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JOBS - Q3 2019 51job Inc Earnings Call

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PRESENTATION

Operator

Good day and welcome to the 51job Inc. Third Quarter 2019 Conference Call and Webcast. (Operator Instructions) Please note, this event is being recorded.

I would now like to turn the conference over to Ms. Linda Chien. Please go ahead.

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

Thank you, operator, and thank you all for attending this teleconference to discuss unaudited financial results for the third quarter ended September 30, 2019.

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 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. Reconciliation 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 an overview of the third quarter and an assessment of current market conditions, and Kathleen will follow with a detailed discussion of our financial results as well as provide our guidance for the fourth quarter of 2019.

Market conditions have been very challenging this year as ongoing economic concerns and U.S.-China trade tensions have significantly influenced the spending and recruitment plans of employers. However, through diligent sales execution and top-quality customer service, we did maintain overall positive momentum, with net revenues growing 4% to RMB 989 million in the third quarter. Profitability also remained solid with non-GAAP income of RMB 4.49 or USD 0.63 for the quarter.

Our online recruitment segment continues to feel the brunt of this current macro slowdown. Employers are still very cautious about head count decisions, and some companies have chosen to conserve their financial resources and staying on the sidelines as they await guarantee on economic direction. As expected, this market tone has negatively impacted hiring demand in 2019, and our online revenues decreased 2% on a year-over-year basis in the third quarter. In line with our forecast, we saw a reduction in the number of unique employers, primarily due to limited activity or dormant behavior by smaller-sized organizations, but this was largely offset by improved ARPU on the back of successful upselling efforts focused on more established companies.

We remain focused on our long-term strategic objective of driving up revenue per customer with our high-quality services, product effectiveness and tangible results. It is our priority to elevate our ability to consistently serve and better monetize an elite customer base, which we believe will further solidify 51job's industry leadership and longevity.

In the other HR Services segment, this area stayed resilient, and revenue grew 16% in the third quarter. A major differentiating feature of 51job's business model is the uniqueness and diversity of our large portfolio of services to address multiple aspects of HR responsibilities. The value proposition of our training, assessment and outsourcing services has continued to resonate with employers. In using our training and assessment services, we believe companies have been able to sharpen their selection and investment in the best talent, thereby improving employee productivity and manage turnover.

For our HR outsourcing services, we are assisting customers with core operational obligations such as payroll, processing and government compliance work which have strict standards that always need to be adhered to by employers. Through our comprehensive suite of HR solutions and an integrated sales force with extensive domain knowledge, we are establishing more engagement points and deepening relationships with HR departments despite this time of uncertainty and volatility.

Turning now to our current market assessment. Given the circumstances we have already navigated throughout this year and the fact that year-end is traditionally a slow period for general hiring, we believe that customer demand will stay soft these few -- these last few months of 2019. However, in our experience, the dynamic nature of the China market triggers [that we set] each year as companies reflect on what has happened, make adjustments and adapt to the surroundings. With Chinese New Year falling on the calendar in late January, the earlier than normal holiday will provide data points on employer sentiment and hiring activity sooner in 2020. We look forward patiently to see how the market tone plays out, and we will share our observations on our next quarterly call.

Periods of difficulty obviously bring business challenges, but we believe they also test and strengthen 51job's organizational DNA for continued evaluation and development. Just in -- just as in past cycles, we have stayed focused in moving ahead to lay the groundwork to capture opportunities when market conditions recover. Our newest recruitment platform, 51mdd, which targets entry-level, front-line positions in service industries, is gaining users and building a solid reputation for information accuracy and reliability.

As Chinese companies expand outside the country's borders and become more globalized, we are working with more customers on the recruitment of overseas talent and returnees, conducting more than 100 events in the past year. 51job has the most operational and financial resources dedicated to the HR industry in China. And we are bringing more partners into our ecosystem.

We have made a recent investment in CDP Holdings, which is a provider of human capital management services through a cloud-based platform that we believe have synergies with our HR outsourcing business. We have also entered into an agreement to be a cornerstone investor in the proposed IPO of Huali University Group, which is an operator of higher education and vocational schools that we believe will enhance the critical supply and demand link for recruitment and worker training purposes.

I'm proud to lead an 8,000-member team at 51job that's unwavering in our commitment to deliver the best to our customers, job seekers, partners and shareholders. Our business fundamentals are robust, and we are confident in our strategic blueprint that will build a bigger and better 51job to realize consistent, sustainable and profitable growth.

