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JOBS - Q2 2018 51job Inc Earnings Call

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PRESENTATION

Operator

Hello, and welcome to the 51job, Inc. Second Quarter 2018 Conference Call. (Operator Instructions) Please note, this event is being recorded. I'd now like to turn the conference over to Linda Chien. Please go ahead.

Linda Chien - *51job, Inc. - Head of IR and VP*

Thank you, operator, and thank you all for attending this teleconference to discuss unaudited financial results for the second quarter ended June 30, 2018. With me for today's call are Rick Yan, President and Chief Executive Officer; and Kathleen Chien, Chief Operating Officer and acting Chief Financial Officer. A press release containing second quarter 2018 results was issued earlier today, and a copy may be obtained through our website at ir.51job.com.

Before we begin, please note that today's discussion will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities and Litigation Reform Act of 1995. All forward-looking statements are based upon management's expectations at the time of the statement and involve inherent risks and uncertainties that may cause actual results to differ materially. Potential risks and uncertainties include, but are not limited to, those outlined in our public filings with the U.S. Securities and Exchange Commission, including our annual report on Form 20-F. Any forward-looking statements that we make on this call are based on assumptions as of today, and we undertake no obligation to update these statements, except as required under applicable law.

Also, I would like to remind you that during the course of this call, we will discuss non-GAAP measures. Please refer to the press release for a description of these non-GAAP measures and their significance to management in evaluating the company's financial performance. Reconciliations to the most directly comparable GAAP financial measures are provided, where available, in the tables appended to the press release.

This conference call is being recorded and broadcasted on the Internet, and a replay will be available through our website at ir.51job.com.

Now I'll turn the call over to Rick.

Rick Yan - *51job, Inc. - Co-Founder, Director, CEO, President & Secretary*

Thank you, Linda, and welcome to today's call. I will begin with a review of the second quarter, followed by Kathleen with a detailed discussion of our financial results and our guidance for the third quarter of 2018. Finally, we'll open the call to your questions.

We stay on course in executing our strategic initiatives in the second quarter and achieved solid financial results that exceeded our forecast. Total revenues grew 33% to RMB 895 million, and non-GAAP EPS was RMB 5.43. Our online business continued to build momentum as revenues increased more than 32% in the second quarter. Maintaining focus on our high-quality growth strategy, we worked on strengthening employer relations --

relationships, drive -- driving upselling and effecting a price increase on entry-level products, all of which contributed to a 34% improvement in online ARPU.

In line with our expectations, because we are placing a greater emphasis of sales resources and attention on higher potential employers, we have purposely moderated the pace of new customer additions in 2018 and saw a small net decrease in the online employer count on a year-over-year basis in the second quarter. This exercise we are undertaking to reassess our customer base will continue into early 2019, and during this time, ARPU improvement will be the primary driver for online revenue growth.

We believe this employer evaluation initiative has significant implications for 51job's future with regards to growth opportunities and our long-term product road map. Through deeper HR connections with an audience of more professional and established enterprise customers, we can better identify and address emerging needs, improve product uptake and realize better monetization of the entire employer base over time.

In the other HR services area, customer interest and demand was robust, and revenue growth was 34% in the second quarter. Our sales team has continued to cross-promote the effectiveness of these value-added services such as training, testing, employee onboarding, payroll and benefits processing to employers with very good progress over the past year. Not only have we highlighted the standalone merits of each type of service, but more importantly, we have provided customizable solutions of how these services, in conjunction with recruitment and one another, collectively strengthen overall talent management and retention.

Companies in China are increasingly recognizing the role of human capital as an integral part of the organizations and a key source of competitive advantage. We are busier than ever, internally developing or collaborating with partners to pilot new service modules, methods and tools to assist our HR customers. Just like everyone else, 51job competes to acquire, nurture and retain the best talent. In the second quarter, we meaningfully increased bonus pools and goal-based incentives to reward top performers and the achievement of the sales force. Investing in our people has been, and will continue to be, a core pillar to 51job's success.

