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JOBS - Q3 2018 51job Inc Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the 51job Third Quarter 2018 Conference Call and Webcast. (Operator Instructions) Please note this event is being recorded. I would now like to turn the conference over to Linda Chien, Vice President and Head of Investor Relations. Please go ahead.

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

Thank you, Claudia, and thank you all for attending this teleconference to discuss unaudited financial results for the third quarter ended September 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 third 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 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 third quarter; followed by Kathleen with a detailed discussion of our financial results and our guidance for the fourth quarter of 2018. Finally, we'll open the call to your questions.

We are pleased to report solid financial results as we continue to deploy our high-quality growth strategy with diligence and success. Total revenues exceeded our forecast and grew 31% to RMB 955 million, and we achieved higher profitability with non-GAAP EPS of RMB 5.09.



Our online business maintained a strong trend as revenues increased 33% in the third quarter. In line with our expectations, the growth came from significant ARPU improvement of 39%, which was mainly offset by a decline in online employers in the quarter. An important strategic priority in 2018 has been to reevaluate and optimize the allocation of sales resources to increase productivity. While this initiative has required us to impose a stricter criteria with regards to the employers we direct our services to, it has also enabled us to meaningfully further deepen relations with employers, drive up selling and deliver greater value to our customers. These efforts again elevated online ARPU, which increased by nearly 39% to another record quarterly level.

As we have been focused on reconfiguring account lists among our sales people to yield higher returns, we have purposely limited new customer additions in 2018 and have also chosen to reduce or eliminate coverage of certain employers. Closing the year, we believe that ARPU will continue to be the primary growth driver, and there will be more adjustments to the customer count. We remain confident that as we build long-term, high-quality HR connections with an audience of more professional and established enterprise customers, we can better identify emergent needs, improve product adoption and realize better monetization of the entire employer base in the future.

In the other HR services segment, revenues grew 27% in the third quarter on the back of robust customer demand and usage of our BPO, training, assessment and placement services. As the need and competition for good talent has intensified in China, employers are expanding their HR strategies beyond just identifying and recruiting talent, but increasingly more about how to retain, promote and nurture such talent. This year, we have increased investment and product development in the fields of individual jobseeker training, advanced assessment methods and new BPO service modules, such as attendance tracking. Through our strengthened sales team that is more adept than ever at upselling and cross-selling to employers, we look forward to commercializing more product and services in the other HR services area over time.

Turning now to our current market assessment. As most employers have communicated that they are committed to completing their HR budgets, as originally planned, early in the year, we have reflected a solid close to 2018 in our revenue forecast for the fourth quarter. While we expect recruitment demand for white-collar workers will wrap up on a positive note, there has been obviously -- there has obviously been a lot of discussion and speculation recently about the outlook of the Chinese economy. Needless to say, increased uncertainty [in the least amount] enterprises can affect the hiring activity.

Although our current conversations with employers do not indicate marked pessimism, many are undecided about their plans for 2019 at this time. Also, as December and January are seasonally soft periods for general recruitment each year, we will be patient as we may not likely have a true gauge of demand until after Chinese New Year 2019. In 20 years, 51job has experienced many business cycles and capital market swings. We are fully prepared, and we work with whatever hand we are dealt rather than using our energy hypothesizing about matters not within our scope of influence. We are 100% convinced of and can continue to tackle other challenges that are fundamental to human capital management regardless of economic or external factors.

Problems on how to find workers, keep them motivated and elevate their capabilities [abound] for employers as they grow and adapt in China's rapidly changing and dynamic markets. We stay focused on product development for the long term, enough to assist our customers in cultivating a talented generation of [future worker] under the mantra of innovated in China. Undistracted, undeterred and armed with a broad portfolio of products and services, robust business fundamentals, a strong balance sheet and a long proven track record of healthy, profitable operations, 51job remains highly confident in our market position and extremely excited about HR opportunity in China.

I'll 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 our 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 include the consolidation of Lagou to our financial statement. 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 third quarter of 2018 were CNY 955 million, representing a 31% increase. Our online revenues for the third quarter grew more than 33% to CNY 649 million, which was due to a significant increase in the average revenue per employer but a modest decrease in unique employers. Through primarily upselling as well as some higher prices for certain online product instituted earlier this year, our overall online ARPU rose 39% in the third quarter. In line with our current initiative to prioritize higher potential employers and recalibrate our customer base, we were selective in acquiring new corporate customers and terminated coverage of certain accounts. This resulted in a 4% reduction in the estimated number of unique employers to 365,000 companies compared with 381,000 in the year-ago period. For the full year 2018, while we do expect to see a modest decrease in the employer count compared to the previous year, we are on track to realize our key strategic goals of significantly raising ARPU, improving sales productivity and strengthening the caliber of our employer interaction.

