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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Yirendai Third Quarter 2018 Earnings Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, Tuesday, the 13th of November 2018.

I would like to hand the conference over to your first speaker host today, Mr. Lydia Yu. Thank you, ma'am. Please go ahead.

Lydia Yu - *Yirendai Ltd. - IR Manager*

Thank you, and welcome to Yirendai's Third Quarter 2018 Earnings Conference Call.

Today's call features presentations by our CEO, Miss Yihan Fang; our CFO, Mr. Dennis Cong; and our VP of Finance, Miss Joanne Liu.

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 reconciliations to GAAP measures, please refer to our earnings press release.

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

Yihan Fang - *Yirendai Ltd. - CEO*

Thanks, Lydia, and thank you all for joining us today.

Despite challenging industry environment during the quarter, we maintained solid performance for our business in terms of liquidity and profitability. We have seen investor confidence in our platform continue to be strong as demonstrated with demand for our loan products. As the regulatory evaluation process continues, we expect industry to further consolidate and will result in a healthier and more sustainable environment.

During Q3 2018, we implemented tighter risk policy to proactively control our business growth in order to improve the asset quality of our new sales. Risk management has remained a top priority for us. We have continued to tighten our risk policy, enhance our collection efforts and fine-tune our credit model by leveraging more effective data sources. We have seen continuously strong demand from our wealth management clients, especially for PICC in short loans, which are literally sold out every day. In addition, we have enhanced our cooperation with our institutional partners such as PICC, Xinwang Bank and Baidu. We're also spending a lot of efforts in developing more institutional partnerships.

In order to prepare Yirendai for more sustainable growth in the long run, we have been spending efforts in the following respect: one, optimize the existing credit offering to make it more convenient and accessible; two, spend more effort in KYC to better understand the general needs from our target customer segment and develop new products and services to cater for it; three, continue to invest in technology, online operating capabilities and risk management; and four, enhance communications among different functional teams to enable greater synergy.

Furthermore, we remain committed to developing Yiren Wealth into a leading online wealth management platform, which provides comprehensive products and services to the growing mass affluent population in China. We're very confident that Yirendai will be the brand of choice for consumers seeking for superior online financial services.

Compliance remains a top priority for us. We completed the connection of our data to [NIPA's] systems in September and submitted our self inspection report in October. We expect and are prepared for both local and national regulators to come in and perform on-site compliance inspections in the following month or so.

We're fully confident in our ability to meet registration requirements. We believe that Yirendai will emerge as the top industry consolidator post-industry rectifications.

With that, I'll turn the call over to our CFO, Dennis, to discuss about the quarter's operating results.

Yu Cong - *Yirendai Ltd. - CFO*

Thanks, Yihan. Hello, everyone.

I will first provide a business operation update, and then I will pass it on to our VP of Finance, Joanne Liu, to provide the financial update of our business.

Q3 had its challenging period of time for China's online lending industry. Over the past few months, there was a large spike in a number of problematic platforms shutting down, leading to investor panic and decreased investor confidence in online lending industry. We noted many platforms having difficulties attracting funding, which limited overall industry growth.

From June to September 2018, total transaction volume for the industry decreased nearly 40%. The total number of active investors in the P2P industry also decreased from over 4 million in June to less than 2.5 million in September.

At the same time, Yiren Wealth experienced a brief period of funding disruption during the early part of the quarter and have since recovered fully back to normal due to our strong investor base and their trust in our platform. As of September 2018, our average AUM for investor increased from

CNY 146,000 in June to CNY 151,000 as we further refine our investor strategy to focus on the mass affluent customer base, which defined as family or person have a few million renminbi investment asset.

In addition, the industry witnessed average funding cost increasing from 9.6% in June to 10.3% in September. While the average investor yield on our platform has remained stable and we have even further decreased the expected yield on investments in PICC insured loans, indicating strong investor demand for our fixed income loan products and strong investor confidence in our platform. The PICC insurance loan products remains a top pick for investors and has been consistently sold out every day.

As we build out our investor base, we're also working on enhancing liquidity management. We increased our average investment tenure to close to 12 months as of October from about 9 months in July to better match the average term of funding needs. Going forward, we plan to continue to leverage our relationship with CreditEase wealth management and build our business into a leading online wealth management platform.

On credit side, loan originations saw double-digit decline in Q3 2018, hitting the lowest points this year due to tightened risk policies amid highly uncertain industry environment. We made several adjustments to our risk policies this quarter to further enhance risk management, including tightening our risk model, closing off high-risk channels, increasing the salary-related data inputs as well as further increasing collection efforts. As a result, we noted improvements in the performance of our recent new loan origination.

