

QuantaSing Group (QSG)
Q2 2024 Earnings Conference Call
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Executives

Leah Guo, Associate Director of Investor Relations

Peng Li, Founder, Chairman and CEO

Tim Xie, CFO

Analysts

Howard Halpern, Taglich Brothers

Hunter Diamond, Diamond Equity

Steve Silver, Argus Research

Pat McCann, Noble Capital Markets

B.J. Cook, Singular Research

Presentation

Operator: Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by, and welcome to QuantaSing's earnings conference call. (Operator Instructions). We will be hosting a question-and-answer session after management's prepared remarks. Please note that today's event is being recorded.

I will now turn the conference over to Ms. Leah Guo, Investor Relations Associate Director of the company. Please go ahead, ma'am.

Leah Guo: Thank you. Hello, everyone, and welcome to QuantaSing's earnings call for the second quarter of fiscal year 2024. With us today are Mr. Peng Li, our founder, chairman and CEO, and Mr. Tim Xie, our CFO. Mr. Li will provide a business overview for the quarter; then Tim will discuss the financials in more detail. Following their prepared remarks, Mr. Li and Tim will be available for the Q&A session. I will translate for Mr. Li.

You can refer to our quarterly financial results on our IR website at ir.quantasing.com. You can also access a replay of this call on our IR website when it becomes available a few hours after its conclusion.

Before we will continue, I would like to refer you to our safe harbor statement in our earnings press release, which also applies to this call, as we will be making forward-looking statements. Please note that all numbers stated in the following management's prepared remarks are in RMB terms. And we will discuss non-GAAP measures today, which are more thoroughly explained and reconciled to the most comparable measures reported in our earnings release and filings with the SEC.

I will now turn the call over to the CEO and Founder of QuantaSing, Mr. Li.

Peng Li: Okay. Hello, everyone, and thank you all for joining us today. Last quarter, we saw a solid 24.7% increase in revenue, proving that our strategy to expand our course offerings is paying off. Following the past success of our Financial Literacy courses, we have been actively adding new courses to diversify our revenue streams. We are also seizing the opportunity presented by growing demand for courses made for senior learners.

We adjusted our revenue presentation under Other Personal Interest Courses this quarter. We further broke down Other Personal Interest Courses into Skills Upgrading Courses and Recreation and Leisure Courses. We think the new revenue breakdown better reflects our business strategies, and can provide useful and updated information to investors. Under the new breakdown, Skills Upgrading Courses mainly include courses for training productive skills, such as short-video production and memory training courses. Recreation and Leisure Courses mainly include more personal enrichment courses, such as personal well-being courses, electronic keyboard courses and standing meditation courses.

Now, let's pivot to discuss some new developments and initiatives within our organization. Recent government data has highlighted the strong growth of China's elderly population. China had over 297 million people aged 60 and above in 2023, which was 21.1% of the total population. As such, China has officially become a super-aged society by World Bank standards.

The silver economy is currently valued at around RMB7 trillion, US\$982 billion, and is forecast to surge to RMB30 trillion, US\$4.2 trillion by 2035. This would make up roughly 10% of the country's total GDP, according to China National Radio. The evolving needs and the desires of middle-aged and elderly people in China represent a significant opportunity for us. There is growing demand for personalized services in the silver economy sector.

In a positive move, the government recently introduced measures to strengthen the silver economy. These initiatives urge enterprises to enhance their offerings for the elderly population. For example, to enhance digital services, thousands of websites and apps are being revamped, and standards are being established for senior-friendly mobile devices. This development is also beneficial for us, as it will enhance the learning experience for our users from a hardware perspective.

We are proud to have anticipated this shift in demand. We have been preparing for these opportunities for years. Our team has built a solid foundation and a mature business model, and we are well-positioned to meet this growing demand. As living standards improve, middle-aged and elderly people seek more than just health or longevity. They want experiences that will provide cultural and intellectual enrichment. Our diverse range of online courses includes many which are tailored to the interests of these demographics. Our platform is dedicated to lifelong learning, and we have always emphasized user engagement and satisfaction. This means we are well-equipped to fulfill user desire for intellectual stimulation and personal growth.

Now, let's move on to our ongoing efforts to enhance user engagement and satisfaction. We've been diligently engaging our learners in a variety of offline and online initiatives, leveraging the

power of AI to elevate users' learning experiences. Additionally, we utilize our scalable self-operated system to boost learners' repurchase rates.

