cooperation with ecosystem partners to better serve the enormous demand in the market.

With that, I will hand the call over to our CFO, Dennis to discuss about our Q3 financial results.

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Dennis Cong – Chief Financial Officer

Thanks Yihan, we had another outstanding quarter in Q3 2016. We facilitated RMB 5.6 billion ($842 million) worth of loans, an increase of 120% year-over-year from Q3 2015. We billed a total of RMB 1.3 billion ($198 million) in fees during the quarter, an increase of 125% when compared with Q3 2015. Transaction fees from borrowers accounted for 98.2% of total fees billed.

Among the total fees billed, Upfront fees billed to borrowers in the third quarter of 2016 were RMB 1,192.4 million (US$178.8 million), increased by 109% from the same period of 2015. Monthly fees billed to borrowers in the third quarter of 2016 were RMB 105.8 million (US$15.9 million), up by 349% from Q3 2015. Service fees billed to investors in the third quarter of 2016 were RMB 110.9 million (US$16.6 million), increased by 318% from the same period of 2015. Both monthly fees billed to borrowers and service fees billed to investors are recurring in nature and grow with the outstanding loan balance, are contributing at an increasing % of our total fees billed.

Total net revenue in Q3 was RMB 877 million ($131 million), an increase of 137% year-over-year and 19% on a sequential basis. This increase was primarily driven by the growth in loan origination volume due to strong customer demand. Looking at our revenue mix, we recognized RMB 848 million ($127 million) for loan origination services provided upfront, and RMB 23 million ($4 million) for post-origination services. RMB 431 million ($65 million) in fees billed associated with risk reserve fund were net included in our income statements.

In terms of our loan product portfolio during the quarter, 79.4% of our new loans facilitated were product D, slightly down from 83.1% in the previous quarter, with a 27.6% average transaction fee rate. The product volume mix for Product A, B and C were 7.0%, 4.7% and 8.9%, with transaction fee rate at 5.6%, 17.3% and 24.8% respectively. New product introduction and channel volume mix change contribute to the product mix shift during the quarter.

On the investor side, our annual Yidingying average investment yield on the platform in Q3 2016 was 8.6%, down from 8.8% in Q2 2016, and average investment tenure was 13.2 months, up from 11.9 months in Q2, as we continue to benefit from strong investor demand for high quality assets on our platform, stronger brand and market leadership, as well as low interest rate environment.

Turning to operating expenses. Sales and marketing expenses were RMB 423 million ($63 million) for the quarter or 7.5% of loan origination volume, slightly lower than 7.8% in Q2 2016 as we continue to benefit from the strong investor demand. Origination and servicing costs were RMB 62 million ($9 million) for the quarter or 1% of loans facilitated, similar to that in Q2 2016. Our G&A expense were RMB 189 million ($28 million) for the quarter or 22% of net revenue, compared to RMB 73 million or 10% of net revenue in Q2 2016. The increase in G&A expense was mainly due to the expense of RMB 81 million ($12 million) related to the fraud incident in July 2016. The rest increase in G&A expense was due to share-based compensation expenses of RMB 15.3 million (US$2.3) and increased salary expenses as we expanded our technology team to support our product and platform developments.

In terms of profitability, our Adjusted EBITDA margin decreased from 36% in Q2 2016 to 25% in Q3 2016 mainly due to the RMB 81 million fraud related expense, and net income margin increased from 36% in Q2 2016 to 39% in Q3 2016 impacted by the fraud expense offset by the tax credit of RMB 152 million ($23 million). The income tax benefit was primarily because the Company’s subsidiary Yi Ren Heng Ye Technology Development (Beijing) Co., Ltd., became qualified as a software enterprise which makes it eligible for an exemption of enterprise income tax for 2015 and 2016. If Yi Ren Heng Ye continues to be qualified for this status, it would subject to a preferential tax rate of 12.5% for 2017, 2018 and 2019. If we exclude the impact of fraud incident, the Adjusted EBITDA margin for Q3 2016 would have been 34%. By excluding the impact of fraud incident and the tax credit, Adjusted net income for the quarter would be RMB 274 million ($41 million).

The recent delinquency rate and vintage charge off performance are well within our expectation, and charge off performances for 2015 and the first two quarters of 2016 vintage loans have shown stable trends, which demonstrate our capabilities in credit underwriting and risk management. During the third quarter of 2016, we went through thorough analysis on the organized fraud incident, implemented more stringent risk and anti-fraud policies, and significantly enhanced our anti-fraud technology. We would also continue our efforts on collection to minimize the loss.

