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

Other Participants
Alex Ye UBS-Analyst
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Patrick Fisher Creation Investments Capital Management-Founder, CEO & Managing Partner
Likki Chen Essence Securities-Analyst

Presentation

Operator

Hello, ladies and gentlemen, and thank you for standing by for Hexindai's Second Quarter Fiscal Year 2019 Earnings Conference Call.

(Operator Instructions)

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

I would then 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 investors, analysts and colleagues 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.

This quarter was certainly challenging for us and the entire P2P sector as the overall market environment shifts around us. The industry is gradually weeding out firms who are financially weaker, fraudulent or unable to maintain compliance standards leaving only the best run remaining. Throughout this turbulent period, many investors are taking a cautious approach, preferring to remain on the sidelines until regulations are fully implemented and ironed out. A clear and definitive regulatory environment will have a positive impact on the industry and allow it to grow sustainably over the long-term. One of the strategic pre-emptive steps we took during the quarter to stay one step ahead of the industry was to protect our existing investors. Leveraging our data analytics systems, we saw demand for loan transfers growing as liquidity in the market tightened. In response, we reduced new loan offerings on our platform and placed a priority on promoting loan transfer services to increase their liquidity and meet the growing demand.

As a result, net revenue during the quarter decreased 83% to US$3.6 million from US$21.2 million in the same period of last year, while total loans facilitated decreased 87% to US$33.8 million from US$273.6 million in the same period of last year. While our top line decreased significantly, these steps helped strengthen confidence in our platform and the loyalty of existing investors. The total amount of investment made on our platform during the quarter, which goes to new loans facilitated and loan transfers, was US$219.5 million. The proportion of new loans facilitated to total investment amount was 15.4% for the quarter, compared with 81.2% during the same period of last year.

Investor participation in the entire sector also declined, with the number of investors in the entire sector who made an investment during the months of July, August and September decreasing 23%, 42% and 46% year-over-year, respectively. This compared to the 9% decrease we saw during the quarter. Furthermore, we acquired a healthy 17,377 new investors during the quarter. The accumulative number of our investors reached approximately 253 thousand as of September 30, 2018, an increase of 94% from a year ago. I believe this speaks to the strength of our platform, the competitive advantage in our products, and the trust investors have in us.

We remain confident in the solid business foundation we have built and believe we will gradually attract investors to return. We still see growing opportunities for investors as borrower demand remains strong. For the P2P industry, borrower demand is the key growth driver and market indicator. A scarcity of capital on the other hand is a temporary problem, as the business potential is defined by the demand side.

Despite this challenging environment, we continued to outperform the industry in terms of loan balance. Recent stats show that the loan balance for the entire sector decreased 25% as of September 30, 2018 when compared with a year ago. Our loan balance however grew 88% year-over-year during the same period. To further highlight this point and how we have outperformed the industry, loan balances for the entire sector decreased 17% sequentially during the three months ended September 30, 2018, while our loan balances only decreased 11% during the same period.

Industry volatility hits its peak in July 2018; however, some positive indicators suggest that investor sentiment on our platform is stabilizing. As of September 30, 2018, the daily average amount of loan transfers applied for on our platform fell by two-thirds from their July peak and have since almost returned to levels seen before the recent turmoil. Investor account balances as of September 30, 2018 also remain at similar levels when compared with June 30, 2018, before our business was impacted by market turmoil. Additionally, 16% of the investors who withdrew their investment in July 2018 when industry performance was at its worst, returned with new investments during the August to October period. This validates our strategy to reduce our loan offerings and promote loan transfers as the appropriate course of action. This has not only strengthened the trust our investors have in our platform but has contributed to the return of investor activity.

Transaction volumes for the top 30 P2P platforms in September accounted for 66% of total volume (RMB110.7 billion), indicating the advantage of industry consolidation the top P2P platforms enjoy. We remain optimistic and strongly believe that we will be ideally positioned to benefit from the enormous growth opportunities China's P2P industry presents once the full extent of the new regulations have been implemented and a healthier and more sustainable environment has been created. Our strategy to focus on medium-sized loans targeting borrowers with stable employment and income allows us to better control risks which is critical during this transition period. I am confident that the strategy we choose and the steps we have taken over the past quarter will only help us emerge stronger and nimbler with greater trust from borrowers and investors across China.