We have hosted a series of community events surrounding our Recreation and Leisure Courses. These events include standing meditation sessions and appreciation sessions for pursuits like electronic keyboard and calligraphy. We provide ample opportunities for interaction, communication, and personal enrichment for our middle-aged and elderly users. For example, one recent initiative involved offering complimentary trial courses to residents of a community in Beijing. Our offline and online initiatives have resulted in consistently high levels of user engagement.

Attendees of our sharing sessions speak highly of the valuable knowledge they gain from instructors and peers during events. We have received lots of positive feedback from participants for both our online courses and offline activities, especially from elderly learners. They express deep appreciation for activities like calligraphy and standing meditation, and recognize them as valuable opportunities for personal growth and learning. This feedback highlights their strong desire for spiritual and cultural enrichment, which emphasizes the importance they place on these experiences.

Among the variety of measures we have used to apply AI in our business, we have successfully enhanced livestreaming quality using AI, improving both visual clarity and stream stability. Additionally, we have leveraged AI in our online tutoring system by intelligently identifying and anticipating learners' behavior. As a result, learners have been able to significantly reduce their waiting time during Q&A sessions with our tutors.

Our commitment to learner satisfaction is closely followed by a more efficient approach to retaining our learners. Recently, we upgraded our integrated business management process and conducted pilot testing before rolling it out to more SKUs. Our tutors can now easily manage tasks like one-click class reminders and optimizing private domain traffic. By doing so, we not only increase our course completion rates, but also enhance overall repurchases.

For example, the repurchase rate of our standing meditation course has improved from 26.2% in last fiscal quarter [corrected by the company after the call] to an impressive 34.7% in this quarter. We aim to streamline the operation system across all SKUs to maximize user retention on our platform.

Next, let's turn to our efforts to increase operational efficiency while growing our top line. We remain focused on streamlining processes and optimizing resource allocation. By carefully investing in sales, marketing, and leveraging technology, we aim to enhance our market presence. Our test and scale approach ensures efficient resource utilization, minimizes financial risk, and allows us to seize market opportunities.

At present, we are focused on streamlining processes and resource allocation to boost cost efficiency. We aim to ensure that the quality of our services also remains top-notch. We have managed to limit our relative growth in headcount. This demonstrates our ongoing commitment to prudent resource management.

Moreover, we are assembling a new team in Hefei. We efficiently capitalized on the cost advantages of operating in that region, including but not limited to, labor cost and administrative expenses. We also made improvements to our operational system. Specifically, we developed our own instant messaging system, which has been officially deployed this quarter. This strategic move not only significantly reduced our operational expenses, but also enhanced real-time interactivity among learners.

We achieve highly efficient sales and marketing by leveraging technology. We are carefully allocating resources to enhance our market presence. For example, we leverage tech including big data and our advanced operational systems to create diversified and effective marketing channels. During this quarter, we upgraded our technologies so we were able to reach paying users more effectively.

Meanwhile, we're employing a test and scale methodology. For this methodology, we invest modestly in new initiatives such as new course offerings, marketing campaigns, and live e-commerce product offerings. Then we assess the ROI. We only take steps to progress and expand the initiative if the ROI meets or exceeds our expectations. This data-driven decision-making process maximizes our resource allocation and minimizes the financial risk for new initiatives.

Also, by collecting feedback from the market and our customers, we gain a better understanding of their needs. This broadens our reach and enhances our ability to address shifting demand. The flexibility of our business model allows us to scale up our operations without sacrificing cash flow. Ultimately, this enables us to seize market opportunities as they arise.

In addition to our ongoing efforts to drive revenue growth and maintain cost efficiency, we are actively pursuing new initiatives that offer significant potential for expanding and diversifying our business. Live e-commerce and overseas markets are important to broaden our revenue streams. Thus, we have launched a number of strategic initiatives in these areas. Live e-commerce provides an interactive platform to enhance sales and drive customer engagement. Recognizing this, we are currently leveraging live e-commerce to strengthen our online presence and increase our market share.

We are also developing private label products that prioritize innovation and customer satisfaction. The recent launch of our private label Chinese Baijiu brand YUNTING is one example.

