

THOMSON REUTERS STREETEVENETS

EDITED TRANSCRIPT

DL - Q4 2018 China Distance Education Holdings Ltd Earnings Call

EVENT DATE/TIME: NOVEMBER 21, 2018 / 1:00PM GMT



CORPORATE PARTICIPANTS

Mark A. Marostica *China Distance Education Holdings Limited - Co-CFO*

Zhengdong Zhu *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

CONFERENCE CALL PARTICIPANTS

Weihaio Lu

PRESENTATION

Unidentified Company Representative

Good evening, and thank you for joining us for the China Distance Education Holdings Limited Fourth Quarter and Fiscal Year 2018 Earnings Conference Call. On today's call are Mr. Zhengdong Zhu, Chairman and CEO; and Mr. Mark Marostica, Co-CFO. (Operator Instructions)

Before we start, we remind listeners that this conference call contains forward-looking statements. These statements are made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. The outlook for the first quarter and full fiscal year 2019, oral statements from management on this call as well as the company's strategic and operational plans, in particular: Anticipated benefits of the strategic growth initiatives, including the promotion of the company's lifelong learning ecosystem; the benefit to be gleaned from the acquisition of Beijing Ruida; the partnership with Tencent; mobile-related products; bundling accounting, practical skills training and employment guidance services; acquisitions and strategic investments; as well as cost control, among other things, may all contain forward-looking statements.

Forward-looking statements involve inherent risks and uncertainties. A number of factors could cause actual results to be -- differ materially from those contained in any forward-looking statement. Further information regarding this and other risks is included in the company's Annual Report on Form 20-F and in other documents of the company as filed with the Securities and Exchange Commission. The company does not undertake any obligation to update any forward-looking statements, except as required under applicable law.

As a reminder, this conference call is being recorded. In addition, the presentation that we will be referring to during the course of the call can be downloaded from the company's Investor Relations website. Further, a webcast of this conference call will also be available on the company's IR website at ir.cdeledu.com.

I will now turn the call over to Mr. Zhu. Mr. Zhu, please go ahead.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Thank you, everyone, for joining our Fourth Quarter and Fiscal Year 2018 Earnings Conference Call. Our operating results were distributed earlier via Internet, newswire services and are also posted on our website, where a slide presentation is available as well.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)



Unidentified Company Representative

If you will now refer to the presentation, I will begin on Slide 4 with an overview of our financial results.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

In the fourth quarter of fiscal 2018, our net revenue was \$53.6 million, up 28.6% year-over-year, modestly below our guidance range, mainly due to higher-than-expected mix of cash receipts from our refundable accounting elite classes, representing 26.8% of cash receipts from online course registration in the fourth quarter. The revenue from elite classes can be recognized only upon the release of related exam results and expiration of the student's right to receive a refund under current U.S. GAAP ASC 605. However, fourth quarter revenue growth was still driven primarily by our accounting vertical in addition to newly acquired Beijing Ruida.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

We are pleased to see continued strong growth momentum in cash receipts from online course registration, which were up 61.7% year-over-year in the fourth quarter to \$36 million, primarily due to robust cash receipts from our core Accounting Test Preparation courses, and in particular, more student enrollments in our longer-duration premium and elite classes.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Total enrollment declined 2.9% year-over-year during the fourth quarter, stemming predominantly from a decrease in continuing education course enrollments. However, excluding the enrollments of continuing education courses, our total course enrollments were up 8.3% year-over-year during our fourth quarter. In addition, for fiscal year 2018, our total course enrollments, excluding enrollments from continuing education courses, were up 15.6%, owing to the strength of our APQE courses and test preparation courses for self-taught learners.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Next, during the fourth quarter, we completed the acquisition of an additional 11% equity interest in Beijing Ruida for a total consideration of RMB 52.8 million or \$8 million, subject to adjustments under certain pre-agreed conditions, bringing the company's total equity interest in Beijing Ruida to 51%. Beijing Ruida is a leading provider of exam preparation services for China's national legal profession qualification examination.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Ruida's solid position in China's legal education market, with its best-of-breed educational content and highly acclaimed instructors, extends our comprehensive lifelong learning ecosystem into a fourth core vertical, legal education, and thus, further diversifies our business model.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Ruida contributed revenue of \$7.4 million in the fourth quarter.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Turning to our health care vertical. We have formed a partnership with Tencent Medical's AI Lab to develop products that will offer our students self-evaluation tools to adjust their study plans, improve learning efficiency and increase their exam pass rates. This partnership leverages each of our company's resources for a mutual benefit, enabling us to optimize products and services, improve medical products and medical education innovations with consistent feedback from our students.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

