

THOMSON REUTERS STREETEVENTS

# EDITED TRANSCRIPT

DL - Q2 2019 China Distance Education Holdings Ltd Earnings Call

EVENT DATE/TIME: MAY 16, 2019 / 12:00PM GMT



## CORPORATE PARTICIPANTS

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

**Zhengdong Zhu** *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

## CONFERENCE CALL PARTICIPANTS

**Gregory R. Pendency** *Sidoti & Company, LLC - Consumer Analyst*

## PRESENTATION

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

Good evening, and thank you for joining us for the China Distance Education Holdings Limited Second Quarter Fiscal Year 2019 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 provision of the U.S. Private Securities Litigation Reform Act of 1995. The outlook for the third 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 the anticipated benefits of strategic growth initiatives, including the promotion of the company's lifelong learning ecosystem, regular class test prep enrollment growth, cost control and year-over-year improvement of operating margins, among other things, may contain forward-looking statements. Forward-looking statements involve inherent risks and uncertainties.

A number of factors could cause actual results to 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 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](http://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 of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] Thank you, everyone, for joining our second quarter fiscal year 2019 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 of the Board of Directors & CEO*

(foreign language)



---

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

[Interpreted] 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 of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] In the second quarter of fiscal 2019, our net revenue increased by 30.3% year-over-year to \$38.8 million, exceeding the high end of our guidance range in what is typically our seasonally weakest quarter of the fiscal year in terms of revenue and profitability. The second quarter's better-than-expected revenue performance was attributable to the strong growth of our accounting vertical together with the significant increase in revenue from the sale of learning simulation software. Revenue from the legal vertical generated by Beijing Ruida also contributed to our second quarter revenue growth.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] Cash received from online course registration grew by 29.8% year-over-year to \$57 million. Second quarter cash receipts were buoyed by strong growth in cash receipts from our market-leading accounting vertical and more student enrollment in our longer-duration premium and elite classes.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] Total enrollments increased by 8.9% year-over-year during the second quarter, owing to strong growth in accounting and engineering & construction or E&C continuing education course enrollments.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] This year, we have been successful in monetizing our longer-duration classes which offer our students more value-added services such as closer oversight from our tutors, employment guidance services, personalized learning reports and longer study periods, among others. Such premium and elite classes are priced at relatively higher price points than our regular classes. While our pivot to higher-value longer-duration classes has driven robust cash receipt growth in recent quarters, we believe our relatively lower-priced shorter-duration regular classes as well as

our free classes are important drivers of increased traffic to our websites or course websites and help us further promote our higher-growth classes. And looking ahead to next year's test preparation season, in an effort to better serve our students, we have formed a team which is focused on enhancing our course websites with enriched content and improved website navigation.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] As previously disclosed, we decided to voluntarily delist CDEL's controlled company, Zhengbao Yucai, from the New Third Board, China's over-the-counter stock exchange. This decision was due to a lack of both trading volume of Zhengbao Yucai share and fundraising opportunities. Zhengbao Yucai completed its voluntary delisting from the New Third Board on April 22, 2019. We will continue to consolidate Zhengbao Yucai's financials in CDEL's consolidated financial statements.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] Next, CDEL decided to acquire an additional 9% equity interest in Beijing Ruida, a leading provider of exam preparation services for participants in China's legal professional qualification examination, for a total consideration of RMB 38.3 million or USD 5.6 million, bringing the company's total equity interest in Beijing Ruida to 60%. The transaction is expected to close in the third quarter of fiscal 2019. In addition, Beijing Ruida recorded revenue of approximately \$4.5 million in the second quarter.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] Turning to our mobile platform. As of March 31, 2019, China Distance Education offers 68 mobile apps and recorded cumulative downloads of 54 million, up from 48.8 million as of December 31, 2018. In the second quarter, daily traffic to our mobile website continued to increase with daily active users in our accounting, health care and engineering & construction verticals increasing by 41.9%, 10.9% and 43.6% year-over-year, respectively.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

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

Thank you. Before I discuss the details of our second quarter financial performance, I want to touch on a few items related to our profitability and operating margin outlook. We believe our second quarter fiscal 2019 marks an important inflection point in terms of profitability. Our second quarter gross margins expanded year-over-year, which is the first quarter in over 2 years where we've seen gross margin expansion. And both second quarter salaries and related expenses and rental and related expenses grew at a slower pace than revenue growth for the first time in the last 6 quarters.