Case in point, last Friday, the Internet Society of China and the Ministry of Industry and Information Technology announced China's top 100 Internet companies of 2018. 51job was the only dedicated HR services company to receive this distinguished recognition. As we focus on high-quality services, new innovations and improved customer engagement, we are confident in our team's motivation and execution to extend our market leadership and further differentiate 51job in the industry.

Turning now to our current market assessment. Our observations continue to show positive trend with regard to hiring demand for white-collar workers in China. While recent global political and economic tensions are concerning and increased uncertainty in the business climate, established enterprises understand the value and importance of human capital for the long term, and we see they are committed to moving forward with their recruitment plans for the year. We remain optimistic about market demand, and we would also push ahead with completing our goals and action plan for the remainder of 2018.

The foundation of 51job's healthy and sustainable development is predicated on proven capabilities, dedicated coverage and industry expertise built over 2 decades. We believe that 51job remains uniquely positioned to capture all aspects of the HR opportunity in China.

I would now pass the call over to Kathleen.

Kathleen Chien - 51job, Inc. - Co-Founder, Acting CFO & COO

Thank you, Rick. In my following presentation, please be aware that all financial numbers are in the reporting currency of the Chinese renminbi, unless otherwise stated. Also, please note that all growth rates are on a year-over-year basis as compared with the corresponding period in 2017, unless otherwise indicated.

Our results for 2018 includes the consolidation of Lagou to our financial statements. But as Lagou's contribution to 51job's overall results was not significant, we will not be discussing or providing separate details for Lagou.

Total revenues for the second quarter of 2018 were CNY 895 million, representing a 33% increase. Online revenues for the second quarter grew more than 32% to CNY 588 million, which was driven by a significant increase in the average revenue per employer. Through primarily upselling as well as some higher prices for certain online products instituted earlier this year, overall online ARPU rose 34% in the second quarter. In line with our current focus to identify and prioritize higher potential employers, we were selective in acquiring new corporate customers but made further inroads among existing customers in the second quarter.

The estimated number of unique employers decreased slightly to 378,000 companies compared with 381,000 in the year-ago period. For the second half of 2018, we expect the online revenue growth to be driven by ARPU as we continue to be selective in customer acquisition and recalibrate the number of customers covered per salesperson.

Revenues for other HR services increased 34% to CNY 307 million in the second quarter. The growth was primarily due to greater customer adoption and usage of BPO, training, assessment and placement services. Our sales teams continue to make solid progress in their cross-promotion effort and to include these value-added services in their discussions and proposals with sophisticated employers.

The gross profit grew 32% to CNY 641 million, and gross margin was 72.4%, modestly lower than last year's due to increased employee compensation expenses and costs related to new services in trial stages. Included in cost of services in the second quarter was share-based compensation expense of CNY 3.4 million.

Our sales and marketing expenses increased 46% to CNY 334 million in the second quarter. The increase was primarily due to higher employee compensation expenses, headcount additions as well as greater advertising expenditures and more branding activities surrounding 51job's 20th anniversary. Included in sales and marketing expenses in the second quarter was share-based compensation expense of CNY 2.9 million. Sales and marketing investments are the fuel to 51job's long-term growth engine, and it remains our intention to stay aggressive in deploying resources into this area. We will continue to invest in the sales force and to support and promote this expanding portfolio of brands, platforms and services under the 51job umbrella.

Our G&A expenses increased 25% to CNY 88 million in the second quarter. The increase was mainly due to the higher employee compensation, rent and office expenses. Share-based compensation expense included in G&A was CNY 18.8 million in the second quarter.

Income from operations increased 16% to CNY 218 million, and operating margin was 24.6% compared with 28.3% in the year-ago quarter. Excluding share-based compensation expense, our operating margin would have been 27.5% compared with 31.3% in the year-ago quarter.

