Event Name: Q4 FY2018 Hexindai Inc. Earnings Call (NASDAQ: HX)
Event Date: June 15, 2018

Corporate Participants
Daisy Wang Hexindai Inc.-IR Director
Xinming Zhou Hexindai Inc.-CEO
Johnson Zhang Hexindai Inc.-CFO

Other Participants
Bo Pang China Renaissance-Analyst
Jane Yang Essence Securities-Analyst

Presentation

Operator
Thank you for standing by for the Hexindai's Fourth Quarter and Fiscal Year 2018 Earnings conference call.

(Operator Instructions)

As a reminder, today's conference call is being recorded.

I would now like to turn the meeting over to your host for today's call to Ms. Daisy Wang, Investor Relations Director. Please proceed, Daisy.

Daisy Wang - Hexindai Inc. - IR Director
Thank you, operator. Hello everyone and thank you for joining us today. Our earnings release was distributed earlier today and is available on our IR website at ir.hexindai.com.

On the call today from Hexindai are Mr. Xinming Zhou, Chief Executive Officer and Mr. Johnson Zhang, Chief Financial Officer. Mr. Zhou will review business operations and company highlights, followed by Mr. Zhang, who will discuss financials and guidance. They will be available to answer your questions during the Q&A session that follows.

Before we begin, I'd like to remind you that this conference call may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are made under the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. These statements can be identified by terminology such as "will," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates," "potential," "continue," "ongoing," "targets," "guidance" and similar statements. The Company may also make written or oral forward-looking statements in its periodic reports to the U.S. Securities and Exchange Commission (the "SEC"), in its annual report to shareholders, in press releases and other written materials and in oral statements made by its officers, directors or employees to third parties. Any statements that are not historical facts, including statements about the Company's beliefs and expectations, are forward-looking statements that involve factors, risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. Such factors and risks include, but not limited to the following: the Company's goals and strategies; its future business development, financial condition and results of operations; the expected growth of the credit industry, and marketplace lending in particular, in China; the demand for and market acceptance of its marketplace's products and services; its ability to attract and retain borrowers and investors on its marketplace; its relationships with its strategic cooperation partners; competition in its industry; and relevant government policies and regulations relating to the corporate structure, business and industry. Further information regarding these and other risks, uncertainties or factors is included in the Company's filings with the SEC. All information provided in this call is current as of the date of this call, and the Company does not undertake any obligation to update such information, except as required under applicable law.

It is now my pleasure to introduce our Chief Executive Officer, Mr. Xinming Zhou. Mr. Zhou, please go ahead.

Xinming Zhou - Hexindai Inc. - CEO
Thank you, Daisy, and thank you everyone for joining our call today. We finished the year with another solid quarter in which loan volumes in the fourth quarter continued to grow at a triple digit pace, increasing 237% to $418 million. This brings total loan principal since our inception to $2.6 billion. We facilitated loans to more than 33,000 borrowers during the quarter, an increase of 285% from the same period last year. Growth momentum continues to be driven by our expanded online and offline user acquisition capacities and improved user conversion rate as well as our platform's reputation, security, trust and convenience.

The fourth quarter is seasonally our slowest quarter. It is due to the impact from Chinese New Year, yet loan volumes grew at a faster pace year-over-year this quarter when compared to last quarter, which I believe demonstrates just how much progress we have made in strengthening our services offering and improving operational efficiency.

We have been developing new loan service offerings, which will be customized to target a specific demographic and profiles within our increasingly diverse borrower base. We continue to expand online borrower acquisition channels and resources and are enhancing our online borrower acquisition efforts. About 11% of the total loan volume during this fiscal year 2018 was acquired through online channels, compared to no loans were facilitated through online channels in fiscal year 2017.

To further diversify and expand our investor acquisition channels, we opened a call center in Hefei City, Anhui Province during the quarter, which will facilitate first-time investments from registered investors on our platform. The call center will also focus on facilitating the investment of any funds from the investor accounts that have yet to be invested. By engaging more actively with our investor base, we hope to not only increase total loan volumes facilitated on our platform, but also increase loyalty to our platform through education and outreach.

Turning now to industry outlook. The notice issued in December 2017 to complete a ratification and the preliminary filing by end of June this year was postponed by regulators. Despite the uncertainty in the market this has created, the number of P2P platforms continues to decrease from 2,000 at the end of year 2017 to around 1,800 today as the market further consolidates.