I would next like to provide a few operational highlights.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

As I mentioned earlier, the strong growth momentum in cash receipts from online course registration in the fourth quarter was mainly due to robust cash receipts from longer-duration premium and elite classes in our accounting vertical. Compared with regular classes, these higher-level

classes provide our students with additional services, including more tutoring guidance, more mock exams, personalized study reports, longer study periods and employment guidance services, and as such, are offered at a higher price point compared to our regular classes.

We believe the enrollment and participation in our longer-duration premium and elite classes shows the high degree of confidence and trust students place in us and demonstrates their loyalty to China Distance Education. In the fourth quarter, approximately 28.1% of our cash receipts from online course registration were derived from longer-duration elite classes.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Our multipronged student acquisition strategy employs multiple formats and platforms in an effort to reach a broader student audience while strengthening the interaction among students, lecturers and the company's websites. Earlier this month, for example, during China's Double 11 Shopping Festival, we hosted a series of live streaming events covering a variety of verticals aimed at enhancing our brand and driving student enrollment.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

With an increasing number of our students relying on mobile devices to complete at least a portion of their overall study time, we've been consistently upgrading and enriching our mobile education products and services to meet students' diversified learning needs and provide superior and comprehensive learning experience. As of September 30, 2018, China Distance Education offered 67 mobile apps and recorded cumulative downloads of 44.8 million, up from 40 million as of June 30, 2018. In the fourth quarter, daily traffic to our mobile website continued to increase, with daily active users in our accounting vertical increasing 26.7% year-over-year. Further, our live streaming courses, which are designed for students who desire a more interactive learning experience, continue to be popular among our students.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

This concludes my update on our business operations and strategies. I will now turn the call over to Mark, our Co-CFO, to walk through key operating metrics and financials.

Mark A. Marostica - *China Distance Education Holdings Limited - Co-CFO*

Thank you. During the fourth quarter, cash receipts from our longer-duration premium and elite classes contributed to the robust growth of cash receipts from online course registration, as Mr. Zhu noted. However, because we generated a higher-than-anticipated mix of our fourth quarter cash receipts from elite classes, our fourth quarter revenue growth of 28.6% year-over-year came in modestly below our guidance range as the revenue associated with these elite classes will be recognized over a longer period.

Now let me summarize some of our key operating metrics on Slide 6 and 7. Enrollments in our Online Accounting Test Preparation courses were up 4.6% year-over-year in the fourth quarter and up 19.7% year-over-year in fiscal year 2018, primarily due to an increase in Certified Public Accountant, or CPA, enrollments; as well as accounting professional qualification exam, or APQE, enrollments. Enrollments in our Accounting Continuing Education courses declined 33% year-over-year and 27.6% year-over-year in the fourth quarter and fiscal year 2018, respectively, primarily due to the downstream effect of the cancellation of the Accounting Certificate exam in November 2017.

Total Online Accounting Test Preparation ASPs nearly doubled year-over-year in our fourth quarter as ASPs increased significantly in most of our core exam preparation areas in our accounting vertical, especially CPA courses. These ASP increases were mainly due to increased student enrollments in our longer-duration premium and elite classes. All told, our fiscal year 2018 cash receipts for our online accounting courses were up 63.3% year-over-year.