Specifically, as of September 30, 2016, the overall delinquency rate for loans that are 15 – 89 days past due was 1.9%, slightly increased from 1.7% as of June 30, 2016, the increase of delinquency rates was in line with the Company’s expected delinquency level of the asset portfolio performance. The charge-off rate for loans originated in 2015 was 6.1% as of Q3 2016, compared to 4.4% as of Q2 2016, as the loans further mature. The charge-off rate for each vintage from Q1 to Q4 2015 is improving as indicated in the Cumulative M3+ Net Charge Off Rates curve on Slide 25 of the Q3 2016 management presentation, indicating strong credit performance of all products in our loan portfolio. As of September 30, 2016, the outstanding balance of liabilities from risk reserve fund guarantee is at 7.6% of remaining principal of performing loans covered by risk reserve fund, up from 7.2% in Q2 2016. We expect the solid credit performance to continue as we further refine our risk pricing model, expand our product portfolio into high quality asset and improve delinquency management.

On the balance sheet side, we had about RMB 1.1 billion ($166 million) in cash and cash equivalents, compared to RMB 1.3 billion as of Q2 2016. The decrease was primarily due to our increase in short-term investments, presented as available for sale financial assets and held-to-maturity investments on balance sheet, to enhance the return from operating cash. As of Q3 2016, balance of held-to-maturity investments was RMB 173 million (US$26 million) and balance of available-for-sale investments was RMB 298 million (US$45 million). Additionally, we had RMB 974 million ($146 million) in restricted cash in our risk reserve fund account and trust account. We also booked RMB 368 million ($55 million) in loans at fair value as a result of consolidating the trust and ABS.

Our liabilities were mainly comprised of two items: RMB 1.2 billion ($186 million) in liabilities from risk reserve fund guarantee and RMB 355 million ($53 million) payable to investors at fair value as a result of consolidating the trust and ABS.

Cash flows in Q3 2016 were also very healthy. We generated RMB 269 million ($40 million) in net cash from operating activities, which was mainly generated from transaction fees charged to borrowers; RMB 679 million ($102 million) in net cash used in investing activities, which was mainly related to the increased investment in short-term assets to enhance the yield on our cash.

With that, let me go over our guidance. Considering the stronger than expected results in the first 3 quarters and continued momentum in the fourth quarter, we are tightening up our full year guidance, for full year 2016, we expect loan origination volume to be in the range of RMB 19.75 billion to RMB 20 billion, increased from our original guidance of RMB 19.0 billion to RMB 20.0 billion. Full year net revenue to be in the range of RMB 3.08 billion to RMB 3.12 billion, increased from our original guidance of RMB 3 billion to RMB 3.1 billion. Full year Adjusted EBITDA to be in the range of RMB 910 million to RMB 930 million, increased from our original guidance of RMB 800 million to RMB 850 million.

That concludes my remarks; I'd now like to turn the call back to operator for the Q&A session. Operator, please.

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Question and Answer

Operator: Yes, thank you. (Operator Instructions) Eric Wen; Blue Lotus.

Eric Wen: Congratulations on a strong quarter. I have two questions. The first question is regarding your loan grade, which showed a decrease of the grade D loan and an increase of other grade. Just wonder what kind of operating improvement have you done to reduce the grade D loan, and how would the loan mix change going forward?

And my second questions is regarding if we are seeing this decrease in the grade D loans but we are [charging] still the same percentage in the billings to the risk reserve fund, should we expect the charge-offs to come down a bit going forward? Thanks.

Dennis Cong: Okay, I guess I will take the question. First, I think the reason for the D percentage coming down in Q3 slightly from Q2 is mainly due to new product introduction that has taken a higher percentage of the volume from our online products. That's causing the volume mix of the D type decrease a slight bit in the quarter.

However, we expect near term our D type of loans should continue to be in the 80 or low 80 range from our current product portfolio (interaction) and our online/offline volume mix. So we actually do not expect the D type of loans to change meaningfully near term.

However, longer term as we continue to expand our product portfolio and entering new markets, we will expect to see a more balanced portfolio mix among our product portfolios.

And then, as to the second question, of course as we expand our loans to cover more type of borrowers and more balanced portfolio, we will see the overall blended charge-off to improve if the mix of the borrowers are shifting more towards the higher credit quality borrowers. But near term we would expect this issue to be stable and maybe longer term we'll see that balancing out.

Eric Wen: Thanks very much.

Operator: Mayank Tandon; Needham & Company.

Mayank Tandon: Good job on the numbers. Dennis, just a few questions for you on the model. First, can you remind us, as we build out 2017 the seasonality in the business? That will help us make sure we get the numbers aligned correctly.

Dennis Cong: Okay. So, usually our business has a seasonality. Usually the first quarter seems to be slower. That's due to the holidays, the Chinese New Year holiday. And this year I think the Chinese New Year holiday is more in January than last year, so probably will impact our January volume somewhat.

So usually our seasonality is that the first quarter tends to be slower. And then the second and third and fourth quarter tend to move up. Of course usually in Q4 you also have October national holiday, sometime also take away the sequential quarter-over-quarter growth a bit.

So usually first quarter is a slow season and then from sequential perspective, Q3 to Q4 tend to slow down slightly. So that's the way that we would look at from the seasonality perspective.

Mayank Tandon: Great, that's helpful. And then in terms of take rate, it's been bouncing around a little bit this year. What should we expect as we move forward in terms of take rate?