Meanwhile, our focus on overseas expansion aims to access new markets and demographics, thereby diversifying our revenue streams and broadening our market reach. We're carefully planning our expansion strategy for sustainable growth. Kelly's Education serves as a key trial venture preceding broader international expansion efforts. We're closely monitoring its progress to refine our strategies and inform further expansion plans, ensuring a prudent and well-informed approach to scaling our international operations.

In conclusion, the second quarter of our fiscal year 2024 demonstrated strong revenue growth, reflecting the success of our strategic initiatives. We have taken steps to diversify our course offerings and to cater to burgeoning demand from middle-age and senior learners.

We are also actively pursuing new opportunities in live e-commerce and international markets, while still maintaining a lean and efficient operational model. With a focus on innovation and prudent resource management, we are well-positioned to sustain our growth trajectory and deliver lasting value to our shareholders.

With that, I will turn the call over to Tim to discuss the details of our financials. Thank you.

Tim Xie: Thank you. Before I go into the details of our financial results, please note that all amounts are in RMB terms, that the reporting period is the second quarter of fiscal year 2024 ending on June 30, 2024, and that in addition to GAAP measures, we will also be discussing non-GAAP measures to provide greater clarity on the trends in our actual operations.

For the second quarter of fiscal year 2024, we grew our total revenues by 24.7% year-over-year and 12.8% quarter-over-quarter to 980.5 million, mainly driven by growth from skills upgrading courses.

Among our revenues, revenues from individual online learning services grew by 24.1% year-over-year to 873.6 million, or 89.1% of total revenues, mainly due to continued demand for skills upgrading courses. Our gross billings of individual online learning services increased by 15.4% year-over-year to 944.6 million.

Revenues from enterprise services were 57.6 million, a change of 30% from a year ago, and representing 5.9% of total revenues, primarily due to a decline in revenues from related party transactions.

Gross profit was 835.5 million, representing a gross margin of 85.2%, compared to 87.4% in the same period last year.

Total operating expenses were 733.2 million, compared to 731.7 million in the same period last year.

To break this down, sales and marketing expenses were 657.1 million, representing a change of 5.5% year-over-year. The change is mainly due to our increased spending on outsourcing labor and marketing efforts. The increase is partially offset by a decrease in our staff costs, which also included a decrease in share-based compensation.

As a percentage of total revenue, non-GAAP sales and marketing expenses, which excluded share-based compensation, decreased to 68.6% from 77.3% a year ago.

Research and development expenses were 41 million, representing a decrease of 36.2% year-over-year, primarily driven by a decrease in share-based compensation. As a percentage of total revenue, non-GAAP R&D expenses, which exclude share-based compensation, decreased to 4% from 5.6% a year ago.

General and administrative expenses were 35.1 million, representing a decrease of 21.3% year-over-year, primarily due to decreases in share-based compensation and office expenses, partially offset by an increase in professional service fees. As a percentage of total revenue, non-GAAP

G&A expenses, which excluded share-based compensation, decreased to 2.8% from 3.1% a year ago.

Net income was 107.6 million. Excluding share-based compensation, adjusted net income was 103.9 million, representing an adjusted net margin of 10.6% during the quarter.

Basic and diluted net income per share were RMB0.65 and RMB0.64 respectively during the quarter. Adjusted basic and diluted net income per share were RMB0.63 and RMB0.62 respectively during the quarter.

Turning to our balance sheet. As of December 31, 2023, our company held 1,050.8 million in cash and cash equivalents and short-term investments, compared to 930.6 million as of June 30, 2023.

Lastly, I want to provide some color on our outlook. For the third quarter of fiscal year 2024, which ends on June 30, 2024, we expect revenues to be between 900 million and 930 million, representing a year-over-year increase of between 11.5% and 15.2%. These projections take into consideration the current market conditions prevailing in the industry.

In summary, our steadfast commitment to delivering exceptional online learning experiences and a broad spectrum of courses, coupled with our focus on cost efficiencies and cash flow optimization, delivered solid results this quarter. Our expansion efforts are executed with a keen eye on maintaining profitability, as we continue to create long-term value for our shareholders. Looking ahead, our strategic direction will remain aligned with our dedication to sustainable growth.

That concludes my prepared remarks. Operator, let's open up the call for questions. Thank you.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Our first question comes from the line of Howard Halpern of Taglich Brothers.