This quarter, we saw continuous movement of early delinquency rates in our portfolio, which was partially due to lower origination volume as well as certain sustained level of credit risk. We plan to maintain a prudent risk policy in anticipation of persistent challenges as the industry goes through the compliance evaluation process, and we expect to resume growth in Q4 2018 and early 2019.

On institutional partnerships, we're pleased to note that we have made positive progress. On the credit side, Du Xiaoman Financial is becoming an important customer acquisition channel for us, and we expect to generate increasing amount of loans through them.

On the funding side, we began our partnership with Xinwang Bank in August this year, and we're currently on track for loans generation in accordance to our schedule.

In addition, we continue to deepen our relationship with PICC. And as of September 2018, the total loan contract amount covered by PICC totaled CNY 7.4 billion.

Growing institutional partnership will continue to be a key area of focus for us as it not only helps to diversify our funding sources, but also reduce the customer acquisition costs as well as allows us to connect to PBOC credit report which is very critical for our credit underwriting process.

I will now turn it over to Joanne for our financial updates.

Joanne Liu - *Yirendai Ltd. - Finance VP*

Thanks, Dennis.

For our financial updates, I will focus on key items of our business operation and financial performance. And you can refer to the detailed financial results to our earnings release and IR deck that is now online.

So the total loan originations declined 46% year-over-year to RMB 6.5 billion. During this quarter, the proportion of loans generated from online channels was 63.4%. About 32.2% of loan volume came from repeat borrowers in Q3 2018.

Total net revenue declined 26% year-over-year to RMB 1.12 billion during the quarter, with a corresponding net revenue take rate of 13.9% as compared to adjusted net revenue take rate of 12.5% last quarter as we optimize our product mix in response to change in the industry.

Please note that our revenue take rate is calculated net of provision expenses for better comparing the year-over-year. This quarter, the average borrower contribution to our credit assurance program is about 11% of the loan contract amount, and we expect to further increase this ratio in Q4 to ensure adequate investor protection.

I would also like to highlight our sales and marketing expenses this quarter, which is approximately 6.9% of loan volume, remaining stable quarter-over-quarter despite a slowdown in business growth, indicating that our business model is highly flexible and can be quickly adapted in response to industry trends to remain profitable despite tightened risk policies and an active marketing environment.

On the balance sheet side, a key priority for us this quarter was cash management. As of September 2018, our cash and cash equivalents were RMB 807 million, balance of healthy maturity investments worth RMB 320 million and a balance of available-for-sale investment was RMB 834 million.

As of September 2018, our usable cash increased from RMB 1.4 billion in June 2018 to RMB 2 billion, putting us in a solid cash position.

In June 2018, our board approved USD 20 million share repurchase program. As of November 2018, we repurchased 2,000 ADS, representing approximately USD 37,000. We believe that our shares are deeply undervalued as we are very confident in the future growth potential of the company.

For business outlook, the uncertain industry environment makes it difficult to provide an accurate outlook for loan originations for the full year. We expect to be able to provide a clearer guidance once the industry ratification is over and we are able to resume high-quality growth.

That concludes our remarks. I would now like to turn the call back to the operator for the Q&A session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Richard Xu Morgan Stanley.

Richard Xu - *Morgan Stanley, Research Division - MD*

Two questions for me. One is I saw -- certainly the global volume have come down so is the cost of sales and marketing. Just wondering what's our new strategy on sales and marketing. And also, given the new risk management, I guess, strategy at the moment, what's the approval rate for online and offline? What's the split at the moment? Secondly is the, I guess, some delinquency trends. Seems like the fourth quarter and the first quarter vintage still probably deteriorating a little bit. What will be the recent trends? And what's expected sort of total loss for the -- I guess, the vintage for example, fourth quarter and first quarter this year?