Enrollments in our Online Healthcare Test Preparation courses in the fourth quarter and fiscal year 2018 decreased by 3.7% year-over-year and 2% year-over-year, respectively. ASPs for our Healthcare Test preparation courses increased by 11.8% year-over-year in the fourth quarter, mainly due to the overall ASP increases; product mix; and in particular, more student enrollments in our longer-duration classes of our licensed pharmacist courses, which were offered at relatively higher price points. Our fiscal year 2018 cash receipts for our Online Healthcare courses were up 11.7% year-over-year.

Enrollments in our Online Engineering and Construction, or E&C, Test Preparation courses increased by 15.9% year-over-year in the fourth quarter and 15.1% year-over-year in fiscal year 2018. Enrollments in our E&C Continuing Education courses increased by 89.6% year-over-year in the fourth quarter, while E&C Continuing Education course enrollments grew 7% year-over-year in fiscal year 2018, primarily due to seasonality. ASPs for our E&C test preparation courses in the fourth quarter increased by 3.2% year-over-year. The ASPs for E&C Continuing Education courses decreased by 6.7% year-over-year in the fourth quarter. Our fiscal year 2018 cash receipts for our online E&C courses were up 11.9% year-over-year.

Now let's turn to Slide 10 to look at some of our financial metrics. To be mindful of the length of our earnings call, I'll focus on key financial highlights and encourage listeners to refer to our earnings press release and financial filings for further details.

Non-GAAP gross margin was 51.2% in the fourth quarter of fiscal year 2018 compared with 60.4% in the fourth quarter of fiscal 2017. The year-over-year decline in gross margin was primarily due to increased salaries and related expenses, increased lecture fees for the expansion of our online and offline course offerings, increased rental and related expenses associated with the company's new office space in Beijing and online -- excuse me, and offline training courses, expenses associated with Beijing Ruida as well as other miscellaneous expenses.

Non-GAAP selling expenses increased by 60.6% to \$14.3 million in the fourth quarter of fiscal year 2018 from \$8.9 million in the prior year period, driven primarily by an increase in salaries and related expenses, higher commissions to our online agents and expenses associated with Beijing Ruida, partially offset by a decrease in advertising and promotional expenses.

Non-GAAP general and administrative expenses decreased by 4.1% to \$5.2 million in the fourth quarter of fiscal year 2018 from \$5.5 million in the prior year period. This decrease was mainly due to a decreased provision for doubtful debts and other general administrative expenses and was partially offset by expenses associated with Beijing Ruida.

Overall, the non-GAAP operating margin for the fourth quarter of fiscal year 2018 was 23.9% compared with 26.8% in the prior year period. The year-over-year decline in operating margin was primarily due to the impact of a higher mix of cash receipts from refundable accounting elite classes on our revenue. Other related student acquisition costs were incurred upfront. The amortization of intangibles arising from the acquisition of Beijing Ruida and an increase in rental expenses from our new Anhui Qiao office location in Beijing also adversely impacted our fourth quarter operating margin to some extent.

Despite the fourth quarter operating margin decline, our headcount remained relatively steady compared with fourth quarter fiscal 2017, excluding Jiangsu Asset and Beijing Ruida. We acquired an 80% interest in Jiangsu Asset in the first quarter of fiscal year 2018 and brought the company's total equity interest in Beijing Ruida to 51% in the fourth quarter fiscal 2018.



In the fourth quarter of fiscal 2018, we recorded a noncash foreign currency exchange gain of \$3 million, mainly related to loans from our PRC subsidiaries to our offshore holding company, due to the depreciation of the RMB against the U.S. dollar from June 30, 2018, to September 30, 2018. We recorded a noncash foreign currency exchange loss of \$1.4 million in the prior year period.

Income tax expense of \$1.7 million in the fourth quarter of fiscal year 2018 compared with \$2.1 million in the prior year period, primarily due to a decrease in taxable income.

In the fourth quarter, we recorded a change in fair value in connection with business combination of approximately \$4 million. This is a noncash item that reflects the change in value of our interest in Beijing Ruida at the time of consolidation.

Non-GAAP net income increased by 73.9% to \$12.5 million from \$7.2 million in the prior year period.