Compliance wise, we recently made progress on several key initiatives to maintain full compliance. In October, we successfully completed the submission of our P2P Compliance Self-Inspection Report to the Beijing Municipal Bureau of Financial Work, and are nearing completion of step 2 with the Beijing Internet Finance Association. The completion of these mark the first two of the three key steps for compliance with industry reforms from the National P2P Rectification Office. Step 2 included an onsite inspection conducted by the Beijing Internet Finance Association. The third step will involve verification of inspection results by the Beijing Municipal Bureau of Financial Work with an additional field inspection and a possible final check by higher-level government organizations. We are actively supporting and participating in this compliance process, which aims to foster the stable growth of the P2P lending industry in China. The result of this process will be a set of standards and best practices across the whole industry to protect the interests of both borrowers and lenders.

We also made progress in enhancing our credit assessment capabilities during the quarter. We recently joined in Baihang Credit, the first credit-reporting platform for the online lending sector that is backed by China's central bank, to begin sharing credit data. Baihang Credit will integrate and process the data collected from multiple other partner companies and transmit individual credit information back. Usage of this shared data pool will help us better assess borrower creditworthiness.

Furthermore, our custodian bank, Jiang Xi Bank, has successfully completed compliance inspection conducted by the National Internet Finance Association (NIFA). According to Circular No. 57 Notice, all online P2P lending platforms must use a designated custodian bank to manage funds from borrowers and lenders to protect investors, guarantee fund safety and avoid fund misappropriation. Jiangxi Bank has been our custodian bank since January 2017, recently listed on the Hong Kong Stock Exchange, and ranks highly among its peers.

We also recently cooperated with Shell Energy (China) Limited to provide price hedging for a substantial volume of National Carbon Allowances and support liquidity and market developments of China's national emissions scheme. This shows our efforts to improve corporate social responsibility and support environmental protection. Meanwhile, we are in the process of putting together our first ESG report.

Before I conclude, this certainly was a challenging quarter for us, but I'm pleased with the strategic steps we took to maintain loyalty and trust in our platform, and in particular with our team's ability to quickly execute our strategy in a changing market environment. After mostly reacting on our feet as the ground shifted around us, we have put together a solid plan which I am confident will leverage the solid foundation our business has and help it to rapidly improve and adapt to the new environment. So far, initial user feedback has been very supportive.

In conclusion we remain optimistic as we have outperformed the industry and retained many of our valuable existing investors and we feel confident in our future and strong financial resources. We believe we have a clear strategy and a great team that will carry us through. 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 second quarter of fiscal year 2019 earnings conference call today.

Before I go through the numbers, please note that we recently announced that we have hired Deloitte Touch Tohmatsu as our new independent registered public accounting firm. Further details regarding the change in our auditing firm can be found on our IR website at ir.hexindai.com.

Now let's start with the financials of the quarter.

We are delighted to accomplish this quarter despite of tough macro environment and difficult industry situation. First, I'll go over some highlights.

During the second quarter of fiscal year 2019, total volume of loans facilitated decreased by 87% year-over-year to RMB0.2 billion, or US$33.8 million. The decline was primarily attributable to the decrease in the number of borrowers from 20,697 to 2,183. Net loss of US$ 17.4 million in this quarter compared to a net income of US$12.7 million in the same period of last fiscal year. Adjusted net loss attributable to the Company's shareholders, which beat the guidance was US$12.5 million in the second quarter of fiscal year 2019.

Now I would like to walk you through more details on our financial results during second quarter of fiscal year 2019.

As I mentioned, net revenue was US$3.6 million, a decrease of 83% from the same period last year. The decrease was primarily due to the significant decrease in the volume of credit loans facilitated through our marketplace, which decreased from US$265.6 million, or RMB1.8 billion, in the second quarter of fiscal year 2018 to US$33.8 million, or RMB0.2 billion, in the same quarter of fiscal year 2019.

Operating expenses were US$21.1 million, an increase of 222% from the second quarter of fiscal year 2018. 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$11.7 million, an increase of 218% from second quarter of fiscal year 2018. The increase was primarily due to an increase in employee expenses and advertising expenses associated with enhancing the Company's brand recognition and acquiring more customers

Service and development expenses were US$2.2 million, an increase of 15% from same period of fiscal year 2018. Service and development expenses remained stable when compared to the same period of last fiscal year, which was primarily due to improvements in operational efficiency.

General and administrative expenses were US$2.2 million (two point two million), an increase of 136% from same period of fiscal year 2018. The increase was due primarily to an increase in employee expenses and professional service fees and rental expenses.

Share-based compensation during the second quarter of fiscal year 2019 was US$4.9 million, an increase from zero 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 loss attributable to the Company's shareholders was US$17.4 million during the second quarter of fiscal year 2019, compared to net income attributable to the Company's shareholders of US$12.7 million in the same period of fiscal year 2018.