In the second quarter, under mark-to-market accounting, we recognized a large noncash loss of CNY 309 million associated with the change in the fair value of the convertible notes. During the second quarter, the trading price of our ADSs on NASDAQ increased significantly, which resulted in the corresponding rise in the value of the convertible notes during this period. As those notes are a liability on the company's balance sheet, the increase in the fair value was recorded as a loss on our P&L, although it has no impact on the company's cash flow or cash position.

In the second quarter, due to the material change in the value of the RMB against the U.S. dollars and the resulting foreign currency impact on our U.S. dollar cash deposits and U.S. dollar-denominated convertible notes, we recognized a noncash foreign exchange loss of CNY 81 million.

Other income in the second quarter included CNY 154 million in local government financial subsidies compared with CNY 20 million in the second quarter of 2017. Due to the significant impact of the loss from foreign currency translation and the change in the fair value of the convertible notes, we recorded a net loss attributable to 51job of CNY 57 million in the second quarter.

Basic and fully diluted loss per share was CNY 0.92 or USD 0.14 per share. But if we're to exclude the share-based compensation expense, the loss from foreign currency translation, the change in the fair value of the convertible notes as well as the related tax effect of these items, our non-GAAP adjusted net income attributable to 51job increased 73% to CNY 359 million in the second quarter. Non-GAAP adjusted fully diluted EPS was CNY 5.43 or USD 0.82 per share.

Turning now to our guidance. Based on current market conditions, our total revenue targets for the third quarter of 2018 is in the estimated range of CNY 905 million to CNY 935 million. For the non-GAAP fully diluted EPS target, our estimated range is between \$3.70 and \$4 per share under the if-converted method. Please note that this non-GAAP EPS target range does not include share-based compensation expense, the impact of foreign currency translation, any change in the fair value of the convertible notes nor the related tax effect of these items. Total share-based compensation expense is expected to be between CNY 32 million and CNY 33 million for the third quarter of 2018.

Guidance for earnings per share is provided on a non-GAAP basis due to the inherent difficulty in forecasting the future impact of certain items such as the gain and losses from foreign currency translation and the change in the fair value of the convertible notes. We are not able to provide a reconciliation of these non-GAAP items to expected reported GAAP earnings per share without unreasonable efforts due to the unknown effect and potential significance of such future impact and changes. This guidance reflects our current forecast, which is subject to change.

This concludes our presentation. We would be happy to take your questions at this time. Operator, please go ahead.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And the first question comes from Wendy Huang with Macquarie.

Wendy Huang - Macquarie Research - Head of Asian Internet and Media

First, I noted that in the second quarter, your ARPU had very healthy expansion, yet gross margin actually contracted. So can you help me to understand why these 2 kind of figures are showing different conflicting change? Usually, from my understanding, if the ARPU expanded, the gross margin should actually expand accordingly as well. And secondly, in terms of the very high sales marketing cost in the second quarter, can you elaborate what particular branding or marketing event are you doing and also on which product lines? Lastly, on your Sales Head David Jin's departure, does this have anything to do with your customer account review initiatives that's conducted right now?