Howard Halpern: Congratulations, guys, great quarter. In terms of your live e-commerce offering, you talked about -- I guess you announced in January, the first private-label brand. So how is this offering being received? And are we going to see additional private-label offerings launched throughout the year to continue the growth in that segment?

Peng Li: Thank you, Howard. I will answer the question. Regarding our recent introduction of YUNTING, our first private-label Chinese Baijiu brand within our live e-commerce offering, we're pleased with the initial reception it has received. YUNTING represents a significant milestone for QuantaSing as it marks our entry into the private label business and to the livestreaming -- leveraging our expertise in livestreaming e-commerce. The response from our customers has been positive, with many expressing appreciations for the rich taste and quality of

YUNTING Baijiu. The limited-edition gift box, especially designed for the Chinese Lunar New Year with dragon-themed packaging, has resonated well with consumers, symbolizing good luck and future success.

And also, I think we still need time to tap the market and to try this kind of private-label live e-commerce business, and then this becomes more evidence that a private-label business is positive. And we will continue our “test and scale” approach and strategy to enlarge this kind of business. As for future plans, while we don't have specific announcements to make at this time, we are actively exploring opportunities to expand our private-label offerings through the year. We recognize the importance of providing unique and high-quality products and services to our customers, and the launching of YUNTING reinforces our confidence in pursuing additional private-label initiatives.

I think this, our customer, the large customer base, and also our business strategy to launch the businesses featuring to the needs of our -- this suitable to the customers' demographic and profile. I think in the future, we will do more effort for this kind of private-label e-commerce business. And we will notice and we will publish any significant news in the future, if any. Thank you.

Howard Halpern: Okay. Thank you.

Operator: Hunter Diamond of Diamond Equity.

Hunter Diamond: Firstly, congratulations on the results. So it was noted that QuantaSing's live e-commerce segment has been demonstrating promising growth. Could you elaborate on some of the key performance metrics that underscore this growth? And then additionally, what strategic initiatives are being implemented to capitalize on this momentum?

Tim Xie: Yes, I think our CEO will answer this question, and Matt (Peng Li) will answer in Chinese, and Leah will help translate.

Peng Li: Okay. To answer your question (Speaking foreign language).

(Translated). Our live e-commerce business has shown promising growth, with key performance metrics such as the average order value, repeat repurchase rate, and paid users and GMV. It strategically aligns product offerings with course content, enhancing relevance and value for our users. For example, for the health management courses, we introduced complementary products like moxa sticks. And as for the short-video editing courses, we paired content with software services. This approach ensures synergy between education and also consumer goods, optimizing customer experience and engagement.

In addition, we leverage our robust customer base, our operational capabilities, and tech structure, so that we can expand offerings beyond the course-related products, such as Baijiu. This means that we are seizing opportunities to diversify and extend our product range in line with evolving market demands. This approach is quite flexible, and underscores our commitment to delivering the comprehensive solutions and capitalizing on growth opportunities in the live e-commerce landscape. Okay. That's all.

Operator: Steve Silver of Argus Research. (Operator Instructions).

Steve Silver: Congratulations on a strong quarter as well. You guys spoke quite a bit in the prepared remarks on your efforts to grow the company efficiently and sustainably over the long-term using AI for many of these initiatives. Just hoping you could provide any additional color on the company's current thinking about scaling the size of the workforce over time as the e-commerce enterprise services and geographic expansion, like Kelly's Education, continue to ramp up?

Peng Li: Okay. Thank you. I'll answer the question. As we grow across a number of areas, especially for our main business – the online learning business, we focus on efficiency and lowering costs by using technology, including AI, to streamline operations, especially in the area that -- which can -- which is difficult to use that kind of technologies to streamline the efficiency of the operation process. Instead of hiring more people, we are now improving and trying to -- many possibilities to improve our processes and reducing headcounts through automation and AI-driven solutions, especially in the processing area.

As e-commerce and enterprise services grow, we also use AI to work smarter and faster. This includes automating everyday tasks, improving decision-making processes, and enhancing resource allocation to reduce costs while keeping our operational effectiveness during the whole process of our daily operation to deliver those services to our online learners.

Likewise, with the acquisition of Kelly's Education and our entry into the global online education market, I think we're trying to test and use AI technology and other technologies, the big data technology and so on, to scale operations efficiently and lower overhead costs. We automate admin tasks, personalize learning experiences, and optimize course delivery to achieve greater cost efficiency while expanding our reach and impact.