Yu Cong - *Yirendai Ltd. - CFO*

Okay. So thanks, Richard, for the question. In Q3, we see our overall volume coming down. I think first, we want to highlight that it's a decision -- from business decision perspective. It's not from funding or other reason. We have more than sufficient funding to grow the business. However, given what the industry is going through and what potential overall micro trend, we're becoming extremely risk-averse in terms of new business growth. So we pretty much control our business growth according to the risk. And then at the same time, we also select the channels for customer acquisition to prioritize the most cost-efficient customer acquisition channel as well as the risk performance so that as we have -- in the quarter with the volume dropping down, at the same time, we were able to also control the customer acquisition cost in a way that's in line with our business growth. And of course, as we go into Q4 and then 2019, we'll expect us to become more comfortable with the industry. We'll be looking to expand the channels that have shown consistent good risk policy. And at the same time, we're working on various ways from both customer acquisition costs as well as approval rate perspective to enhance our overall sales and marketing efficiency. I think as we see near term, we'll probably see the approval rate has already bottom and rate increasing from the Q3 level as we further expand our business. So that's the first question. And in terms of the second question, I think the overall risk is -- our loan tend to be longer durations, and it takes some time for the risk to fully show itself. So we see some continuous movement of our either vintage performance or the early delinquency rate. I think part of the early delinquency rate is also contribute to the lower volume growth, which is result in a lower ending balance. If you look at our vintage performance by quarter, you probably can see that the recent quarters have actually shown somewhat better performance if you just take the 2018 Q1 vintage. The first points has already shown a reverse trend compared with 2017 Q4. In terms of the full vintage charge-off, right now, we're still monitor all the data every month to evaluate what's the potential. I think one way to look at this is if you look at our yearly vintage, so 2015, full year vintage around 10.3. Of course, there are some potential further collection recover that could potential for the 2015 full year below 10. In 2016 right now stands at 9.6. And 2017 right now is 8.5. I think during last quarter, we mentioned that we're probably looking the vintage performance peaking around 10 to 11. I think right now, probably more 11 and could be slightly higher than that for some of the peak vintages. So that's why in this quarter, we have contribute 11% for the [CAP] program. And then in Q4, we probably will adjust accordingly so that we have sufficient buffer in terms of the risk.

Operator

Your next question comes from the line of Alice Li from Credit Suisse.

Alice Li - *Crédit Suisse AG, Research Division - Diversified Financial Services Analyst*

I have 2 questions. The first one is still on the asset quality. Because you mentioned in the results that increasing the provision expense assist you to the more conservative changes in the future collectibility estimates. So I would like to know what's your latest capability or actually the loss assumptions for your fee receivables? And to what extent did they change from the previous assumption? This is my first question. My second question is on the funding side. We know that you have been diversifying your funding sources. So what percentage of loan was facilitated by institutional funding partner in the third quarter? And I would like to know what's the -- what would you expect the percentage to increase in fourth quarter and in 2019? Also, it is reported recently that more restriction that will put on the banks, corporation with the online lending platforms. So how would you expect this to affect your institutional funding?

Yu Cong - *Yirendai Ltd. - CFO*

Sure. I will answer the first question, then maybe Joanne can answer the second one. So in terms of our collection efforts, we have started early this part of the year from operation perspective to have a focus in terms of strengthening our collection capabilities. Historically, our collection success rate has been ranging between 10% to 15% if you're looking for longer enough time period. So we have seen that actually coming down somewhat during the middle of this year, which we believe have certain factors that impact the overall borrower's ability to repay. One is that there are some economic difficulties in certain areas that could potentially impact people's income. And also due to the industry uncertainty -- regulation uncertainties. There's some -- borrowers are taking the advantage of not paying. Most recently, I think during the later part of Q3, we have initiated certain other efforts in terms of social marketing efforts that we've seen some promising trends of improving the collectibility of the assets. Does that answer your question?

Alice Li - *Crédit Suisse AG, Research Division - Diversified Financial Services Analyst*

Yes.

Yu Cong - *Yirendai Ltd. - CFO*

Yes.

Joanne Liu - *Yirendai Ltd. - Finance VP*

So in terms of the institutional funding. Yes, there were news last week that it's supposed to be a discussion circulate of the commercial bank running the loan origination business. So we also studied the news, and we do think it will significantly impact the regional banks and also the banks who are heavily involved in joint lending business. And of course, there is not that much impact on our current business -- on our current institutional funding. And we will -- in the future, I think, going forward, we will more focus on the cooperation opportunities with national joint stock banks who can operate nationwide and it's least impacted by the news or by the regulations.

Operator

Your next question comes from the line of Alex Ye from UBS.