Kathleen Chien - 51job, Inc. - Co-Founder, Acting CFO & COO

Wendy, thank you for your questions. Let me go through them, and hopefully, we'll be able to give you more clarity on these issues. On the first question related to the ARPU increase and the gross margin, I think what we've actually been able to do is obviously make further inroads in selling more through our existing customers. But concurrently, we were actually also piloting in China new services. So we're actually also adding new product into our platform, if you will. So some of the expenses related to that will be reflected in the cost of services line. So some of that additional cost uptick is actually related to some of the new products that we expect to bring to the market later on. So that's really what's driving it. So it's not really about existing services not being efficient, if you will, but it is that we are continuing to bring more products and services or portfolio, and we've actually made some additional investments in certain areas. So that's what's driving that dynamic, if you will. Second question was on sales and marketing. Yes, we were actually stepping up our sales and marketing in general this year. Partly is that in the second quarter, there is actually an annual salary adjustment that we go through. So that accounts for part of the increase in the sales cost structure in addition to the fact that we were actually providing more sort of (inaudible) bonus pools given that we felt that the team had actually done very well in the first half of the year by going ahead of budget, if you will, based on performance. And then in terms of the specific marketing campaigns, it is actually our 20th year anniversary. So we actually have identified a number of initiatives that we're supporting as general branding campaign for the company. So for example, we actually did a campaign with the launch of the movie Jurassic World in the second quarter. And so there was actually a number of events and marketing spend related to that, in particular in the second quarter. So those are the type of things that's actually behind the scenes, if you will, in terms of looking at the increases in the sales and marketing spend for the second quarter. And then finally, you mentioned whether or not the departure of one of our Vice President has anything to do with the review process, if you will, that were ongoing for anything. So to answer that very directly, there's no impact and there's no direct correlation to that. This is purely due to family reasons. He has been a very solid and loyal employee of 51job for a very long time. It's just because of family reasons that he will be taking leave and so moving on to spend more



time with family, if you will. So that's really the only thing. It has nothing to do with any of the business or operational changes ongoing at 51job. So...

Wendy Huang - *Macquarie Research - Head of Asian Internet and Media*

Can you also elaborate a little bit more on the new products that you are preparing to roll out, which is affecting the gross margin?

Kathleen Chien - *51job, Inc. - Co-Founder, Acting CFO & COO*

Yes, we're not quite ready to launch quite a lot of things. But obviously, we've talked about before that we are looking at more new products in planning and services area. We've also looked at products in the other BPO-related services. We've talked about before how we are actually creating new platforms for -- with attendance testing, timely reimbursement. So we're making investments in that area. So they will be extensions of stuff that we're actually already doing, but they're actually going to be new products and services that we're going to bring to the floor down the line. So that's kind of generally area we're looking at.

Operator

(Operator Instructions) And the next question comes from Alicia Yap with Citigroup.

Alicia Yap - *Citigroup Inc, Research Division - MD and Head of Pan-Asia Internet Research*

I have a couple of questions. One is to follow up on the margin question. So just wanted to clarify further. I understand, Kathleen, you mentioned gross margin is mainly related to the new services, the higher cost. But should we also be thinking potentially if Lagou contribution to the total revenue is bigger than expected, which -- I mean, I think Lagou probably had slightly lower margin. That's one. And then second is on your sales and marketing increase and all that. How should we be thinking about the margin trend in the third quarter and the rest of the year on both gross margins and the OP level? And the third question is related to the decrease in the numbers of employers. I understand this could be because of the results of the pricing strategy. And also, you guys mentioned moderating the apps, right? And then anything other than that should we be reading into it? And perhaps you can give us some color in terms of the industry verticals for those employer that actually churn away during the quarter.

Kathleen Chien - *51job, Inc. - Co-Founder, Acting CFO & COO*

Thank you, Alicia, for the question. Maybe I'll answer the question slightly in reverse order then, if I can. The first question then is then related to customer count and how -- what's kind of the dynamic behind that. It goes back to what we mentioned in the earlier comments that we're kind of recalibrating the number of customers that each sales person can cover and also the type of customers that we'll take. So that is actually 2 things ongoing, which will drive the dynamics. I mean, firstly, I mean, historically, let's say, a salesperson wouldn't be able to cover, let's say, 400, 500 customers. But we've decided to recalibrate that so that we would actually than reduce their coverage, let's say, by 100 customer per salesperson. So in fact, to cover the same amount of customers in total, 51job would actually need to hire new salespeople to cover those accounts. Or in the short term, there may be very small accounts that we choose not to cover, if you will. So that is part of that transition process, if you will, that there will be some customers who are very small historically who we work for that we will not be paying as much attention with. So that recalibration will be somewhat impacting sort of how we serve and if we serve them in that process. And then on the other end of that, as we're kind of recalibrating and kind of filtering the accounts that we want to continue to cover with our resources, in terms of the new customers that are coming in as well, I mean, again, we're being very selective about the type of customers we want. We want them to come in with a certain type of spend level or certain types of product that we would actually want to promote rather than the introductory prices that historically we have done a lot of. So that's the dynamic behind that. And so that new addition may be a lot more modest, obviously, than previous years when we were less discriminating, if you will. So both of those dynamics actually end up [limit] than total number of customers we work with, and that is actually a conscious choice that we're actually going through. And so that's kind of what's going on. I don't think that it's a line that we would draw on an industry-specific