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.

Our net revenues for the third quarter of 2019 were CNY 989 million, representing a 3.6% increase. Although our online revenues increased on a sequential basis to RMB 633 million, it declined by 2.4% on a year-over-year basis. As we continue to be more selective about our customer base, we focused on and successfully drove up revenue per employer. In line with our long-term, high-quality customer coverage strategy, we continue to prioritize our sales efforts and strengthening relationship into more established companies in China. We do expect similar dynamics for the fourth quarter, in which we will continue to focus on ARPU improvement.

Revenues for other HR services increased 16.4% to CNY 356 million in the third quarter, driven by the growth of our training, assessment and HR outsourcing services. The training business has been a star performer this year, and our HRO services is more back on track after some adjustments made in accordance with the new tax and government regulations that went into effect earlier this year. Similar to previous years, for the fourth quarter, we are expecting meaningful contribution from our seasonal campus recruitment services, which is still seeing healthy activity this year despite the soft tone for general hiring.

Beginning January 1, 2019, we have changed the presentation of government surcharges and included these amounts into cost of services. 2018 figures were reclassified to conform to this new presentation. Reflecting this change, gross margin was 69% in the third quarter of 2019 compared with 71.7% in 2018.

The increase in cost of services was primarily due to higher employee compensation expenses as well as seasonal head count additions for our campus recruitment business. This year, we saw some employers choosing to launch a graduate hiring campaign earlier than usual in September, which resulted in some additional costs incurred in the third quarter. Per usual, for the fourth quarter, we are expecting a further rise in logistics costs such as venue rental and event decorations related to providing our campus recruitment services. Included in cost of services in the third quarter were share-based compensation expense of CNY 5.6 million.

Our sales and marketing expenses increased less than 1% to CNY 326 million in the third quarter as we were disciplined in our spending. As we mentioned on past calls, we have slowed our internal sales hiring for 2019, although we continue with our marketing campaign to promote our brands and services. Included in sales and marketing expenses in the third quarter was share-based compensation expense of CNY 4.8 million.

G&A expenses increased 10% to CNY 100 million in the third quarter. The increase was mainly due to higher employee compensation expenses, especially share-based compensation expense and a larger provision for doubtful accounts. Share-based compensation expense included in G&A was CNY 24.5 million compared with CNY 20.5 million in the third quarter of 2018. As a reminder, share-based compensation expense is calculated in U.S. dollar, which is the currency of our traded stock price, so the recent depreciation of the RMB further increased the share-based compensation expenses when reported back into RMB.

Income from operations decreased 5% to CNY 257 million in the third quarter, and operating margin was 26% compared with 28.3% in the year-ago quarter. Excluding share-based compensation expense, operating margin would have been 29.5% compared with 31.4% in the year-ago quarter.

Excluding share-based compensation expense, gain from foreign currency translation as well as the related tax effect of these items, non-GAAP adjusted net income attributable to 51job was CNY 304 million in the third quarter. Non-GAAP adjusted fully diluted EPS was CNY 4.49 or USD 0.63 per share.

As Rick mentioned earlier, we have recently made investments and entered into agreements which will utilize the company's existing cash resources. The total cash consideration from these transactions will be funded from our cash held offshore and is expected to be around USD 112 million in the fourth quarter.

Finally, turning to our guidance for the fourth quarter of 2019. Based on current market conditions, our net revenue target is in the estimated range of CNY 1.08 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. Please note that this non-GAAP EPS target range does not include share-based compensation expense, the impact of foreign currency translation nor the related tax effect of these items. Total share-based compensation expense is expected to be between CNY 34 million and CNY 35 million for the fourth quarter of 2019.

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 translations. 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 will be happy to take your questions at this time. Operator, please go ahead.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Alicia Yap with Citigroup.

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

I have a couple of questions. Number one is regarding your fourth quarter guidance. So assuming if the HR services remain resilient, is that translate to the bigger year-over-year decline in the online recruitment services? And so have you seen any worsening hiring sentiment in the fourth quarter than the third quarter?

And then on the second questions related to the margins outlook, if there's any color that are early indications in terms of the operating margins as we head into next year?

And lastly, on your CNY 80 million investment in CDP. Just wondering yourself, on your job internally, have you developed various cloud-based solutions as related to the HR services? Would that be reasonable to think about that your BPO business could be very well evolved into more standardized solution packages?