During the fourth quarter, we incurred a \$2.8 million impairment related to our investment in Piyongke Technology, a web animation cloud technology provider; and Mayi Investment Management, an online lending platform.

Now turning to our full year results as shown on Slide 11. I'll just quickly summarize the revenue, non-GAAP operating income, non-GAAP net income growth for fiscal year 2018. We encourage you to refer to our earnings press release for further details regarding our full year financial results. Total net revenues increased by 27.2% to \$166.7 million in fiscal year 2018 from \$131 million in fiscal year 2017. Fiscal year 2018 non-GAAP operating margin was 11% compared with 17.7% for fiscal year 2017. Net income was \$11.6 million for fiscal year 2018, a decrease of 22% year-over-year. Non-GAAP net income was \$16.1 million for fiscal year 2018, a decrease of 8.9% from fiscal 2017.

Now let's turn to Slide 12 to review our cash flow. Net operating cash inflow increased by 437.4% to \$15.7 million in the fourth quarter of fiscal year 2018 from \$2.9 million in the prior year period. The operating cash inflow was mainly attributable to net income before noncash items generated in the fourth quarter of fiscal 2018. The decrease in inventories, prepayments and other assets and the increase in taxable -- excuse me, and the increase in the income tax payable and refundable fees generated from our longer-duration elite classes also contributed to the operating cash inflow. The operating cash inflow was partially offset by the increase in accounts receivable and the decrease in deferred revenue.

Cash and cash equivalents, restricted cash and short-term investments as of September 30, 2018, increased by 8.9% to \$99.6 million from \$91.5 million as of June 30, 2018, mainly due to the operating cash inflow generated in the fourth quarter of fiscal 2018, partially offset by capital expenditures of \$8.5 million.

This completes my financial overview. I will now return the call to Mr. Zhu for concluding remarks as well as financial guidance for both the first quarter and for the fiscal year 2019. Mr. Zhu, please.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

Thank you, Mark.

(foreign language)

Unidentified Company Representative

In summary, the investments we've made in enhancing our business have strengthened China Distance Education's leadership position in China's education industry. We are well positioned as China's preeminent professional education brand and offer our students a wide range of course offerings and value-added services aimed at helping them to achieve superior learning outcomes, advance their careers and have better lives.



We will continue to enhance our lifelong learning ecosystem across our 4 educational pillars of accounting; health care; engineering and construction; and now, legal, to provide students the best-of-breed education content and services, exceptional lecturers and tutors, an innovative online learning platform as well as multiple learning modalities to appeal to individual learning styles.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

While fiscal 2018 was clearly a challenging year from a financial perspective, we expect to generate non-GAAP operating income growth in fiscal 2019 with improved non-GAAP operating margins while we balance growth with a keen focus on prudent cost control. And with fiscal 2019 well underway, we are encouraged by the continued strong growth in cash receipts from online course registration, which increased by 75% year-over-year on a constant-currency basis during the first quarter fiscal 2019 through the end of last week.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

Turning to guidance. For the first quarter of fiscal year 2019, the company expects to generate total net revenue in the range of \$38.7 million to \$40.5 million, representing year-over-year growth of approximately 8% to 13%.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

For fiscal year 2019, the company expects to generate total net revenues in the range of \$208.3 million to \$216.7 million, representing year-over-year growth of approximately 25% to 30%.

Zhengdong Zhu - *China Distance Education Holdings Limited - Co-Founder, Chairman & CEO*

(foreign language)

Unidentified Company Representative

This concludes my prepared remarks. Thank you for your time. Operator, we're happy to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first line comes from [Linda Chai] from [121 Capital].

Unidentified Analyst

I have 3 questions for Mr. Zhu and Mr. Mark. Well, the first is I'm wondering about -- now you mention that there is 4 pillars, right, in your main business sectors. And I'm wondering about the proportion of each sector, especially what percentage of your CPA professional education. The second question is actually about, I notice that there's a huge increase in selling and marketing expenses, so I'm wondering about your marketing channel and marketing methods of the general kind. While the third question will be that, well, who do you consider as the core competitor in -- maybe in your -- in Mainland China? Or saying, who would you name? Yes.

