Sunlands Technology Group [STG]
Fourth Quarter and Full Year 2019 Earnings Conference Call
Friday, March 27, 2020, 7:30 AM ET

Company Participants:
Yingying Liu, IR Director
Tongbo Liu, Chief Executive Officer
Steven Yipeng Li, Chief Financial Officer

Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Sunlands' fourth quarter and full year 2019 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, Yingying Liu, Sunlands' IR Director. Please go ahead.

Yingying Liu: Hello, everyone, and thank you for joining Sunlands' fourth quarter and full year 2019 earnings conference call. On the call, our CEO, Tongbo Liu, will provide an update on our operational performance as well as our strategic initiatives. Our CFO, Steven Yipeng Li, will give you an overview of our financial performance and also provide our guidance for the first 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 statements. For more information about the potential risks and uncertainties, please refer to the Company's filings with the Securities and Exchange Commission.

With that, I will now turn the call over to our CEO, Tongbo Liu.

Tongbo Liu: Thank you, Yingying. Hello, everyone. Welcome to Sunlands' fourth quarter and full year 2019 conference call. Against the backdrop of macroeconomic challenges during the fourth quarter, we remain attracting students to our online platform and improving engagement through a variety of strategic methods.

Our fourth quarter net revenue was for RMB549.7 million, in line with our guidance. We narrowed our net loss margin to 25.4% in the fourth quarter versus 32.3% in the same period last year, as we continued to prudently manage costs and expenses.

In the fourth quarter of 2019, we continued to focus on our multi-pronged strategy for students' acquisition and retention. Our efforts centered around the further development and the differentiation of our products and services through the application of big data analytics and AI technology. This has allowed us to produce significant operational benefits to both our employees and students, facilitate our digital transformation and further strengthen our data security and risk control capability.

Next, let me provide some key specifics on the drivers of our fourth quarter performance. First, we continued developing our STE programs, especially the master's-oriented products to build a more well-rounded course portfolio, and meet the diverse needs of our students.

In 2019, the number of people entering the entrance examination for master's program reached 2.9 million in China, growing 21.8% year-over-year and representing the fastest growth rate in the past 10 years. Equipped with a deep understanding of the online learning process, as well as solid operational track record, we have been setting upon this mark-to-market opportunity by actively investing in master's-oriented products, making every effort to create specialized programs and solutions.

For example, we provide students with comprehensive tutoring and training for test preparation and MBA program interviews taught by teachers from both domestic and international top universities. This has resulted in a solid interview pass rate of 65% in 2019.

In addition, we have continued expanding our partnership with international universities in order to bring students in China access to high quality and higher education resources from Europe and the United States, as well as share China's educational resources with other developing countries.

For example, we reached cooperation agreements to jointly launch Online Master's Program with renowned international universities. With efforts such as this, our master's-oriented products continue to attract high interest for students, culminating in 19.8% of gross billing, nearly RMB120 million at the end of the fourth quarter, from approximately 7.8% of gross billing or RMB59 million at the end of the fourth quarter 2018.

Second, for our STE program, we remain dedicated to improving the breadth, depth and the efficiency of this program for our students. For 2019, our students achieved an average pass rate of 61.1%. This is significantly higher than the average pass rate of 43.4% achieved by self-taught students during the 2012 to 2016 period according to iResearch. For subjects such as fiscal policies and finance, principles of computer science and management economics, pass rate for our students were over 90%, demonstrating the effectiveness of our learning platform.

I would also like to highlight the tremendous potential ahead of us in terms of our post-secondary and professional education. According to the statistical report, our internet development in China published in August 2019 by Office of the Central Cyberspace Affairs Commission, less than 10% of internet users have college degrees or higher, while online education penetration was just

27% of total internet users as of June 2019, both showing significant room for further expansion, which will underlay our future growth.

Third, we made solid progress in the fourth quarter with our trial programs that enable prospective students to experience our advanced online and mobile learning platform. Through a targeted and process user outreach, trial classes that accurately cater to user needs, and the effective follow-up of trial users by our teachers and staff, achieved material increase in conversion rates for some of our trial classes.

Going forward, we will continue to leverage various tools such as our mobile app and Wechat mini-program, to improve our sales efficiencies and grow our gross billings over time.

Finally, in regard to the recent coronavirus epidemic that has posted unprecedented global challenges, our thoughts are with the people who have been affected by the outbreak. As a show of support, we're donating masks, goggles and protective clothing with a total value of RMB5 million, in addition to free online courses worth approximately RMB15 million to medical staff and the people most affected by the coronavirus.

Despite the disruption caused by the pandemic to our business operation, we expect the adverse impact the coronavirus outbreak has on our business and results of operations to be limited, given that the quarantine and other types of restriction imposed due to the outbreak are expected to be temporary, and that our courses and other offerings are delivered in a live-streaming format and can be consumed in an indoor environment.

Looking ahead, we are optimistic about the long-term growth of our gross billings and new student enrollment as we continue to seek balanced top line and bottom line performance. Our leading technology, high quality educational content, coupled with our solid track record of pass rates, position us well to capture the strong long-run growth opportunity present in the online post-secondary and professional education market.

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

Steven Yipeng Li: Thank you, Tongbo, and hello, everyone. Thanks for joining us. Our net revenues were RMB549.7 million in the fourth quarter of 2019 in line with our guidance.