perspective. It's not to say that I can only work with a finance company or an Internet company, but I can't work with a distribution company or a realtor company. It's not industry related. It's really about the size and the prospect and the potential of these customer organizations that we come across as we continue to assess their focus and their need and their investment in the HR area. So that's the equation that we kind of are facing. I don't know if that answers your question fully.

Alicia Yap - *Citigroup Inc, Research Division - MD and Head of Pan-Asia Internet Research*

Yes, yes. It helps.

Kathleen Chien - *51job, Inc. - Co-Founder, Acting CFO & COO*

Okay. And then kind of going back to the sales and marketing, margin and even the question related to Lagou, I will not attribute the sort of somewhat -- the increase in spending related to spending to Lagou as a factor because we started with the comment earlier that Lagou is not material to our results overall in terms of scale. So anything that's going on in terms of changes in dynamics, whatnot, is still 51job-related. So it is not really attributable to Lagou in terms of where it's at. Lagou is still not making profits at this point in time, but I think that we have expectations that they will continue to make improvements. So I would not attribute any of the sort of margin changes to Lagou. In terms of our own sales and marketing spending, as I mentioned to Wendy in response earlier is that, yes, we are stepping up on our sales and marketing. And part of that is we actually pinpointed and identified specific branding projects that we're launching surrounding the 20th anniversary of 51job. So we will be at a slightly elevated level versus prior years, if you will, on that front. And then in addition, we will expect to be rolling out some new products as well down the line this year. So that will also contribute a little bit to that. I would say that second quarter, if you will, the sales and marketing spending is probably at a bit of a peak overall because that -- with the branding campaign that we launched in addition to the salary increases that were implemented, some additional bonus pools, if you will, so a lot of that came together to make that sort of a higher base than we would expect for the rest of the year and on a percentage basis. So I would expect that the second half of the year, we should be actually coming down a little bit versus where we are in the second quarter, although that we expect that we still will be sort of in the sort of mid-30s percentage point in terms of where we are in terms of spending level. So first quarter, I think we were little bit lower than that, but I think in the sort of the mid-30s would be a reasonable place for us to end up for the year -- for margins for the second half, yes, for the sales and marketing spend.

Alicia Yap - *Citigroup Inc, Research Division - MD and Head of Pan-Asia Internet Research*

Sure. And just quickly, what about gross margin? Is the second quarter level, should be read into the rest of the year?

Kathleen Chien - *51job, Inc. - Co-Founder, Acting CFO & COO*

If you look at where we are for the second quarter, yes, I mean, we did spend a little bit more as we actually prepare for some -- but again, I would expect that it will be a little bit lower for the second half but maybe not meaningfully lower but as we continue to make some investment to actually prepare for some additional products that we want to launch down the line.

Operator

And that is the end of the question session. I would like to return the call to Rick Yan for any closing comments.

Rick Yan - *51job, Inc. - Co-Founder, Director, CEO, President & Secretary*

Thank you for joining us today. We look forward to speaking with you next quarter, and we value your continued support of 51job. Have a good day. Bye-bye.



Operator

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

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