QuantaSing Group
Q2 2023 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
Liping Zhao, CICC
Jeffrey Chan, CLSA
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Presentation

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 2023. With us today are Mr. Peng Li, our founder, chairman and CEO, and Mr. Tim Xie, our CFO. Mr. Li will give a general business overview for the quarter; then Tim will discuss the financials in more details. 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 second fiscal quarter financial results on our IR website at ir.liangzizhige.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 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 to the CEO and Founder of QuantaSing, Mr. Li.

Peng Li: Hello, everyone, and thank you all for joining us on our first earnings call as a public company. It's been an exciting journey so far. Our desire to provide users with lifelong personal learning opportunities remains as strong as ever. We are grateful to our employees. They are highly committed to our mission of improving people's quality of life. We're also grateful to our enterprise customers and learners for putting their faith in us. They have chosen us to help them to meet the needs of the modern workplace and their personal goals. Thanks to all of them, we had a successful IPO and continue to deliver strong financial results.

During the second fiscal quarter ended December 31, 2022, we grew our revenues on a pro forma basis. We also generated positive adjusted profit margins, showing our resilience in a challenging economic environment.

During the quarter, our pro forma revenues, excluding revenues from the disposed group, increased by 19.3% quarter-over-quarter, and by 1.9% year-over-year, to RMB786.4 million. Our gross billings of individual online learning services were RMB818.8 million, a 23.1% quarter-over-quarter increase. We recorded RMB21.8 million in non-GAAP adjusted net income, a 2.8% adjusted net income margin for the quarter.

Our strong growth and profitability are due to three factors. First, a systematic approach to creating an innovative learning journey for our users. Second, an intelligent content development system for our instructors and tutors. Third, an agile and scalable business model.

Let's discuss the latest updates on each, starting with our systematic approach. It covers every step of the learner's journey with us. We use technology-driven tools for user engagement, interactive learning, in-class participation, and post-course assessment. For new learners, the learning journey usually begins by attending our introductory courses. For such courses, we have pioneered the “dual-instructor” mode. We appoint a lead instructor, who lectures online via livestream to a large class.

The large class is then divided into smaller groups, which are supported by our off-class tutors. Tutors interact with our learners and answer questions. Under this dual-instructor mode, we can easily connect over 100,000 learners at the same time. This has enhanced our user stickiness and user engagement.

It has also boosted demand for our premium courses. Our registered users doubled from a year ago to 77.8 million as of December 31, 2022. Paying learners grew by 33.3% year-over-year to about 0.4 million for the quarter.

Second, we developed an intelligent content development system for our instructors and tutors. This system helps them to hone their teaching skills. Using big data analysis, our instructors can observe user engagement in real-time during lectures. We continue to invest in our technology and business intelligence. We have applied big data analysis to all key aspects of our business operations. These aspects include content development, live streaming, pre-recording, study toolkits, customer engagement, sales conversion, and operation management. We are able to produce content with quality, depth, and freshness, to attract users, improve our conversion rates, and optimize our management processes.

In addition, by leveraging our advanced technology infrastructure and business intelligence, we are able to develop new course offerings within an average of 3 to 4 months. This lets us launch our service offerings in a cost-effective manner. Each of our off-class tutors is able to serve more than 200 learners at the same time, without impacting the learning experience.

Third, our business model is agile and scalable. It fuels the engine of our business growth and revenue diversification. For new online courses, our online learning platform provides the backbone for our rapid expansion. Based on QiNiu's infrastructure, which underlies our success in financial literacy courses, we quickly introduced new platforms, including JiangZhen and QianChi. These platforms have supported our efforts to offer more personal interest courses in fields that are gaining popularity.

Some examples are short video production, personal well-being, and electronic keyboard. Since the launch in August 2021, these courses helped us to accumulate about 17.2 million registered users as of December 31, 2022. Our revenues from these courses grew six-fold year-over-year, reaching RMB205.1 million in the second fiscal quarter.

We are not resting on our laurels. Our team remains vigilant of economic headwinds and macro uncertainties. We are aware of longer sales cycles from enterprise customers, weak consumer spending, and changing user behaviors. To maintain our operational resilience and stability through all economic cycles, we have proactively adjusted our operational tactics in several ways.

First, we have diversified our customer base to include both individuals and enterprises. We started to provide financial literacy learning services in July 2019, and quickly became the largest online financial learning service provider for adults in China. According to a report by Frost & Sullivan, we held a market share of 36.9% in terms of revenue in 2021. In August 2021, we expanded our offerings into a carefully selected range of personal interest courses beyond financial literacy. By doing so, we leveraged the general public's growing interest in diverse areas of study for personal development and lifelong learning.