Revenues for other HR services increased 27% to CNY 305 million in the third quarter, which was driven by greater customer demand and usage of BPO, training, assessment and placement services. The pace of growth has remained healthy but less than from the first half levels due to easier comps in early 2017. Our sales teams continue to deliver and make solid progress in their cross-promotion effort and to include these value-added services in their discussions and proposals with sophisticated employers. As has been the case for the past several years, we expect a busy campus recruitment season to bring important contribution to our other HR services in the fourth quarter.

Gross profit grew 31% to CNY 685 million. And gross margin was 72.5%, slightly lower than last year's level due to increased employer compensation expenses and some additional costs related to the rollout of new services. Included in cost of services in the third quarter was higher share-based compensation expense of CNY 4.7 million.

Sales and marketing expenses increased 32% to CNY 323 million in the third 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 third quarter was higher share-based compensation expense of CNY 4 million. While we will continue to invest in the sales force and to support and promote the expanding portfolio of brands, platforms and services under the 51job umbrella, we will also stay equally active and disciplined in monitoring the return of these investments. Our G&A expenses increased 16% to CNY 91 million in the third quarter. The increase was mainly due to higher employee compensation, rent and office expenses. Share-based compensation expense included in G&A was CNY 20.5 million in the third quarter.

Income from operations increased 35% to CNY 271 million in the third quarter, and operating margin was 28.7% compared with 27.9% in the year ago quarter. Excluding share-based compensation expense, operating margin would have been 31.7% compared with 31.1% in the year ago quarter.

In the third quarter, under mark-to-market accounting, we recognized a large noncash gain of CNY 549 million associated with the change in the fair value of the convertible notes. The decrease of the trading price of our ADSs on NASDAQ resulted in a corresponding decline in the value of the convertible notes during the period. As the notes are a liability on the company's balance sheet, the decrease in the fair value was recorded as a gain on our P&L, although it has no impact on the company's cash flow or cash position.

In the third quarter, due to the material change in the value of the RMB against the U.S. dollar 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 67 million.

During the third quarter, we also recognized a gain of -- on the sale of long-term investments in the amount of CNY 61 million. We modestly reduced our holding in Shanghai Gaodun Education & Training Co., or Golden Finance, which is a provider of online and offline finance and accounting training programs. However, we are obviously still an avid supporter and continue to have many collaborations with Golden Finance.

Due to the significant impact of the change in the fair value of the convertible notes, we recorded net income attributable to 51job of CNY 785 million in the third quarter. Fully diluted earnings per share was CNY 5.16, or USD 0.75 per share.

Excluding share-based compensation expense, the loss from foreign currency translation, the change in the fair value of the convertible notes as well as the tax effect related to these items, our non-GAAP adjusted net income attributable to 51job increased 59% to CNY 333 million in the third quarter. Non-GAAP adjusted fully diluted EPS was CNY 5.09 or USD 0.74 per share.



Turning now to our guidance. Based on current market conditions, our total revenue target for the fourth quarter of 2018 is in the estimated range of CNY 1.09 billion to CNY 1.12 billion. For the non-GAAP fully diluted EPS target, our estimated range is between CNY 4.45 and CNY 4.75 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. Our total share-based compensation expense is expected to be between CNY 30 million and CNY 31 million for the fourth 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 gains 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) Our first question is from Wendy Huang with Macquarie.

Frank Chen

This is Frank Chen with Macquarie on behalf of Wendy Huang. Congratulations on the very strong set of results and the very solid guidance. This year, the company did quite an impressive job of increasing ARPU by upselling and the price hike. And how should we think of the ARPU trending to next year? Are we still going to have -- increase our ARPU by 20% to 30% year-over-year into next year? And on the other hand, the way our customer base is -- we lost 4% year-over-year in terms of customer base. Can you share us more about what kind of customer leave us? Or what kind of customer would choose to serve them less, including which industry are they in and the slice of those customers? And looking ahead, how should we think of the customer trend into 4Q and 2019? And my last question is about macro. Do we see any of our customer are cutting their HR budgets this year? And into next year, if they are cutting their budgets significantly or are freezing their hiring process due to the macro uncertainty, how should we [accomplish] this situation?