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

First, to discuss guidance if you will. We are actually -- we're of the mindset that I don't think that the fourth quarter is worsening per se, but because it is actually year-end and overall, the year has been relatively slow compared to prior years, that we are expecting that the general hiring to be lighter in general. So I think this is not a worsening scenario if you will, but because it's actually been a slower year overall, I don't think that we would expect to be -- maybe pickup for the remaining 1.5 months for the year.

And also because next year is a early Chinese New year, I think people will be actually trying to reset for next year rather than do a lot more hiring for the end of the year. So that's why we are actually forecasting as we are in terms of having a lighter kind of a year-end for online recruitment. So -- but I'm not saying that there is a deterioration in market sentiment, but I do think that the timing and -- of the Chinese New Year and also because it's just been a not as robust year overall, that we are not expecting things to pick up for the remaining 1.5 months for 2019.

In terms of then for the margin, as you mentioned, I think, obviously, I -- we believe that we are here for the long term, and our customers are here for the long term, and we continue to evolve and develop product and services that we believe will bring value to our customers for long term. So despite the fact that this year has been more challenging for us on the recruitment side especially, we have continued to make investments in product development, to bring new services and products online so that we are always focused and forward-looking in terms of trying to anticipate and meet customer demand. So we will continue to be making investments on that front, and so that is our philosophy on that.

I think that, obviously, in the short term, that will mean that because our revenue growth is not robust and we are not forecasting for revenue growth at this point in time for the fourth quarter, it will mean that our margin will have to take a little bit of a step back. And so I think that's where we are for the fourth quarter. I don't think we are -- we can actually forecast too far ahead in terms of 2020 at this point because I think our margins are always predicated on how our top line looks, and we will build a infrastructure with that in mind if you will. So I think we'll be able to give you more color on margins and in revenues in general, actually once we discuss Q4 results after Chinese New Year. So I think that's the timeline.

Finally, on the CDP investment, I think we're very excited that we are able to move ahead with this partnership that we believe that we'll be developing with CDP. I think that we have -- we both serve the HR customer, if you will, but I think in a slightly different fashion. I think that it is a different way to serve customers if you will. I think that most of our services, we are able to have a wider coverage, and we have a larger customer base recovery. I think CDP has a slightly different approach historically where they've gone deeper with certain customers in certain verticals. But I think there will be a good mix of technology and solution that we could actually co-develop going forward as well. So I think that this is something that's actually very exciting for the company as we can move forward in bringing a whole suite of product and services and that, hopefully, we can integrate this even better for our customers and so that their user experience will be improved down the line. So I hope that answers your question.

Operator

Your next question comes from [Ken Chen] with Jefferies.

Unidentified Analyst

I have a few question actually. The first one is on the number of unique employers. I looked at both on a year-on-year or quarter-on-quarter basis that has -- the decline has accelerated. I'm just wondering, is there any particular reason behind -- is it just a result of the weak macro backdrop? Or is it also because of us being more selective in serving these employers? And is it a minimum level that we want to maintain on a quarterly basis? And how should we think about this number towards the fourth quarter or even 2020?

And my second question is on the cost. Because what we understand is that we have more control on the sales and marketing cost, we control the payroll, the bonus to ourselves and employees, I mean we do see some leverage, but seems like there's not enough to offset the pressure. I just want to get some more color towards the later trend. Also on G&A, I want to understand more of the reason behind the increase in the head count cost and more with the trend going forward.

And my last question is on the other HR services. I think that actually did better than expected. The year-on-year growth actually accelerated this quarter. We talked about the (inaudible) who account for more revenue proportion of these segments in the second half, but now we are talking about campus recruitment is not likely general recruitment, and it's actually doing better. I just wanted to understand the reason behind and how would that impact our fourth quarter growth for this segment.

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

I think you had a long list of questions. Let me try to address them, I guess, hopefully, in order.

The first question, I think, you mentioned related to unique employers. And to be honest, I think we've talked about this as their strategy for the last few quarters, which is that we're much more focused on the quality of customers we're serving and that we're not focusing on account per se. We're working to identify the higher-value customers, and we want to make sure that we're serving them more deeply rather than to actually take in customers of all sizes. So I think that in terms of the customer account showing some declines, I think that's in line with our strategy, and it is not a surprise if you will because it's actually a part of the strategy if you will. So I think that is not something that we're focused too much on as a metric at all. So that is not how we would look at the growth of our business in terms of using customer count as the driver behind it.