We launched our marketing services and enterprise talent management services to enterprise customers. This allows us to provide the enterprise customers with online talent assessment, training, and learning services. These services have enabled us to broaden our service offerings into enterprise customers. We have evolved into a two-sided service provider for both individuals and enterprises. Our new platforms, JiangZhen and QianChi, continue to serve as our main growth engines, and our pipeline for enterprise services is strong. We are encouraged by the continued strength of our businesses, which are supported by a growing shift from offline to online skills development.

Second, we have remained prudent in our operating expenses while upholding our commitment to product development. We applied closer scrutiny of ROI on our sales and marketing and G&A expenses. We also channeled more resources towards cross-selling additional services to our existing customers. At the same time, we maintained a careful approach to our investment in R&D. We are confident that by taking proactive steps to control expenses in the near term, we are boosting the durability and agility of our business operations in the long term.

Lastly, we have allocated more resources to explore cross-selling opportunities. We are constantly exploring new ways to cross-sell add-on services to enhance our customers' lifelong value. We have introduced our marketing services to enterprise customers on QiNiu, and we intend to replicate our proven business model on JiangZhen, QianChi, and other platforms. We will leverage our proprietary technology and supporting systems to launch SaaS services to enterprises.

In June 2022, we launched our enterprise talent management services, which integrated talent assessment, training, and management functions for enterprise customers. We are working with a top-tier media group in China in a pilot program to further our SaaS service initiatives.

Looking ahead, we believe these strategies leave us well-positioned to balance revenue growth and margin expansion in an uncertain environment. Although we foresee 2023 as a challenging calendar year, particularly in the first half, we are also uncovering many market trends favorable to our company. These include the continued shift from offline to online, the growing digital transformation, greater work-from-home flexibility, renewed business investment, and continuous skill development for workforces.

In addition, China's general public has more diverse personal development and lifelong learning needs. With more supportive government policies for vocational training, this should continue to boost the growth trajectory of China's adult learning market. As the industry leader in the adult personal interest learning, we should be able to seize those emerging business opportunities and capitalize on their market potential.

As we look to the remainder of the fiscal year 2023, we see the tailwinds of upskilling and reskilling continue to sustain our revenue growth momentum. Our 18.8% year-over-year increase in pipeline should also provide a comfortable cushion for our revenue growth for the remainder of the fiscal year. This is evidenced by our RMB467.5 million in contract liabilities at the end of the second fiscal quarter.

In summary, we believe that we have developed the resilience and agility needed to thrive regardless of market conditions. Our success will come from our emphasis on quality and our passion for improving our users' lives. The systems we have built are robust and flexible, and we are always focused on making improvements to our platforms. Above all, we have a visionary, seasoned management team with a track record of entrepreneurial success through various economic cycles. The opportunity available to us is massive, well beyond 2023. We remain committed to our development trajectory, the exploration of new expansion avenues, and the creation of long-term value for our shareholders.

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

Tim Xie: Thank you, Mr. Li. 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 2023 that ended on December 31, 2022; 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 2023, excluding the impact from revenues from the disposed group, we grew our total revenues by 1.9% year-over-year and 19.3% quarter-over-quarter to 786.4 million, mainly driven by growth within our individual online learning services.

Among our revenues, revenues from individual online learning services grew by 4.7% year-over-year to 704 million or 89.5% of total revenues, mainly due to continued demand for other personal interest courses, consistent with our strategy to diversify course offerings. Our gross billings of individual online learning services increased by 23.1% from the first quarter of fiscal 2023 to 818.8 million.

Revenues from enterprise services increased by 68.2% year-over-year to 82.3 million or 10.5% of total revenues, primarily driven by enterprise customers' strong demand for marketing services and talent management services.

Gross profit was 687.2 million, representing a stable gross margin of 87.4%, compared to 87.5% in the same period last year.

Total operating expenses increased to 731.7 million from 650.3 million last year.

To break this down, sales and marketing expenses increased by 11.2% year-over-year to 622.9 million as we increased spending on marketing and promotion activities for other personal interest courses. As a percent of total revenue, non-GAAP sales and marketing expenses, which excluded share-based compensation, increased to 77.3% from 68.5% a year ago.

Research and development expenses increased by 24.6% year-over-year to 64.3 million, as a result of our strategy of investing in technology and data analytics. As a percent of total revenue, non-GAAP R&D expenses, which excluded share-based compensation, increased to 5.6% from 5.2% a year ago.