Our efforts to balance growth with profitability are beginning to bear fruit. Excluding the operating results at Beijing Ruida and \$1.7 million in amortization expenses of intangibles arising from the acquisition of Beijing Ruida, our second quarter fiscal 2019 operating margin would have improved by 436 basis points year-over-year, underscoring the improving profitability of CDEL's core business. This would mark the first quarter in the last 9 quarters where we have seen year-over-year operating margin expansion, again, excluding the operating results at Beijing Ruida and the amortization expenses of intangibles attributable to Beijing Ruida.

Of note, we began consolidating Beijing Ruida into our consolidated financial statements in the fourth quarter of fiscal 2018. Looking ahead, we expect our operating margins will expand year-over-year in both our third and fourth quarters of fiscal 2019 based on our expectation of healthy revenue growth and diligent expense control.

Enrollments in our online accounting test preparation courses were down 21.8% year-over-year in the second quarter primarily due to declines in certified public accountant or CPA enrollments as well as accounting professional qualification exams or APQE enrollments. That said, our accounting premium class test preparation enrollments were up almost 600% year-over-year in the second quarter and drove accounting test prep cash receipts growth of 47.8% year-over-year in the quarter.

Enrollments in our accounting continuing education courses increased by approximately 180% year-over-year in the second quarter of fiscal 2019, primarily due to a resumption of accounting continuing education in certain jurisdictions. Total online accounting test preparation ASPs increased by 89% year-over-year in our second quarter as ASPs increased significantly in our CPA and APQE courses. These ASP increases were mainly due to increased student enrollment in our longer-duration premium classes.

Enrollments in our online health care test preparation courses in the second quarter of fiscal 2019 decreased by 20.9% year-over-year, primarily due to enrollment declines in our medical practitioner and physician assistant test preparation courses. ASPs for our health care test preparation courses increased by 24.6% year-over-year in the second quarter, mainly due to overall ASP increases and in particular our longer-duration premium classes.

Enrollments in our online engineering & construction or E&C test preparation courses decreased by 9.8% year-over-year in the second quarter primarily due to enrollment declines in our associate constructor and constructor test preparation courses. Enrollments in our E&C continuing education courses however increased by 52.5% year-over-year in the second quarter.

ASPs for our E&C test preparation courses in the second quarter increased by 30.5% year-over-year primarily due to overall ASP increases of our longer-duration premium classes. The ASPs for E&C continuing education courses decreased by 32.1% year-over-year in the second quarter. The significant year-over-year increase in our second quarter E&C continuing education enrollments and corresponding year-over-year decline in E&C continuing education ASPs were primarily due to a policy change implemented by the E&C professional certification authorities whereby students are now allowed to purchase continuing education services from multiple providers in order to fulfill their continuing education requirements instead of from a single provider as was the case previously.

Let's now 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 39.9% in the second quarter of fiscal year 2019 compared with 37.3% in the second quarter of fiscal year 2018. The year-over-year expansion in gross margin was primarily due to decreased salaries and related expenses and better leverage on lecture fees and rental and related expenses partially offset by expenses associated with Beijing Ruida, including amortization expenses of intangibles arising from the acquisition of Beijing Ruida.

Non-GAAP selling expenses increased by 65.9% to \$13.8 million in the second quarter of fiscal year 2019 from \$8.3 million in the prior year period driven primarily by increases in advertising and promotional expenses, salaries and related expenses, commissions to our agents and other miscellaneous selling expenses as well as expenses associated with Beijing Ruida. Non-GAAP general and administrative expenses increased by 15.5% to \$6.1 million in the second quarter of fiscal year 2019 from \$5.3 million in the prior year period mainly due to an increase in salaries and related expenses and expenses associated with Beijing Ruida.