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

Thank you, Frank. I would try to address the 3 questions, I guess, in the order that you raised them. First question relates to ARPU and trend. I mean, I think what we expect and what you have seen already this year is that ARPU is going to be the primary driver of the -- of our revenue growth at this point in time, and we do expect to see this trend going forward in 2019 as well. So that is a reflection of the strategic focus that we've had in terms of trying to do a much better job in terms of cross-selling and upselling the products and services in our portfolio, and that is something that we do expect to continue in 2019. The second question relates to then the customer coverage, and maybe the customer account trend. And yes, you did notice -- and we've actually spoken to this as well. It's that we are actually recalibrating the type of account and the number of accounts at each of our customer -- our sales rep can serve effectively and productively, if you will. And we actually purposely terminated coverage on smaller accounts where we felt that there was very limited potential. And so because we've defined them as, if you will, limited potential, they are actually going to be very small customer who has spent very little in terms of dollars with us, which is actually, in effect, a way for us to also be able to manage ARPU then of the total average once we actually stop coverage of some of these small accounts as well. So I think that we do expect that there will be some trimming of the customer base in the fourth quarter as well as we continue on this trend of making some recalibration. But I think this is something that's just a transitional period that we must go through and that -- we expect that, that will probably still continue for a couple of more quarters as we move ahead. And then the last question on macro, in general, I think it's too early for us to make any commentary on 2019 because I think that most companies don't have actually a budget fixed for 2019 at this time. I think that we expect that 2018 has been a year that -- I think people have been very active in the marketplace, and that we will have a solid close to the year, as we expect. But I think we will



have to wait for the actual 2019 post CNY period to come around before we can actually say what our people's real plans are. I mean, obviously, we're having discussions with employers at this time, but I don't believe that discussions now is going to be necessary, something that we could, for sure, count on for -- post CNY 2019. But I think regardless of what happens in terms of the demand levels that we see from employers, I think what we have been doing and what we've gone through in the past as well is that we continue to be very, very focused on just trying to maximize our share of wallet within customer accounts. And if someone decides to spend more or less, it is not something that we can control. But we believe that we have the biggest portfolio of products and services and that we have been there through thick and thin with our customers and that we believe that we should be able to weather any of these so-called fluctuations in the environment going forward. So that, I hope, answers your 3 questions.

Operator

Our next question is from Alicia Yap with Citigroup.

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

I have 2 questions. Sorry to ask the macro questions again. Understand we wouldn't have visibility at this point in terms of how much the hiring sentiment or the overall broader market could look like into next year, but given jobs have been through a feel of the down cycle, right, including the global financial crisis in 2008 and worries and all this, like, trend will slow down back in 2013, but just wondering, compared to the past feel of cycle, have you seen anything different that you would call out this time, either it is more positively or more negatively in terms of what's the message from the conversation that you had with some of the employer and then in terms of what 51job would be able to do differently this time versus the past couple of times in the downturn. If you could share some of that, it will be great. And then just second on follow-up on the sales and marketing initiative, could you share with us in terms of the sales force coverage per account, like how many accounts of the typical sales team now cover and then our plan for future sales team hiring.