In terms of then, if I can skip ahead, talk a little bit about, just generally speaking, cost and people, I think for us, we always have discussed the fact that cost -- people cost is a very big part of our total cost structure, and it's actually something that we are very thoughtful about when we actually plan ahead usually. But usually, with people, you don't decide to hire a person month 1 and just because market sentiment may not be exactly as you expect, fire them the second month because I don't think that's the right way to build and develop your people and your talent pool. And so I think we kind of go into every year with a baseline of what we're -- want to actually have in terms of support infrastructure and then we go from there. Obviously, through the year, if actually the market demand does not bear out in terms of -- versus our forecast, we're very cautious. And as we mentioned earlier in the call, we have also been very disciplined in making sure that we are disciplined about adding new people if you will. But in the short term, there's still people that we have kept and that we want to make sure that they're focused on developing product and services. So we do not believe that cutting people would be the right way to manage our costs. So I think that given that the revenue growth is not as robust as we wanted or that for the fourth quarter, we're actually not forecasting growth, that will create some pressure on the margins. So I think that's, overall, how it looks.

Finally, on the other HR services. In terms of what we discuss on campus recruitment, campus recruitment is a -- much more of a seasonally product, and the bulk of that happens in the fourth quarter. And I think that what we feel so far is that we're pleased to say that in terms of the impact on campus recruitment, given the -- that it has been a softer recruitment market overall, it actually has fared better than we had expected when we actually discussed this point in the third quarter. So I think that, most likely, that campus equipment will be a little bit bigger than what we had anticipated, and it will probably make up a bigger part of the fourth quarter than overall in terms of percentage terms if you will. So we think that when we talk about recruitment being hit, I think that more of that is on the general hiring side and that campus recruitment has proven to be more resilient versus that. So I hope that answers most of your questions.

Operator

Your next question comes from Tian Hou with T.H. Capital.

Tianxiao Hou - *T.H. Capital, LLC - Founder, CEO & Senior Analyst*

Yes. Actually, it's not easy to really manage the business under today's business environment. So my question is as we split like a cleaning up our customer base or employer base, and I think by now, it's sort of almost 1 year long, so when are you going to start to do the reverse, actually start the expansion cycle? So that's #1 question.

Also, among your more than 300,000 employers, how many of them you also provide HR services? That's the second question.

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

It's easy to answer the second question first, I guess, because yes, it's a very small set of people that actually purchases our other HR services overall. And I think that the percentage is, I think, overall, I believe -- it's a single-digit percent if you will. So it is a small amount versus the large kind of recruitment base out there. So I think that we -- again, these are the very high-valued customers because if you look at the breakdown into the 2 categories, other HR services make up 1/3 to 40% of our revenues if you look through the different quarters of the year and yet, it only takes a single percentage of the total customer count. So the contribution per customer is a very, very, very significant magnitude difference.

In terms of expansion, what you said about when do we want to -- I think it's not -- it's not a case where it's kind of sitting on the same set of customers and just decided to cut away certain ones and then now getting new ones. It's actually a dynamic process if you will. There are always customers that we feel like, hey, they are not growing as a company if you will, and so they have less growth prospects for us. And then that the service level that we'll provide or their internal demand will decrease, and that will be a situation where we will cease probably transacting with them. And then there are always new customers coming into the portfolio where we need to then identify and understand whether or not they have growth potential and that we will be focusing more attention on those over time. So I think it's not a case where we're just standing on the same set of customers and just cutting away some of them without actually adding new ones. So even during this past 1.5 years if you will, where we've actually been very focused on trying to prune out the really lower-potential customers, we've added customers to our portfolio. So it is not a case where we haven't done so, but I think that it's obviously a case where this year is one where I think there is probably more customers that have actually then not been able to continue themselves as ongoing concern just because the overall macroeconomic conditions are not very robust. And so that has probably added to the degree of -- the sort of the drop, if you will, to some degree. So I think that we will continue to be hunting for new customers. And we have continued to do so in the last several quarters. It just seems that -- when we look at the numbers and net numbers -- so there's additions and then subtractions at the same time, and so we're not saying that we've not added customers in the interim. So that's the situation.

Operator

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