Mark A. Marostica - China Distance Education Holdings Limited - Co-CFO

Well, thank you for your questions, yes. In terms of your first question, just to review, the 4 pillars that we focus on from an industry vertical perspective are: First of all, accounting, where we got our start; secondly, health care; third, engineering and construction; and fourth, of course, legal education, which we advanced, I would say, at a rather significant way with the acquisition of a 51% interest in Beijing Ruida. Looking at our revenue contribution from each of those particular verticals, we'd just start off by saying accounting is our largest vertical, representing in the mid-40s as a percentage of revenue, whereas health care is in the mid-teens as a percentage of revenue and construction and engineering in the mid-single digits as a percentage of revenue. So that's where we stand. Of course, Beijing Ruida was consolidated for the first time in our fourth quarter fiscal 2018 results, and we disclosed the specific amount of revenue contributed by Beijing Ruida in the fourth quarter already. So now you have a sense of the revenue mix.

On to your second question in terms of selling and marketing, we have a multipronged approach to driving student acquisition. First of all, we employ advertising and promotions, as we have for a number of years, utilizing paid search from a number of providers as well as taking advantage of the fact that we have a very strong and well-known brand that we built over the last 18 years and have a huge following across China with respect to our business. We have returning students, of course, who are in programs that are multiyear. And we're seeing more of those, actually, as we talked on the call. And they are an important source of student lead flow as we kind of move forward. So aside from what we call those items as direct student acquisition, we have indirect channels as well. Here, referring to our network of offline distributors, such as bookstores and on-the-ground training centers, that sell our prepaid study cards to students. And also, we work with various agents, third-party agents, we'll refer to as student leads. And should we convert that lead flow into paid enrollments, we will pay a commission accordingly to those third-party agents. So as I mentioned, it's a multipronged approach where we rely on multiple levers to drive student lead flow.

And then regarding competition, the competitive landscape really hasn't changed a whole lot for us over the years. We like the idea that there are more players in online education that draw attention to the idea that online education is viable, constructive and productive way to learn, given its convenience and it's -- the fact that it's amenable from a price point perspective as well. The idea that other players have been focusing in this area as well draws more eyeballs to this space. And we feel our brand stands above the fray, if you will, given that we've operated in this sector for so many years. We built over 35,000 hours of prerecorded online audio/video content to have a vast library of content. We're multi-vertical, as we talked earlier. And so the breadth of what we offer is quite expansive. And I think that's quite unique in China. There's really no one quite like us from that perspective. So I'll end it on that point.

Operator

Our next question comes from Milton Lu from Da Lu Asset Management.

Weihao Lu

I actually have 2 questions. One is about dividends. I didn't see the mentioning of dividends this year in press release, and I'm wondering if there will be one. So if not, can I know the rationale behind giving dividends any time because that would be the first time since the company was listed. That's my first question. And my second question is about the tax school. So you sold the business to an operating team. Can I have an idea whether the tax school is profit-making or loss-making in the last fiscal year before the sale happened?

Mark A. Marostica - *China Distance Education Holdings Limited - Co-CFO*

Sure, Milton. Thanks for your question. Regarding your first question on dividend, I want to emphasize, first of all, that there's been no change whatsoever to our dividend policy. And as you know from following us for some number of years, that we base our dividend decision based on excess cash, cash on the balance sheet. Of course, we've looked at and we evaluate our cash needs going forward. So that, in fact, has not changed whatsoever.

In regards to your second question on the tax school divestiture. I just want to point out that it did incur a material loss in -- from a U.S. GAAP perspective in fiscal '18. So it definitely is loss-making.

Operator

(Operator Instructions) As there are no more further questions, I will now turn the call back to management for closing remarks.

Mark A. Marostica - *China Distance Education Holdings Limited - Co-CFO*

Thank you, operator. On behalf of the management team, we thank you for joining us today, and we look forward to updating you on our progress.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2018, Thomson Reuters. All Rights Reserved.