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

Alicia, thank you for the questions. First, on the macro question, I guess, I think for 51job, as a company, I do believe we're in better position than we were in previous cycles simply because of the fact that we actually have a much broader product portfolio, if you will, and our reliance on recruitment products, in itself, is actually smaller versus the previous cycle that we had gone through. As you know, that -- other HR services, as a group, actually now accounts for probably over 30%, 35% of our total sales levels, and that was not the situation if we were to roll back the clock to the last sort of significant downturn that we experienced. So I think that in terms of the company, overall, I think that having the -- a broader set of products and services does help us probably in terms of having more diversification, if you will. So -- and then in terms of just in general, I mean, in the case if there's going to be a significant downturn of some kind or -- I really don't think that there's been anything new and alarming that I would point out at this point. I think that there's a lot of uncertainty, which is sometimes not so good. But in a way, I mean, typically, at the end of the year, people are not as active anyways. So I think that it's time for everyone to kind of sit down and revisit their situation but think about what they want to do for next year and that -- we have conversation that every single company has to go through and reevaluate how they're going to allocate their resources. But on the other side of the equation is that at the end of the day, China's economy, in general, will continue. I'm sure it goes through ups and downs, but in terms of the supply of labor, if you will, that number is not increasing overall so that, I think, most companies are finding that recruitment, in general, is the bigger challenge. So I think that people are valuing their human resources more so that I think, hopefully, people won't be doing sort of sharp turns, if you will, trying to cut too thin and then have to make back the -- try to recover once things kind of turn around. So we'll see, but I do feel that the company is in better circumstances versus the previous cycles. And I don't think that there's anything too alarming in terms of new signs of deterioration that we're seeing at this time. So I guess that's where I would leave it at. And then in terms of just sales coverage, in general, yes, I mean, we're going through -- different levels of sales reps have different numbers of customer that we expect them to cover, and it really depends on the size of the customers and their portfolio. But I would say that in general, I would say that we're probably cutting away, on average, I would say, at least 15%, 20% in terms of the number of customers that we expect to cover versus our previous standard, if you will. So overall, that is something that we need to kind of work through, and that's been something that we've been working on consistently throughout this year as well. So that's kind of the magnitude in terms of the recalibration that we expect to go through. And of course, I guess the different seniority levels will have different numbers. And so -- but that is something that we're going through.



Operator

(Operator Instructions) Our next question is from David Li with Lizard Investors.

David Li

I have a couple of questions. First, can you just quantify -- maybe give us a little bit more anecdotes on just the opportunity in cross-selling, upselling in the online business? I mean, things like number of products the customer are taking now. Or is there a percentage of products that -- percentage of customers taking way more products versus the other end? So we can get a frame of reference as how big an opportunity really is longer term.

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

Yes. I guess -- so for us, I mean, we have -- I would say probably -- we can probably have 15, 20 product lines that people can sell -- our sales guys can sell. And I think that in terms of where we are overall in terms of the cross-selling, I mean, we are still at a pretty low percentage because we will expect that in this last quarter, where we transacted over 365,000 customers. The take rate across the board is still less than 10% in terms of the other HR services. So that's a low number at this point in time even though that's already significantly improved versus where we were last year. So I think that we feel like there's a lot more room for us to continue our penetration, and that is something that we'll be working very hard on.

David Li

Okay, great. And second, also, can you talk a little about the pricing increase you guys have? How should we think about the price increases? Is this going to be ongoing or at a certain point in time, in a few years from now, you guys will stop and then go to another phase of stable pricing again? Maybe comment a little bit about that.

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

Well, we didn't change on any pricing in the third quarter, and we had actually done the price change for some of our basic products and services in the first quarter. So it is not something that we expect and we put in kind on an annual basis. So I don't think that philosophy or that approach were changed in the near term. But the upselling doesn't come from necessarily the price changes on a like-for-like product, but it's really sort of the ability for us to sell more of the different services into a customer account within the online space so that people are maybe not just utilizing the most basic services of posting but taking up resume search, priority listing and other options that are available within the online recruitment services portfolio. So I don't think that the price change, in itself, is something that will be the primary driver of our growth.

David Li

Okay. And -- okay. And also, can you tell me a little about -- so I'm trying to understand the guidance. So your Q4, the revenue growth guidance implies close to 30% year-on-year revenue growth, but the earnings is going to be slightly up. So there's a big margin contraction. I just don't understand. Maybe I misread the financial statements, the disclosure. Is that fair? So -- and if that's the case, what kind of drove this margin compression in Q4?

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

I am not sure what you're alluding to, but I think in terms of our guidance, I think the top line suggests 25% to 28% on an RMB basis. And I don't think that we're suggesting necessarily a huge margin. I don't know if you're looking at year-over-year or quarter-on-quarter but I think...

David Li

Year-on-year.

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

This is pretty much in line with our trajectory for this year so far.

David Li

Okay. Because I was looking at year-on-year, yes. Is the earnings per share year-on-year? What is that on a Q4 basis, Q4 year-on-year based on the guidance growth?

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

You can look at the number, but this is on a non-GAAP basis. So I don't know which number you're alluding to, but we can have that discussion maybe offline then if this is a specific question, yes.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Rick Yan for any closing remarks.

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

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

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