Increased regulation will help create a healthier market environment over the long-term and will raise the barriers to entry, so we believe we are fully compliant with current regulations and have the upmost confidence in our internal operations. And as industry consolidation continues under tightening relations, we believe that we are ideally positioned to expand our market share.

I'm very pleased with our performance during the quarter as we began fiscal year 2019 on a very strong footing. We will continue to invest in expanding borrower and the investor engagement and acquisition, strengthening our risk management systems and improving our operational efficiency in order to reinforce our competitive advantage in this enormous and growing market to consumer lending in China.

With that, I will now turn the call over to Johnson who will review the financials. Johnson, please.

Johnson Zhang - Hexindai Inc. - CFO
Thank you, Mr. Zhou. Hello everyone. Thank you for joining our fourth quarter and fiscal year 2018 earnings conference call today. We are pleased to deliver another solid quarter and to wrap up the year with significant operational and financial growth.

First, I will go over some highlights. During the fourth quarter of fiscal year 2018, total volume of loans facilitated increased to 237% year-over-year to US$418 million or RMB2.7 billion, US$28 million above our guidance. The increase was currently attributable to the increase in the number of borrowers from 8,651 to 33,322. Our net revenue increased 271% year-over-year to US$27.6 million and net income increased 303% year-over-year to US$17 million, as a result of the sustained improvement of our operational efficiency. The solid progress we made in enhancing our operational performance can be seen in our operating expenses as a percentage of net revenue which decreased from 52% in the fourth quarter of fiscal year 2017 to 30% in the fourth quarter of fiscal year 2018.

During the fiscal year ended March 31, 2018, total loan volume facilitated was US$1,258 million, which translates to RMB8.3 billion, an increase of 151% from US$493 million, or RMB3.3 billion, during fiscal year 2017.

Number of borrowers was 101,172, an increase of 252% from fiscal year 2017. Number of investors was 137,950 during the fiscal year ended March 31, 2018, an increase of 118% from the same period of fiscal year 2017.

Now I would like to walk you through more details of our financial results during the fourth quarter of fiscal year 2018.

As I mentioned, net revenue was US$27.6 million, an increase of 271% from the same period last year. The increase was primarily due to the significant increase in the volume of credit loans facilitated through our marketplace, which increased from US$0.1 billion, or RMB0.7 billion, in the fourth quarter of fiscal year 2017 to US$0.4 billion, or RMB2.7 billion, in the same quarter of fiscal year 2018.

Annual average investment yield decreased to 10% during the fourth quarter of fiscal year 2018 from 14% during the same quarter of last fiscal year.

Our risk reserve liability charge decreased from US$0.8 million to nil.

Operating expenses were US$8.4 million, an increase of 115% from fourth quarter of fiscal year 2017. The increase was driven primarily by an increase in sales and marketing expenses, general and administrative expenses and share-based compensation.

Sales and marketing expenses were US$3.5 million, an increase of 80% from fourth quarter of fiscal year 2017. The increase was primarily due to an increase in employee expenses and a series of promotional and brand image campaigns to enhance the Company's brand recognition and attracted more customers. We continue to invest in our marketplace app and are expanding our user acquisition channels through search engines and different industry cooperation projects which we expect will continue to refer more customers to our platform and generate higher conversion rates.

Service and development expenses were US$2.1 million, an increase of 61% from the same period of fiscal year 2017. The increase was primarily attributable to an increase in employee expenses, custodian bank account management fees and rental and property management fees, which were mainly driven by the growth in the volume of loans facilitated through our marketplace platform.

General and administrative expenses were US$1.7 million, an increase of 157% from the fourth quarter of fiscal year 2017. The increase was due primarily to an increase in employee expenses and the professional service fees.

Share-based compensation, during the fourth quarter of fiscal year 2018, was US$1.1 million, increased from nil during the same period of last fiscal year. The increase was attributable to awards granted under the 2016 Equity Incentive Plan since November 3, 2017 on which date the Company completed its IPO.

Net income increased by 303% to US$17 million from US$4.2 million during the fourth quarter of fiscal year 2017.

Adjusted net income attributable to Company's shareholders, which excluded share-based compensation expenses increased by 330% to US$18.2 million from US$4.2 million in the same period of last fiscal year.

