

**Sunlands Online Education Group [STG]
Q1 2020 Earnings Conference Call
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Executives

Daisy Wang, Head of Investor Relations
Tongbo Liu, CEO and Director
Selena Lu, CFO and Director

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Sunlands' First Quarter 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. After prepared remarks by the management team, there will be a question-and-answer session. Today's conference call is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the call over to your host today, Daisy Wang, Head of Investor Relations of the Company. Please go ahead.

Daisy Wang: Hello, everyone, and thank you for joining Sunlands' first quarter 2020 earnings conference call. The Company's financial and operating results were issued in a press release via newswire services earlier today and are posted online. You can download the earnings press release and sign up for our distribution list by visiting our IR website.

On the call, our CEO, Tongbo Liu, will provide an update on our operational performance as well as our strategic initiatives. Our CFO, Selena Lv Lu, will give you an overview of our financial performance and also provide our guidance for the second quarter of 2020. Following their prepared remarks, we will move into the Q&A session.

Before I hand it over to the management, I'd like to remind you of Sunlands' Safe Harbor statement in relation to today's call. Except for the historical information contained herein, certain of the matters discussed in this conference call are forward-looking statements. These statements are based on current trends, estimates and projections, and therefore, you should not place undue reliance on them.

Forward-looking statements involve inherent risks and uncertainties. A number of important factors could cause actual results to differ materially from those contained in any forward-looking statement. For more information about the potential risks and uncertainties, please refer to the Company's filings with the SEC.

With that, I will now turn the call over to our CEO. Please go ahead, Tongbo.

Tongbo Liu: Thank you, Daisy. Hello, everyone. Welcome to Sunlands' first quarter 2020 conference call. Sunlands delivered solid first quarter results despite significant challenges stemming from the COVID-19 pandemic, specifically the lockdown of our Wuhan campus, which affected almost half of our sales force, and the postponement of national STE exams from April to August that has delayed student enrollments for our preparation classes.

Our capacity utilization was significantly limited due to the pandemic and gradually improved to about 80% during the quarter, thanks to the extraordinary efforts of our employees and our robust online infrastructure.

We achieved gross billings of RMB516.8 million in the first quarter, in addition to profitability improvement with net loss margin narrowed by 8.4 percentage points to 11.6%, resulting from our prudently managed costs and expenses.

While the COVID-19 pandemic has posed challenges for both individuals and businesses, they have also presented emerging opportunities. The pandemic has forced schools, universities, and companies to turn to remote working and teaching, creating a boom in online learning.

Although the STE exams have been postponed, our students are actually spending more time to prepare for the tests, and showing a higher level of loyalty and enthusiasm for learning.

In the first quarter, total time spent on live-streaming classes and the number of quizzes taken per active user increased 19% and 21% respectively year-over-year. We expect the increasing engagement to lead to improved examination results, and help promote our courses in the future.

Inspired by people's changing behavior patterns during the lockdown period, in the first quarter of 2020, we began experimenting with new approaches to student acquisition, aiming to increase sales efficiencies and student conversions. In addition to our strengthened student acquisition strategy, we continued to diversify our online course offerings to include more Master's-oriented, professional certificate and non-degree programs, by adding new courses to satisfy the needs of our students to develop their interested knowledge areas and professional skills.

Leveraging our online education expertise and online infrastructure, this will help us drive new growth by catering to a wider student base, increasing our students' willingness to pay for more courses and maximizing their engagement.

As the admission rate of Master's programs recently reached a 10-year low of 28.2% in China last year, we see strong market growth potential for our products in this segment. Our Master's degree-oriented programs accounted for 22.5% of total gross billings in the first quarter of 2020, significantly higher compared with 12.1% and 3.7% in 2019 and 2018 respectively. Our MBA programs, in particular, are attracting strong interest from our students, as we offer joint programs with leading institutions domestically and abroad at an affordable price range.

In addition to our efforts to drive the development and innovations of our core businesses, we have expanded our offerings by establishing a new business vertical designed specifically to provide online employee training services to corporations. Our B2B training services offer mobile-based learning infrastructure, numerous professional skill training courses and other related services designed for corporations. Since its initial launch, our B2B training services have

received positive feedback, with [315] corporate clients signed up. Despite its current relatively small scale, I am confident that our B2B training services will well complement our core business in the future.

Turning to the pandemic, as a show of support during this time, we donated approximately RMB 5 million in cash, in addition to offering free online courses to Wuhan. As conditions relating to the COVID-19 outbreak continue to gradually improve, we are confident to enhance our financial and operating results for the remainder of the year.

For the long run, we will further focus on student acquisition strategies, diversification of our course offerings, upgrade of our offerings and investment in IT infrastructure, all in an effort to better satisfy our students' needs and strengthen our brand value.