Accordingly, basic loss per common share in the second quarter of fiscal year 2019 was US$0.36, compared to basic EPS of US$0.30 in the same period of fiscal year 2018. Diluted loss per common share in the second quarter of fiscal year 2019 was US$0.36, compared to diluted EPS of US$0.30 in the same period of fiscal year 2018.

Adjusted net loss attributable to the Company's shareholders, which excluded share-based compensation expenses was US$12.5 million compared to an adjusted net income of US$12.7 million in the same period of last fiscal year.

Adjusted EBIT, which excluded interest income, income tax and share-based compensation was a loss of US$12.0 million compared to US$14.7 million in second quarter of fiscal year 2018.

We generated strong operating cash flow and maintained a strong cash position. As of September 30, 2018, our cash position stood at US$53.1 million. During the six months ended September 30, 2018, net cash used in operating activities was US$5.9 million, net cash used in investing activities was US$51.2 million and net cash used in financing activities was US$15.8 million, which is a reflection of our dividend payments.

As we have continuously 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 sustainably over the long-term.

Turning to revenue guidance, for the third quarter of fiscal year 2019, we expect loan volumes to be in the range of US$56 million to US$60 million, and total net revenues to be in the range of US$1.4 million to US$1.6 million.

For full fiscal year 2019, we expect loan volumes to be in the range of US$700 million to US$720 million, and total net revenues to be in the range of US$66 million to US$70 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)

Our first question comes from the line of Alex Ye from UBS. Please ask your question.

Alex Ye - UBS - Analyst
I have 3 questions from my end, if I may. So the first question is regarding the latest progress on the national compliance check. So I understand that Hexindai is close to completing the second phase of compliance check. So just wondering, what are the next time line or expected date of completion of the third phase are you currently expecting? Do you still expect it to be finished by the end of this year? And my second question is regarding the investors side. So given there has been some industry news that the regulator is considering forced shutdown on some small-sized P2P platforms, well, I wonder if this will cause another round of investor panic and what's your view on this? And finally, about your guidance for the next -- upcoming 2 quarters. So we see that there's a -- for the quarter ending March of 2019, we are expecting our loan volume to resume back to normal business and -- compared to very, like, decline in these 2 quarters. So I'm wondering, what are the underlying scenarios we are assuming for this guidance?

Johnson Zhang - Hexindai Inc. - CFO
Thank you, Alex. Regarding to the -- your question about the timetable for the regulation, the government inspection process is scheduled to be completed by the end of this year. But it is not known, if there are any licenses will be issued at a very clear timetable. And the cleanup of uncomplianced peer-to-peer companies will be the government's focus in the first half of 2019 and is expected to be completed by the end of 2019. In the second half of 2019, peer-to-peer platforms that have a successful -- successfully passed the compliance inspection will be permitted to finish filing and registration. Lastly, a national list of successful registrations who filed will be -- come up. And regarding your question, the government would like to set up some more peer-to-peer company if -- no matter how regulations attitutde, but we believe that this industry has already concentrated to the platforms; as well as we are one of the companies who also benefit from the regulation. And the regulation -- the final target of the regulation is to create a more healthy and sustainable environment for this industry. And your question regarding to our guidance, we have already decreased our full year guidance according to the environment. As our CEO mentioned, that the demand of the -- from the borrowers' side is still strong. And we believe that the demand is really a key factor to drive the industry growth, and we are focusing on the medium-sized consumption loans. Our target customer is emerging middle class with stable job and stable income, which targeted customers have a lack of impact to the micro economy. And the key reason that we decreased our guidance is considered from the lenders' side, when the lenders are more -- lenders are cautious to invest in the following quarters. That way, we decreased our volume and revenue guidance for the full fiscal year. But for the long term, we believe that after the investor recover their confidence, this industry will be -- growth in loan volumn. And as one of the top companies in this industry, will be also benefit from it.

Operator
Your next question comes from the line of Patricia Cheng from CLSA.

Patricia Cheng - CLSA Limited, Research Division - Head of China Financial Research
I have 2 questions. The first one is about borrowers. Have you changed any underwriting criteria or like have you seen any like changes to the loan approval rates? And then related to that one is about delinquency, how is that one trending? And your outlook for the coming quarters as the industry continues with the cleanup. And then the second question is on investor profile. The total investment -

- the number of investors usually are much less than the drop in your loan facilitation. Has there been any change of your investor profile or like the size of the investments?