Adjusted EBIT, which included interest income, income tax and the share-based compensation, increased by 473% to US$20.4 million from US$3.6 million in the fourth quarter of fiscal year 2017.

I'll now quickly go over our fiscal year 2018 results.

During the fiscal year ended March 31, 2018, net revenue was US$107.3 million, an increase of 368% from US$22.9 million in the last fiscal year. The increase was mainly driven by the significant increase in the volume of credit loans, which increased from RMB2.3 billion or US$337 million in the fiscal year 2017 to RMB8.3 billion or US$1.2 billion in fiscal year 2018.

Annual average investment yield decreased to 12% during fiscal year 2018 from 14% during last fiscal year. We believe there are still opportunities to decrease investment yield for investors on our platform since we expect to acquire more risk-adverse investors going forward. We believe that most of the decrease of the investment yield will be transferred to our revenue.

Our risk reserve liability charge decreased from US$4.9 million last fiscal year to nil in fiscal year 2018, as our risk reserve liability policy was discontinued and replaced by a third-party insurance arrangement starting February 1, 2017, which also contributed to the increase in the net revenue.

Operating expenses during the year was US$31.4 million, an increase of 141% from the fiscal year 2017.

Sales and marketing expenses was US$15.2 million, an increase of 192% from fiscal year 2017.

Service and development expenses was US$8.5 million, an increase of 65% from last fiscal year.

General and administrative expenses was US$5.8 million, an increase of 120% from fiscal year 2017.

Share-based compensation was US$1.8 million, increased from nil during last fiscal year.

Net income increased by 664% to US$65.5 million from US$8.6 million last fiscal year.

Adjusted net income attributable to the Company shareholders, which excluded share-based compensation expenses, increased by 686% to US$67.3 million from US$8.6 million in the last fiscal year.

Adjusted EBIT, which excluded interest income, income tax and share-based compensation, increased by 679% to $78 million from $10 million in fiscal year 2017.

We generated a strong operating cash flow and cash position. Net cash provided by operating activities was US$87.7 million during fiscal year 2018 compared to US$8.2 million in fiscal year 2017. As of March 31, 2018, our cash position stood at US$132.6 million compared with US$19.2 million as of March 31, 2017. The increase in the total balance of cash was mainly due to increased operating cash as a result of our accelerated business growth and the net proceeds from our IPO after deducting related cost expenses.

As we have continually emphasized, we are investing in qualified borrower acquisition by developing deep partnerships and innovating new technologies, security tools and products. We believe that the acquisition of qualified borrowers and our ability to rapidly generate recurring revenue will directly impact our ability to grow sustainability over the long-term.

Turning to revenue guidance for the first quarter of fiscal year 2019, we expect the loan volume to be in the range of US$460 million to US$510 million, total net revenue to be in the range of US$51 million to US$56 million, and adjusted net income to be in the range of US$26 million to US$29 million.

For the full fiscal year 2019, we expect the loan volume to be in the range of US$1.9 billion to US$2.1 billion, total net revenue to be in the range of US$240 million to US$260 million, and adjusted net income to be in the range of US$115 million to US$127 million.

This concludes our prepared remarks. I'd now like to turn the call back over to the operator to begin the Q&A session.

Questions and Answers

Operator
(Operator Instructions)

Your first question comes from the line of Bo Pang from China Renaissance. Go ahead. Please ask your question.

Bo Pang - China Renaissance - Analyst
Hi, Xinming, Johnson and Daisy. Congrats on the stunning year. I do have a couple questions here. First question would be on your pricing. I see your APR is down a little bit versus previous roughly 28% level. I just wonder whether you guys voluntarily move up to the high-quality customer group and how that implies a long-term APR level and customer quality structure. This is my first question.

Second question will be on the delinquency. Your delinquency level is up a little bit from 3% to 4% due to the maturity of the loan and maybe some other reasons. So I just wonder whether this is different from the previous expectation of ultimately like 5% level, and that also associated to the delinquency rate, how the insurance premium changed in this quarter. This is my second question.

My third question is regarding to the funding of that. Due to the regulation delay, I said as the previously licensing delay, the consolidation of the market is also slow a little bit. I just wonder we've seen the funding size a little bit tightened lately. I want to get an idea on your expectation on the funding cost, and then also on the other hand whether you guys have a plan to move toward the loan facilitation model partnering with bank. This is my third question.