I'm glad that starting from April 30, Ms. Lv will serve as the CFO of the Company. Ms. Lv has served as Sunlands' Chief Strategy Officer since joining the Company in 2015, and has been an instrumental part of the senior management team leading 3 rounds of private financing and the Company's IPO.

With that, I would like to hand over the call to our CFO Selena to run through our financials.

Selena Lu: Thank you for the introduction, Tongbo, and hello, everyone. Thanks for joining us. I'm very happy to begin my new role with the Company and host this conference call. I will have my 5th anniversary with Sunlands in July this year. In the past 5 years, I have been privileged to serve Sunlands, and deeply and passionately engaged in its growth and development. I strongly believe that the online education industry is one of the most promising industries in China.

In the future, together with Tongbo, our CEO and my best partner, I will communicate our Company strategies, operational performance and corporate governance, transparently, openly and responsibly to the capital markets.

During the first quarter, we continued our balanced approach to both revenue growth and profitability. We were pleased, especially amidst the difficulties caused by the COVID-19 outbreak, to see sustained strength in our gross profit, which increased sequentially for 2 quarters in a row, as well as narrowing our net losses both sequentially and year-over-year.

With cost structure optimization as a continued priority, our operating expenses decreased 7.3%, compared with the same period last year.

Looking ahead, we are optimistic that along with our new initiatives focused on student acquisition and enriched content, we can further leverage our existing infrastructure to improve both the sustainability and effectiveness of our business model, and ultimately, drive long-term growth.

Now, let me walk you through some of the key financial results for the first quarter 2020. All comparisons are year-over-year and all numbers are in RMB.

In the first quarter of 2020, net revenues were RMB565.1 million, relatively flat to the first quarter of 2019.

Cost of revenues increased by 13.4% to RMB96.9 million in the first quarter of 2020 from RMB85.5 million in the first quarter of 2019, which was primarily due to an increase in expenses related to fees to educational institutions.

Gross profit decreased by 2.2% to RMB468.2 million from RMB478.7 million in the first quarter of 2019.

In the first quarter of 2020, operating expenses were RMB567.8 million, representing a 7.3% decrease from RMB612.7 million in the first quarter of 2019.

Sales and marketing expenses decreased by 7.9% to RMB457.9 million in the first quarter of 2020 from RMB497.3 million in the first quarter of 2019. The decrease was mainly due to reduced marketing spending, reflective of disciplined, prudent cost management, and the decrease in expenses related to sales and marketing personnel.

General and administrative expenses was RMB88.5 million in the first quarter of 2020, relatively flat compared with the first quarter of 2019.

Product development expenses decreased by 20.6% to RMB21.4 million in the first quarter of 2020 from RMB27 million in the first quarter of 2019. The decrease was primarily due to a decrease in the compensation incurred related to our product and technology development personnel during the quarter.

Other income increased to RMB29 million in the first quarter from RMB298,000 in the first quarter of 2019. The increase was primarily due to the value-added tax exemption offered by the relevant authorities in an amount of RMB19.8 million during the COVID-19 outbreak, and government subsidies of RMB8.4 million.

Net loss for the first quarter of 2020 was RMB65.6 million, compared with RMB112.9 million in the first quarter of 2019.

Basic and diluted net loss per share was RMB9.62 in the first quarter of 2020.

As of March 31, 2020, the Company had RMB1,340.2 million of cash and cash equivalents and RMB143.4 million of short-term investments, compared with RMB1,402.2 million of cash and cash equivalents and RMB217.6 million of short-term investments as of December 31, 2019.

As of March 31, 2020, the Company had a deferred revenue balance of RMB3,105.5 million, compared with RMB3,228.8 million as of December 31, 2019.

Capital expenditures were incurred primarily in connection with IT infrastructure equipment and leasehold improvement necessary to support Sunlands' operations. Capital expenditures were RMB7 million in the first quarter of 2020, compared with RMB1.1 million in the first quarter of 2019.

For the second quarter of 2020, Sunlands currently expects net revenues to be between RMB500 million to RMB520 million, which would represent a decrease of 9.5% to 5.9% year-over-year.

The above outlook is based on the current market conditions and reflects the Company management's current and preliminary estimates of market, operating conditions, and customer demand, which are all subject to change.

With that, I'd like to open up the call to questions. Operator?

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions).

There are no questions at this time. I'd like to turn the conference back over to Daisy Wang, Head of Investor Relations, for closing remarks.

Daisy Wang: Once again, thank you, everyone, for joining today's call. We look forward to speaking with you again soon. Good day and good night.

Operator: This concludes the earnings conference call. You may now disconnect your line. Thank you.