Dennis Cong: Sure. Yes, that's actually a very good question. So, our take rate is actually driven by our product mix. One reason is that we have a very prudent revenue recognition policy that we recognize our revenue on a cash collection basis. And then, if you look at our product categories, for the offline products, given that the previous business practice most of the fees are collected up front, so we recognize the fees up front and then usually tend to have a somewhat higher take rate from those product portfolios.

But for our online, when we first designed we wanted to be more customer friendly. So for online products we tend to collect about 40% of the fees to the borrowers up front, and then the remaining 60% to be collected on a monthly basis throughout the loan lifetime.

So in that sense, the take rate of the online products for any current period tends to be lower than the offline products. And then [as] the online percentage of loans are growing as a higher percentage you're actually going to see the overall take rates slightly coming down just because of the product mix.

However, the remaining deferred collection of those monthly revenue will actually come in in the later months. And as we highlighted in this conference call, the monthly fees billed to borrowers has already becoming a very high percentage. So it's only a matter of the timing of these revenue being collected and recognized.

But near term you will see trending down of our take rate because the increasing percentage of online business as our online grows faster.

Mayank Tandon: Right. That makes sense. Okay. And then two quick ones, one on the taxes. I'm sorry; I know you walked us through the tax rate. But did you say that going forward we should expect a 12.5% tax rate from a modeling perspective -- 12.5%? Did I hear you right?

Dennis Cong: Yes. Well, for the (inaudible), for [here] we will have about 12.5% tax rate. However, we also have a China operation that still has certain of our business revenue coming in that's actually going to have somewhat higher tax rate. So from a modeling perspective, going forward I think 18% total effective tax rate will be the right way to model it.

Mayank Tandon: Okay, 18%. And then, last question from me is on the share count. Again, just what are you expecting? Just so we get our EPS numbers right, what are you expecting in terms of share count creep?

Dennis Cong: Yes. Just wait one second. Yes, let me just find the number for you. I have it here, I remember. Okay. For Q3 the weighted average number of [ordinary] shares in terms of common shares is 119.4 million common shares. So if you convert to ADR and divide by 2 -- however, if you're computing on the diluted basis, it would be 120.86 million because of the (inaudible) we issued.

Mayank Tandon: Right. I was sort of wondering going forward what kind of share creep are you building into the model, just so we get our EPS numbers aligned correctly.

Dennis Cong: 2017?

Mayank Tandon: Right.

Dennis Cong: Yes, just give me a second.

Mayank Tandon: Sure. You can get back to me later if you like, either way.

Dennis Cong: Okay, yes. We can get that number back to you later. Yes.

Mayank Tandon: Sure. Thank you.

Operator: (Operator Instructions) [Judy] Hou; Morgan Stanley.

Julie Hou: I have one question on the outlook of regulatory framework and the competitive landscape of P2P platform in the future. And recently the State Council issued the expected regulations and I heard that members also received training from Internet Finance Association. So could you share with us the [upload] of regulatory framework and the competitive landscape of P2P platform in the future?

Yihan Fang: Hi, Julie. This is Yihan. Just to give you update that we were among the first batch upload the data sharing platform and that we already uploaded [one] for our lending base. And there were 17 platforms who uploaded in the first batch. And soon we'll be able to look up for our borrowers information across the other platforms through the data sharing platform. Yes. And I believe the Internet Finance Association will include other online lending platforms in the near future.

Yes, so the competitive landscape. First of all, although a lot of platforms are in the process of complying to the new regulations, we still see the few stronger platforms actually are growing pretty healthily in each segmentation. So when we look at third-party data, actually we see the total market size still growing very well. And we believe that there is market consolidation opportunities as well in the process.

Dennis Cong: Yes. Julie, I'll also add just as a quick comment on top of Yihan's comments. One thing is that if you look at some of industry research showing that year over year the P2P industry has probably grown

70%, or 80% this year. However I think Yirendai is growing 100%. So in that sense we are gaining some market share. But we also want to grow our business at a sturdy pace because we're a risk management business.

And from our daily operations we actually feel that there is less irrational competition, either from the borrower side or from the investor side. And also, through the regulation implementation, we actually have seen that the [leading] platform is enjoying a better market share or customer awareness. Our brand name is definitely extending out from our participation in the Internet Finance Association as well as in our full compliance status with the regulations.

I think the data system, as Yihan also mentioned, is very significant for our industry because that could create a new industry-wide credit reporting system, so we can actually check multiplatform borrowing to minimize that risk. And also any borrower who defaults on our platform will impact their next borrowing costs from other platforms, so will also help us to minimize the overall default rate as well. So that's definitely a very positive trend for our industry.

Julie Hou: Thank you very much.

Operator: And as there are no more questions at the present time, I would like to return the call to Management for any closing comments.

Yihan Fang: Yes. Thank you very much for joining our call. If any of you have any questions, please feel free to contact our IR. Thank you very much.

Dennis Cong: Thank you.

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