My last question will be on the 2019 outlook. Though I see your number is pretty encouraging with a 60% year-over-year loan growth and a 130% of revenue growth, I want to get a better sense on what the drivers are behind these solid growth and improvement on monetization. And also, we've seen that the Beijing Bureau is kind of more stringent on the P2P volume control. Some of your competitors already got meaningfully impacted. I want to know whether we will face the similar challenge down the road in fiscal year 2019.

That'll be it. Thank you.

Johnson Zhang - Hexindai Inc. - CFO
Our average APR is close to 28%. And we believe that the 36% is kind of pack and 28% is kind of a competitive price we are offering to the consumer loan in our marketplace. And for the long-term, we believe that for the consumer loan marketplace, it will be sustainable at the same level as before.

And our management team have over 10-year experience, have already experienced several economic credit cycles. And we have a strategy that we will be more aggressive when the economy is going better, to acquire more grade D or grade C level borrower. And if the economy goes in recession, our strategy is to move conservatively to control the risk. And we prefer to acquire more grade B level forward.

And regarding to your question about delinquency, as our number from first vintage, our default rate goes to 4%. And if we normalize the – when every vintage goes to material, as you expected the normalized default rate will be close to 5%. That also matched our expectation.

And of course, we also have disclosed that we have already renewed the agreement with Changan Insurance. Changan Insurance has already increased 2% of the service fee, we can consider this service fee as kind of a premium, in that way the effective premium will be implied to 4.4%. That 4.4% of premium will be implied in the new fiscal year.

Although we will maintain all-inclusive APR charged to borrowers, if the premium rate increases, either all revenue will decrease or the yield rate to the investor will decrease. And as we have mentioned in our earnings call, we have already attracted more risk-adverse investor. And we believe that we do have a space to decrease the yield rate to the lenders. In that way, we could keep our gross billing ratio in the next fiscal year.

And for the fund sourcing, regarding to the current regulation environment, we don't think it is a good time to cooperate with the financial institutions in the fund. And we also do not rely on any financial institutions. We are relying on our own 0.2 million investors. And in every quarter, there are 60,000 active investors. All of our funding is from retail side. We believe that would be more stable rather than other peer companies who are relying on one or two financial institutions.

And regarding to our guidance, both revenue and loan volume are expected to increase over 100%. I think the first driver is China's economy which fuels the growth and the younger generation prefers to consume in advance. And the consumer finance demand is still very strong.

According to Oliver Wyman's research, the consumer finance in terms of loan volume will increase in the next three years. The CAGR is supposed to be 49%. And I think the second driver is as we are one of the top companies, the transactions are more concentrated to the top companies. In that way, our growth rate would be faster than the industry average level.

And the third driver is that we have already expanded the online/offline channels in the last fiscal year. Some of the offline channels have not gotten the full capacity. And for the new fiscal year, our offline channel will still grow and the new branches we discussed in the last fiscal year will get a full capacity.

And for online side, we got to establish some cooperation with the search engine and APP distributors in the last fiscal year. And we still have a lot of space to increase our conversion rate. In our view, our online channel growth rate would be faster than our offline channel growth rate. These are the three key drivers to contribute to our over 100% growth in both revenue and loan volume.

And regarding to the regulation, I'll pass it to our CEO Xinming.

Xinming Zhou - Hexindai Inc. - CEO
Okay. (Speaking Foreign Language)

Daisy Wang - Hexindai Inc. - IR Director
Let me help with the translation here. Regarding the Beijing regulation you just mentioned, we asked around but so far there is no official document about this. If the news were true, this requirement should be from a notice issued by Beijing Municipal Bureau of Finance to P2P platforms in the fourth quarter of 2017.

At the time of our IPO, we had totally RMB30 million of loans that its individual loan amount exceeds the limit of RMB200,000. By the end of 2017, we have adjusted this part of the business according to the notice and terminated it. From what we have seen, the notice limits the scale of businesses that are not in compliance with current regulations, rather than the whole business scale.

Shanghai has issued similar regulations. According to the results we have seen, businesses of US-listed Shanghai-based companies haven't been impacted by this regulation. In conclusion, I would assume that regulators have been targeting the businesses, which are not in compliance with regulations, and have not limited the overall loan volume.