Alex Ye - *UBS*

So my first question is about your take rate. So from your reported take rate, it shows an Q-on-Q improvement. But if we take out the investors -- the fee from investors, what I get is like unstable take rate Q-on-Q. But on the other hand, if we look at your -- the risk profile of your customer grades, it seems like you're moving towards a more lower-risk customers. So can you give us some color on some of the moving parts above the net revenue line? For example, how does your fee billed to customers have changed over the period? And how is your API have changed? And second question is about your partnership with Baidu-Du Xiaoman? How would you expect this to impact your customer acquisition costs as well as your asset quality from the customers acquired from this channel? I wonder if there's any difference in the credit performance.

Yu Cong - *Yirendai Ltd. - CFO*

Yes. So in terms of the pricing and take rate, you're very good observation. So with our overall asset actually moving to better category, our take rate has been stable. We actually made certain adjustments during the quarter to optimize our prototyping in anticipate of the -- to reflect the industry risk. So the average APR -- volume-adjusted APR actually moved up certain level. So even though in terms of risk rate has been moving towards better risk score, our overall take rate has been stable. And then this will continue into the Q3 in 2019 as we facing the industry uncertainties. We want to make sure that we price our risk correctly so that we have a sustainable and profitable business. I think in terms of the channel with Baidu -- sorry Du Xiaoman, we have a good partnership with them. We have a CPS level of customer acquisition costs. I would say it's quite good for us and for them because we contribute a lot of business with them as well. So I think it's a win-win partnership. Risk performance-wise, it's quite good as well. And so, we believe these type of strategic-level partnership will be more what we focus on going forward in terms of customer acquisition.

Alex Ye - *UBS*

Can I have just a quick follow-up on what's the percentage of contribution of Du Xiaoman in terms of new customer acquisition?

Yu Cong - *Yirendai Ltd. - CFO*

Yes, we can get the number. Just give us a minute. Maybe we'll get back to you later after the call. Yes, I think there's -- we would also need -- okay.

Operator

Your next question comes from the line of Anderson Cha from BNP Paribas.

Munyoung Cha - *BNP Paribas, Research Division - Analyst*

I have 2 questions, basically. So the first one is you previously mentioned about this in your presentation, but I'm just wondering if you can update on your current liquidity position along with the liquidity mismatch that you've seeing and also any new developments in terms of institutional funding pipeline that you are expecting towards the end of 2018. And my second question is with regards to increasing the provision expenses, can you share some sort of key inputs on this estimate to the extent that you can share? Do we have to expect another round of provision expenses increase in the coming quarters or not?

Yu Cong - *Yirendai Ltd. - CFO*

Okay. So I think from the liquidity management perspective, as you know, our product design is slightly different, especially with our alternate reinvestment process. So when an investor invests $100 for 12 months, every month, when the principal interest repayment return every month, it will get reinvested. So the average weighted tenure is actually longer compared with the type of loan we have because the loan was repaid back in monthly with the principal and interest. So the full principal ending balance actually reduced through the year. So we have done a calculation to match with the, let's say, 36-month duration loans. If you calculate, the ending balance average weighted lifetime is actually probably half of that. And then if you deduct the early repayment and credit loss, you're probably looking for something about 14 to 15 months liquidity needs to match that funding needs. So right now, as we mentioned, our loan are on 12-months duration now. So probably another 20% until we actually going to get into a fully perfect liquidity match perspective. I think from funding -- institutional funding sources, we're working very closely with several large banks. Some of our stockholding banks. Some are city-level banks, all very established with very large business operation. We're rather selective in terms of partners we work with. We need to have them to have at least 5 billion to 10 billion level line of credit for us before we engage with very deep discussion. So we hope in the next 1 or 2 quarters, we'll be able to sign up 2 or 3 more banks which are large-scale and deep relationship to boost our institutional side of fundings. And of course, looking into 2019, it's a little bit early, but we hope to have somewhere close to 20% of our fundings coming from institution. In terms of provision, yes, Q3 is around 11%. As we go through Q4, we probably think will be somewhat a little bit elevated level than that. But still, as you have seen our financial model, we have good room of profitability as well as the unit economics perspective. So -- and also, as we look -- as our current new loan volume risk performance were quite comfortable, we're generating better asset. And then the risk performance is performing well, so we will have good profitability room as we ramp up the business starting Q4 and then into 2019.

Operator

Your next question comes from the line of Jacky Zuo from Deutsche Bank.

Jacky Zuo - *Deutsche Bank AG, Research Division - Research Associate*

So I have 2. One is the operating expenses. So I saw the G&A, it's still at -- a bit elevated level, around I think 2.6% of the loan origination volume. Can I get some color on that, and what's the outlook? Also, I saw the origination service expenses was higher due to, I guess, more collection efforts. Can I also get some color on the outlook? And second question is related to the P2P funding cost. I think our P2P cost is similar as industry trend basically is higher than second quarter, but try to understand what's the reason behind. And what's the outlook as well?