Overall, the non-GAAP operating loss for the second quarter of fiscal year 2019 was \$3.6 million compared with non-GAAP operating loss of \$2.4 million in the prior year period. Income tax benefit was \$1.3 million in the second quarter of fiscal year 2019 compared with income tax benefit of \$1.4 million in the prior year period, primarily due to a lower-than-estimated effective tax rate applied in fiscal year 2019 compared with the prior year period. Non-GAAP net loss was \$3.4 million in the second quarter of fiscal year 2019 compared with non-GAAP net loss of \$2.7 million in the prior year period.

Now let's turn to Slide 11 to review our cash flow. Net operating cash inflow increased by 128.8% to \$16.5 million in the second quarter of fiscal 2019 from \$7.2 million in the prior year period. The operating cash inflow is mainly attributable to the increase in deferred revenue generated from our professional education services segment. The operating cash inflow is partially offset by the increase in accounts receivable, prepayments and other current assets and a decrease in accrued expenses and other liabilities, income tax payable, deferred tax liabilities and amount due to related party.

Cash and cash equivalents, restricted cash and short-term investments as of March 31, 2019, increased by 17.7% to \$130.1 million from \$110.5 million as of December 31, 2018, mainly due to the operating cash inflow generated in the second quarter of fiscal year 2019 partially offset by capital expenditures of \$1.7 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 third quarter and for fiscal year 2019. Mr. Zhu, please.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

Thank you, Mark. (foreign language)

---

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

[Interpreted] Overall, we're pleased with our progress through the first half of fiscal year 2019 as we generated healthy growth of cash receipts from online course registration while effectively controlling our cost structure, setting the stage for improved profitability in the quarters ahead.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] Our steadfast efforts to broaden our lifelong learning ecosystem has enabled us to build a well-diversified business model with multiple revenue streams across 4 key industry verticals, including accounting, health care, engineering & construction and legal. We've also deepened our service offering within our industry verticals, particularly in our market-leading accounting ecosystem. We now offer exam preparation services for high-stakes professional certification exams with multiple class types and learning modalities tailored to individual learning styles and preferences.

Our continuing education ensure students maintain the professional certifications in good standing. Our practical accounting training courses bundled with employment guidance services better prepare students to start their careers. We also offer career enhancement skills training for working professionals, college-focused accounting learning simulation software for enhanced self-learning experience as well as accounting services for corporate clients.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] We remain committed to delivering high-quality courseware and educational services to our students to help them advance in their careers while integrating best-of-breed learning technologies into our educational solutions. Our focus on optimizing the integration of learning and technology will ultimately pave the way for future growth and strengthen our leadership position in China's education industry. As China's trusted leader in online professional education, our vision has remained consistent over the years, which is to cultivate online learning as a lifestyle while striving to position China Distance Education as our students preeminent learning partner on their lifelong learning journey.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] We are confident in the long-term value we could bring the investors. We continue to expect to generate non-GAAP operating income growth in fiscal 2019 with improved non-GAAP operating margins while we balance growth with a key focus on improving cost control, and we are pleased to report that we are seeing continued strong growth momentum in cash receipts from online course registration, which increased by approximately 30% year-over-year on a constant currency basis during the third quarter fiscal 2019 through the end of last week.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

---

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

[Interpreted] Turning to guidance. For the third quarter of fiscal year 2019, the company expects to generate total net revenue in the range of \$61.6 million to \$64 million, representing year-over-year growth of approximately 30% to 35%. For the fiscal year 2019, the company expects to generate total net revenue in the range of \$210 million to \$218.3 million, representing year-over-year growth of approximately 26% to 31%. The company's prior fiscal year 2019 full year total net revenue guidance range was \$208.3 million to \$216.7 million.