Overall, our strategy for managing our workforce involves using technology, including AI and other technologies, to reduce costs and improve efficiency across all business segments. By using the power of technology, we achieve our growth objectives while reducing the need for more manpower and resources.

But I think in the end, all of the technologies and solutions we adopted, they're aiming to cater to our customers' needs and desire, and to improve and upgrade our service levels to our customers. So in the end, whether we use technology, including AI, or not, depends on the servicing and to the service quality we provide to our customers. And also, in terms -- it depends on the business nature, if we can upgrade our service level and improve the operation efficiency, we will use that, invest that. So that is our methodology. Thank you.

Steve Silver: That's helpful. Thank you so much.

Operator: Pat McCann of Noble Capital Markets.

Pat McCann: My question is that given the acquisition of Kelly's Education, can you comment on the market opportunity for you for online learning in Asia, given that you traditionally target a market that's more adult-learning focused?

Peng Li: Okay. Thank you. Yes, in China, we currently -- the adult online learning service providers, we're the largest. And also using our technology edge and also our experiences, we cooperate and we will help Kelly's Education to enlarge their service offerings to the children's online learning in Asia, currently, the middle market in Hong Kong. And also, we are researching and trying other market. And also, our acquisition of Kelly's Education is an important step for us to enter into the rapidly-growing market for children's online learning in Asia.

In Asia, many parents are very keen about their children's education and their massive need for this kind of services. And we are also expanding beyond our former focus on adult education. This growth of the children's online education -- online learning market is driven by increasing digital adoption, parents' focus on education, and the post-Covid rise of online learning. As parents seek convenient and effective educational solutions for their children, I think we are ready to use our expertise to become a leading provider of personalized online learning experiences, meeting the changing needs of families across this region.

In terms of the method we use to develop and to deliver our services to each of the local market in Asia, maybe worldwide we will always speak to the methodology that we will cater to the local market. We will research the local market; we will make our services suitable to the local market. By creating fresh new curriculums and with our commitment to excel, I think we plan to take advantage of this huge market opportunity and drive growth in children's online education in Asia to worldwide. I think this is a good start and we will stick to our "test and scale" methodology for this kind of market. Thank you.

Pat McCann: Thank you.

Operator: B.J. Cook of Singular Research.

B.J. Cook: Can you just talk about your strategy for attracting repeat customers and turning them into paid customers?

Peng Li: Okay. I think for our customers, repeat customers, turning them into paid customers, our strategy for attracting them and converting them revolves around continuously enhancing our online learning platform's quality, ensuring it's user-friendly, interactive, and filled with valuable content. For example, because we are now catering and developing services for more and more elderly people, we cater and we tailor-made our APP we tailor-made our products to suit -- to make it suitable to their personal habit to cater for their fruitful years.

Also, for regular updates, driven by our user feedback and educational trends, maintain our competitive edge. I think in addition to this, we host a diverse range of engaging events, both online and offline, including webinars, workshops, seminars, and networking sessions, tailored to our customers' interests and learning needs. So these events not only enrich the overall learning experience, but also foster a sense of community among our learners.

I think in summary, by integrating these efforts, we cultivate a loyal customer base, driving sustainable growth for our online learning service company, our platform. And also, I think maybe more importantly, during the past years of operation experiences, we accumulated a seamless technology called Operation Process. This is a technical -- the technology skills, and

also our experience can streamline the operation during the course delivery. For example, for our initial launch, financial literacy courses, we have delivered a very strong repeat purchase rate, and by leveraging such kind of experiences, we scale our personal Skills Upgrading courses and Leisure and Recreation courses.

For that kind of courses, we can duplicate and leverage our experiences, accumulating from the financial literacy courses to launch the repeat purchase programs to launch the -- to attract the repeat customers to our advanced courses, so that demonstrating a very healthy ratio for our operation metrics. So that is our methodology. Thank you.

B.J. Cook: Thank you.

Operator: This concludes our question-and-answer session. I'd like to hand the conference back to management for closing remarks.

Leah Guo: Thank you again for joining our call today. If you have further questions, feel free to contact us, or submit a request through our IR website. We look forward to speaking with everyone in our next call. Have a good day.

Operator: The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.