Our gross billings and new student enrollments declined at 15.5% and 22.6% respectively year-over-year, primarily as a result of slowing macroeconomic growth in China.

During the fourth quarter, we continued to pursue a balanced approach to improve profitability, while executing our student acquisition strategy by focusing on streamlining our cost structures.

Our administrative expenses, as well as sales and marketing expenses, decreased by 30.9% and 10.2% respectively compared with the same quarter last year. Our cost efficiency improvement measures led to a reduction in net loss in the fourth quarter to RMB139.5 million, 24% lower compared with a loss of RMB183.7 million in the fourth quarter of 2018.

Looking into 2020, we are optimistic that our dedication to persistent product and service upgrades will continue to bring value to our customers and ultimately, our shareholders.

Now let me walk you through some of the key financial results for the fourth quarter and full year 2019. All comparisons are year-over-year and all numbers are in RMB.

In the fourth quarter of 2019, net revenues decreased by 3.4% to RMB549.7 million from RMB568.8 million in the fourth quarter of 2018. The decrease was mainly due to the decrease of gross billings in 2019 compared with 2018.

Cost of revenues increased by 29.3% to RMB101.5 million in the fourth quarter of 2019 from RMB78.5 million in the fourth quarter of 2018, which was primarily due to insurance premiums related to online education services with insurance coverage since late in 2018.

Gross profit decreased by 8.6% to RMB448.2 million from RMB490.3 million in the fourth quarter of 2018.

In the fourth quarter of 2019, operating expenses were RMB599.0 million, representing a 14.4% decrease from RMB699.7 million in the fourth quarter of 2018.

Sales and marketing expenses decreased by 10.2% to RMB476.1 million in the fourth quarter of 2019 from RMB530.1 million in the fourth quarter of 2018. The decrease was mainly due to reduced marketing spending, reflective of disciplined and prudent cost management, as well as a decrease in expenses related to sales and marketing personnel.

General and administrative expenses decreased by 30.9% to RMB98.6 million in the fourth quarter of 2019 from RMB142.6 million in the fourth quarter of 2018, mainly due to a decrease in office and compensation-related expenses.

Product development expenses decreased by 9.9% to RMB24.3 million in the fourth quarter of 2019 from RMB27 million in the fourth quarter of 2018. The decrease was primarily due to a decrease in the number of employees and compensation paid to Sunlands' product and technology development personnel during the quarter.

Net loss for the fourth quarter of 2019 was RMB139.5 million compared with RMB183.7 million in the fourth quarter of 2018.

Basic and diluted net loss per share was RMB20.46 in the fourth quarter of 2019.

As of December 31, 2019, the Company had RMB1,402.2 million of cash and cash equivalents, and RMB217.6 million of short-term investments compared with RMB1,248.8 million of cash and cash equivalents and RMB1,028.6 million of short-term investments as of December 31, 2018.

As of December 31, 2019, the Company had a deferred revenue balance of RMB3,228.8 million compared with RMB3,286 million as of December 31, 2018.

Capital expenditures were incurred primarily in connection with purchases of buildings and IT infrastructure equipment necessary to support Sunlands' operations. Capital expenditures were RMB10.4 million in the fourth quarter of 2019 compared with RMB263.1 million in the fourth quarter of 2018.

And in terms of the key financial results for the full year 2019, let me walk you through in the details too. In the year of 2019, net revenues increased by 11.1% to RMB2.2 billion from RMB2 billion in 2018.

Cost of revenues increased by 20% to RMB396.3 million in the year of 2019 from RMB330.4 million in 2018.

Gross profit increased by 9.4% to RMB1.8 billion from RMB1.6 billion in 2018.

In 2019, operating expenses were RMB2.3 billion, representing a 15.5% decrease from RMB2.7 billion in 2018.

Sales and marketing expenses decreased by 16.7% to RMB1.8 billion in 2019 from RMB2.2 billion in 2018. The decrease was mainly due to reduced marketing spending, reflective of disciplined, prudent cost management and the decrease in the expenses of sales and marketing personnel.

G&A expenses decreased by 18.1% to RMB363.3 million in 2019 from RMB443.7 million in 2018.

Product development expenses increased by 33.8% to RMB101.7 million in 2019 from RMB76 million in 2018.

Net loss for 2019 was RMB395.2 million compared with RMB927 million in 2018.

Basic and diluted net loss per share was RMB57.81 in 2019 compared with RMB147.27 in 2018.

Capital expenditures were incurred primarily in connection with purchases of buildings and IT infrastructure equipment necessary to support Sunlands' operations. Capital expenditures were RMB25.5 million in 2019 compared with RMB518.4 million in 2018.

For the first quarter of 2020, Sunlands currently expects net revenues to be between RMB540 million to RMB560 million, which would represent a decrease of 4.3% to 0.7% 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 the customer demand, which are all subject to change.

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

Questions and Answers

Operator: (Operator Instructions). Showing no further questions, this concludes our question-and-answer session. At this time, I would like to turn the conference back over to Yingying Liu, Investor Relations Director, for any closing remarks.

Yingying Liu: Once again, thank you, everyone, for making efforts joining today's call despite the serious coronavirus disruptions. We look forward to speaking with you again, and good day and good night.

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