---

**Zhengdong Zhu** - *China Distance Education Holdings Limited - Co-Founder, Chairman of the Board of Directors & CEO*

(foreign language)

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

[Interpreted] This concludes my prepared remarks. Thank you for your time.

Operator, we're now happy to take questions.

---

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Your first question comes from the line of Mr. Greg Pendy from Sidoti.

---

**Gregory R. Pendy** - *Sidoti & Company, LLC - Consumer Analyst*

Just a couple here. Just wanted to know I think first of all if you could expand a little bit -- you said the resumption of continuing education. I believe it was a headwind last year in the prior quarter. Can you just give us a little bit more color on what's going on there, why is it -- is it throughout China and certain provinces and why it might be kind of coming back?

---

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

Sure. In the wake of the cancellation of the Accounting Certificate examination, there was certainly a low and inconsistent enrollment results for accounting continuing education for several quarters, and we saw that certainly in our results. What we have been seeing recently is a resumption by certain jurisdictions across China in providing accounting continuing education services and promoting those services. So in fact, we saw a pretty substantial increase in our accounting continuing education course enrollments in the quarter as a result of this resumption. I would also add, to your question, the note on engineering & construction continuing education enrollments, which also surged in the quarter for a different reason on the back of a policy change which allow students to fulfill their continuing ed requirement using multiple providers instead of a single provider as was the case previously.

---

**Gregory R. Pendy** - *Sidoti & Company, LLC - Consumer Analyst*

Great. That's helpful. And then just -- I think on just the cost outlook, can you give us an update on where you are in terms of rent? I believe that you had elevated rent this quarter. But does that -- is that something that you've exited some space, I guess, on a going-forward basis?

---

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

Yes. We are beginning to enjoy some improved leverage on rental and related expenses. You may recall that a year ago, with our renting the Anhui Qiao location, we doubled up on rent expense during the period we were making leasehold improvements at Anhui Qiao, which are behind us for the most part at this point. And so as we mentioned in our prepared remarks, we're now seeing some nice leverage on rental and related expenses as we've anniversary-ed the Anhui Qiao initial rent expense as well as exiting some space in our Haidian headquarter building, namely the second floor and part of our first floor as well as the seventh floor of our Haidian location. So this is something we have talked about on prior calls that we are planning to do.

And I think for these reasons as we go forward, in the third quarter, current quarter and fourth quarter and beyond, we should see improved leverage on rental and related expenses. And in fact, looking at the overall expense outlook for the company in the second half of the fiscal year, we do expect continued year-over-year gross margin expansion and leverage on G&A spending as we saw in the second quarter. We do expect year-over-year selling expense growth to moderate in Q3 compared to Q2, with some leverage on selling expenses coming back in Q4 due to the



fact that we're now able to capitalize and amortize certain agent commissions over the service period, which was not the case in Q4 of fiscal 2018. All in all, Greg, we do expect 50 to 100 basis points of operating margin expansion in fiscal 2019.

---

**Gregory R. Pendency** - *Sidoti & Company, LLC - Consumer Analyst*

Great. That's helpful. And then just one more, if I can. You have a 51% stake in Beijing Ruida, so I guess a controlling stake. You decided to increase it. Can you kind of give us just the big picture on kind of any thoughts on what kind of -- what was behind the decision to go -- I know you had the option to go up to 60%, but any kind of color on what the longer-term strategy is behind Beijing Ruida? And any thoughts on just kind of what you've learned in terms of your current ownership?

---

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

Sure. I'd like to highlight 3 key reasons. First, upping our equity stake in Beijing Ruida underscores the importance of Ruida to our overall business strategy. Ruida has clearly moved us squarely into a fourth vertical, that being legal education, which helps diversify our business model. Secondly, we like Ruida's high-quality content, leading lecturers and market positioning. And third, we believe the returns on invested capital with respect to Ruida will be attractive over the next several years.

---

**Operator**

(Operator Instructions) There are no further questions at this time. I would now like to turn the call back to the management for the 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.

---

**Operator**

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

---

**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.

©2019, Thomson Reuters. All Rights Reserved.