Bo Pang - China Renaissance - Analyst
Thank you. I have two more follow-up, if I may. So first one is on your online channel. Since your online channel is growing faster than offline, I wonder how you could make a better control over the online traffic quality. Because as seen in your competitor, their online traffic is delinquency rate is as twice as the offline channel. Also, their online approval rate is only a fraction of offline. I wonder when you move towards the online channel whether there will be a negative impact on, for example, your user acquisition cost or your conversion rate. That's the number one question.

Number two question is on the overall loan margin trend. So, given your third-party insurance partner or any raised the premium and also you are voluntarily lowered your APR level to have a better control over asset quality. It seems to me that the loan margin is under a little bit pressure into the 2019 fiscal year. However, your revenue guidance is at the similar level of your loan volume growth guidance. I just wonder what I missed to better understand the trajectory of the loan margin trend in the long-term especially during the online lending rectification period. Could you please clarify that? Thank you.

Johnson Zhang - Hexindai Inc. – CFO
Thank you. I think no matter whether the borrower is from online or offline channel, our risk management process is the same. For example, some of the online channels, comparing with the

other online channels, it's true that their borrower quality is quite different. But If the channel A refers borrowers with better credit quality, our approval rate will be higher. And for the channel B, if the borrower has lower quality, our approval rate would be lower.

As a whole, no matter which channel the borrowers come from, our criteria is the same. And from our operating online channel for the past several quarters, we haven't observed their delinquency rate or the M3 + Charge-off rate has a significant difference compared with the offline channel.

And if we're comparing with the acquisition cost between online channel and the offline channel, our offline channel acquisition cost is 6%. And for the online channel, the acquisition cost is also close to 6%. And if the Internet traffic price continues at the same or even increases later, we believe that our conversion rates would have a space to increase as our brand image becomes stronger. And if our conversion rate increases, we still have an opportunity to decrease the acquisition cost in average.

And regarding to our own margin, our APR will maintain charged to the borrowers as the last fiscal year as before. And then we expected that the yield rate to the lender will be decreased in the next fiscal year. And that kind of decrease would be -- part of them will become upside to the increase of the insurance premium. And a part of that will be transferred to our own margin. In that way, we believe that our vigorous scenario, our margin will be improved and our most conservative scenario, our margin will be as same as fiscal year 2018.

In our guidance, we apply a neutral scenario. Thank you.

Bo Pang - China Renaissance - Analyst
Thank you very much for the color. Thank you.

Operator
Your next question comes from the line of Jane Yang of Essence Securities. Please ask your question.

Jane Yang - Essence Securities - Analyst
Thanks, Management, for taking my questions. I have two quick questions. The first one is what is your strategy to drive revenue growth in midterm in the next two to three years?

And the second one is we noticed that currently, you have a promotion of additional 200 basic points from interest rates in your app and who will bear the cost and will it have any impact on the margin? Thank you.

Johnson Zhang - Hexindai Inc. - CFO
Thank you again. We're trying to continue investing in the upgrade of our operating infrastructure and build a stronger business. This will primarily focus on investing in technology first, strengthening our risk management system and adding headcounts here, and improving our ability to rapidly assess and increase the amount of loan applications with big data analytics.

As a public company, we believe we will be able to attract more borrowers and lenders and scale up our loan volume, to upgrade our risk control and the management systems, to improve our privacy protection methods and to enhance our anti-fraud and billing systems. In addition, we will continue brand building by implementing multi-faceted marketing strategy to promote our brand through traditional media, search engine, online advertising and social media.

And for our promotion today is an anniversary marketing campaign. And we don't believe that this one-time promotion will impact to our P&L at a significant level.

Jane Yang - Essence Securities – Analyst
Okay, thank you.

Johnson Zhang - Hexindai Inc. - CFO
Okay.

Operator
(Operator Instructions)

There are no further question at this time. I would now like to hand the conference back to Ms. Daisy Wang. Please continue.

Daisy Wang - Hexindai Inc. - IR Director
Thank you, Operator.

In closing, on behalf of the entire Hexindai Management Team, we like to thank you for your interest and participation in today's call. If you require any further information or have any interest in visiting us in China, please let us know. Thank you for joining us today. This concludes the call.

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