Yu Cong - *Yirendai Ltd. - CFO*

Sure. And -- okay. So in terms of the P2P funding cost in Q3.

Yihan Fang - *Yirendai Ltd. - CEO*

Yes, I'll try to answer that. P2P funding cost in Q3 actually -- I think was a decrease, yes, from the previous quarter despite -- yes, increased a little bit, but we actually -- I think the duration -- because we actually have 2 measures. You cannot only look at the cost -- the funding cost by itself.

Because of the liquidity situation, we actually strengthened our risk -- liquidity risk because we know liquidity risk is the most important that we actually lengthened our average duration for our Yiren product. So for the product we give to client, the longer duration they hold, actually, the higher yield we give to our clients. So on average, I think the funding cost increased slightly while on par with before. But actually, we have better quality funding, and the longer funding from the previous quarter. And we are very proud that we actually have lots of loyal customers staying with us for longer investment with about the same cost. And we see the trend of cost of funding from individual investors actually keep stable or decreasing. That actually indicates that we have -- we're doing better in terms of funding side.

Yu Cong - *Yirendai Ltd. - CFO*

The duration adjusted as well as the customer quality -- customer base.

Yihan Fang - *Yirendai Ltd. - CEO*

Yes.

Yu Cong - *Yirendai Ltd. - CFO*

So in terms of G&A?

Joanne Liu - *Yirendai Ltd. - Finance VP*

Yes, so for the first question, I think overall in this quarter, we booked lots of loans, so the net revenue number decreased. And G&A -- both G&A and our origination servicing costs are more of a fixed cost in the business. So when the volume drops, the percentage of the operating cost or the fixed cost as a percent of the revenue would naturally increase. If you compare the actual amount quarter-over-quarter, the increase of G&A is mainly due to the issuance or the divesting of RSU in this quarter. And origination and servicing costs is mainly due to the -- the increase is mainly due to the collection efforts -- increasing collection efforts. And also having -- has mentioned in her transcript that we can utilize more and more data -- third-party data to improve the credit underwriting process. So for the outlook, I think, for G&A, the major part of G&A is the account or HR expense. And we are expecting -- or the stable headcount level in Q4 and going to 2019. And origination, I think, we'll continue our efforts on the collection, and we would expect the absolute amount be stable compared with this quarter.

Operator

Your next question comes from the line of Daphne Poon from Citi.

Daphne Poon - *Citigroup Inc, Research Division - Associate*

So first on the account management fee. So we see quite a lot in terms of take rate this quarter. But while the funding cost or P2P side is relatively stable, so I'm wondering what would be the driver behind this increase in fees? And I guess, second is about the PICC partnership. As you mentioned that the product has actually been very popular.

Yu Cong - *Yirendai Ltd. - CFO*

Daphne, we can't hear you -- second question.

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Daphne Poon - *Citigroup Inc, Research Division - Associate*

Is it better now?

Yu Cong - *Yirendai Ltd. - CFO*

Yes.

Daphne Poon - *Citigroup Inc, Research Division - Associate*

Yes. So the second question is about the PICC partnership, just wondering if you have any plan to expand your scope of the partnership given the popularity of the product among your investors.

Joanne Liu - *Yirendai Ltd. - Finance VP*

So for the first question, the account management service fee, that's -- the driver is basically the AUM under management from the investor. So -- and also the spread or the fee rates we can take from the investments. So basically, 2 factors. One is the AUM. And if you compare this quarter with last quarter, the AUM didn't drop as much as the loan volume, so it's just around 5% drop. So it doesn't really impact the service fee from investors. And also, because some of the products, we lowered the yield to our investor. For example, the PICC insured loans, we can take more of fees -- more management fees from their investment. So basically, that's the spread. We did -- we were able to increase some of the product spread in Q3 to increase the fees. In terms of your second question, the partnership with PICC, the answer is yes. We are -- both parties are seeking for larger scope of cooperation for the multiple-year's loan.

Daphne Poon - *Citigroup Inc, Research Division - Associate*

Okay. So may I know what is the current yield that you are also gain investors on the PICC-insured loans?

Yihan Fang - *Yirendai Ltd. - CEO*

Currently, for 6-months lock-up period, we offer a 5.5%.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.