Johnson Zhang - Hexindai Inc. - CFO
For the long-term, we have a strategy of our -- risk management strategy. When the economics are going up, we are more aggressive to facilitated more borrowers, for grade c and grade d; and when the economics are going in recession, we are more conservative for -- facilitated more grade b borrowers to control our risks. And for the last quarter, we have already shifted our -- or facilitated to -- facilitated more grade b borrowers to control our risk. And meanwhile, we -- our past due rates have been going down. It's not only we apply more strategically criteria for approval of borrowers, but also, we have extended our channels. Our -- we have extended our channels from off-line to online and we began acquiring borrowers through a variety of new channels, which resulted in a larger and a more diversified number of applications and decrease in our approval rates. As I mentioned before, we are focusing on the medium-sized consumption loans. With didn't see our delinquency rate or default rate has been increased significantly. The aggregate default rate is still in our range of expectation.

Operator
Our next question comes from the line of Patrick Fisher from Creation Investments.

Patrick Fisher - Creation Investments Capital Management - Founder, CEO & Managing Partner

Clearly, it was a very difficult quarter and I'm sure your whole team was working overtime. I'm wondering -- I have 2 questions, wondering about your cost control on your expenses -- employee expenses, given the volatility of the market and the difficulty of placing and getting new liquidity, wondering how you're going to control costs to align with the lower income targets, or if that's possible or if all those expenses are really related to replacing investors that are leaving just as much as needed to increase investors coming in. And my second question has to do with the loans receivable on the balance sheet. It grew significantly from $28 million last year to now $56 million current, with also $16 million noncurrent. Could you describe those loans and what you're doing to get those turned into cash? It's -- yes, I wonder what they're doing on the balance sheet growing in that manner.

Johnson Zhang - Hexindai Inc. - CFO
Regarding to your first question on our -- how do we cost control during the environment? We have already decreased some of the building expenses directing to our brands, but shifting more sales and marketing expenses to the channels, which could have higher investor attractiveness. And for your second question regarding to our balance sheet, I think that the current and the noncurrent assets are kind of reclassification of our loan receivable. We maintain our online micro-lending balance at a level of RMB 500 million or in terms of USD 70 million, current and noncurrent. Did that answer your question?

Patrick Fisher - Creation Investments Capital Management - Founder, CEO & Managing Partner

Yes. could You describe what measures are being taken to collect the $16 million that's past due? Or how past due it is or how likely it would be that, that will result in a loss for the company? Were you able to hear my questions?

Johnson Zhang - Hexindai Inc. - CFO
Yes. All of the borrowers to our micro-lending business is a higher-level -- higher grades. And from when we started online micro-lending business until now, we have no delinquency. All of the borrowers paid the interest on time. We are confused with the noncurrent and the past due. Noncurrent, that means duration of the loans are longer than 1 year.

Patrick Fisher - Creation Investments Capital Management - Founder, CEO & Managing Partner
Longer than 1 year. Yes.

Operator
Your next question comes from the line of Likki Chen from Essence Securities. Please ask your question.

Likki Chen - Essence Securities - Analyst
I have 2 questions. First one is can management share your thoughts on when will the industry recover and when will your company's growth and earnings recover to the normal level? And the second question will be, could management share any color on your margin trend in 2019? What's your strategy regarding marketing and how it counts for the next year? Could you hear my questions?

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

Unidentified Company Representative
For the industry, we think that we'll see general recovery in the second half of next year 2019, after the policy becomes clearer and the regulations become implemented.

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

Unidentified Company Representative
For Hexindai, as a publicly listed company and an industry leader, we expect the recovery of our business to happen earlier in the first half of next year.

Johnson Zhang - Hexindai Inc. - CFO
I'll answer your question regarding to the margin trends. As we mentioned in the previous earnings call, our APR charged to the borrowers will be maintained as the same as before, but our yield rate provided to the lenders will be decreased in the long-term. I mean, in the future 2 years, our yield rates to the lenders will be -- still have 5% to 6% decrease. Those kinds of decrease will shift to our own revenue. That way, for the long term, our margin is going to be increased. But for the short term and in the recent 1-2 quarters, our margins will be decreased. That's mainly because of -- we have to do

more promotion to attract more and more lenders and provide more cash incentives, which will decrease our margin in the future, 1 or 2 quarters.

Operator
There are no further questions at this time. I would like to hand the conference back to today's presenter. Please continue.

Xinming Zhou - Hexindai Inc. - CEO
Thank you again for joining us this evening. While this quarter was challenging, we remain very optimistic about our future business prospects. The strategic steps we took this quarter to maintain investor loyalty and increase trust and confidence in our platform will leave us ideally positioned to capture the vast market opportunities. I am confident in our strategy and our ability to execute and look forward to updating you next quarter on the progress we have made.

Daisy Wang - Hexindai Inc. - IR Director
Thank you, Mr. Zhou. In closing, on behalf of the entire Hexindai management team, we'd 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 just concludes the conference for today. Thank you for participating. You may all disconnect.