General and administrative expenses increased by 15.5% year-over-year to 44.5 million, as we continued to operate efficiently. As a percentage of total revenue, non-GAAP G&A expenses, which excluded share-based compensation, decreased to 3.1% from 3.7% a year ago.

Net loss was 41.4 million. Excluding share-based compensation, adjusted net income was 21.8 million, representing an adjusted net margin of 2.8% during the quarter.

Basic and diluted net loss per share were both RMB0.89. Adjusted basic and diluted net income per share were both RMB0.07 during the quarter.

Turning to our balance sheet, as of December 31, 2022, our company held 525.7 million in cash and cash equivalents and short-term investments, compared to 399.1 million as of June 30, 2022. We completed our initial public offering in January 2023, with a partial greenshoe being exercised in February 2023, the proceeds of which will be recorded on our balance sheet for the next quarter.

Lastly, I want to provide some color for our outlook. For the third quarter of fiscal year 2023 that ends on March 31, 2023, we expect revenues to be between 750 million and 780 million, representing a year-over-year increase of between 8.6% and 12.9%, after taking into consideration the challenging market conditions across the industry. Our bottom line during the third fiscal quarter will also be impacted by the listing fees associated with our IPO.

While we see some indications that the macro environment may improve in the quarters to come, the present situation remains uncertain and volatile. In the near term, we are adopting a prudent approach to our cost structure and expenses to maximize our operational agility and adaptability to macro volatility. In the long run, we strongly believe that our robust cash position, optimized cost structure, and diversified revenue streams have positioned us well to overcome challenges and seize growth opportunities. We remain confident in our ability to balance growth and profitability and deliver sustainable value to our shareholders.

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

Questions and Answers

Operator: And thank you. We will now begin the question-and-answer session. (Operator Instructions). When asking a question in Chinese, please translate your question in English for the convenience of everyone on the call.

Our first question today will come from Liping Zhao of CICC.

Liping Zhao: (Speaking foreign language). I have two questions here. First, do you see increasing demand of your financial literacy courses since the beginning of the year? And what are the future growth drivers for this business line?

And second question is how is your progress of other personal interest courses during the quarter?

Peng Li: (Speaking foreign language).

(Translated). I'll take the first question. First of all, thank you for your question. As our reporting period is for fiscal year 2023 second quarter ended the end of December 2022 calendar year, we think that if I remember it right, the major adjustment of the Covid prevention policies for a majority of the cities here in China, are adjusted at the mid or the end of December 2022. So, the data for the second quarter fiscal year 2023 would hardly help us to provide any color this subject.

As for the growth drivers for our future business, our diversified offering strategy has boosted our revenue quality. Our financial literacy learning courses are an important part of our individual learning services. They have maintained sound and healthy growth with increase in the fiscal year 2023 second quarter compared to the fiscal year 2023 first quarter. In August 2021, we expanded our offerings into selective repertoire of other personal interest courses. We also introduced brands like JiangZhen and QianChi. These income resources , beyond the financial literacy courses, have diversified our revenue sources.

Of course, we are preparing for the post-Covid market. After 3 years of development and learning, we concluded that there might be three big indicators that might influence our business.

First of all, individual learners are more accustomed to the online paid services. Second, people want to up-skill themselves and the demand is quite urgent. They are pursuing higher competitiveness through continuous learning, which probably would be one of the best of the survive and thrive strategies against a new economic norm. Learning is a must for everyone in the post-Covid world. Thirdly, people are caring more both about their mental and physical health, and they are exhibiting higher willingness through learning courses online.

In conclusion, we're continuing to expand our two-sided business strategy while adapting to the market and introducing courses that will serve users' needs. We continue to invest in enterprise services, and strive to keep our business stable, sound and fast-growing.

I would like also to take your second question. Since August 2021, when we expanded our courses from the financial literacy to other personal interest courses, we have already rolled out and introduced courses like short-video production, personal wellbeing courses, electronic keyboard, Chinese painting, data analysis, etc. We have already launched more than 10 courses. In this fiscal quarter and also in the near future, we are also investing our efforts to scale these courses to deepen the content and covers more thorough aspects. We're also testing new courses and introduction when the time is right.

Okay. That's all for my answer. Thank you for your question.

Operator: Jeffrey Chan of CLSA.

Jeffrey Chan: So, I have two questions here. The first one is about the target revenue portions of your individual online learning segment and the enterprise segment in the longer-term future. Would you like to maintain the current share of the revenue contribution of your individual segment? Or increase the contribution of the enterprise segment to a current level?

And my second question is about the GP margin. So, would you mind sharing about what are the GP margin of your financial literacy courses and also enterprise service segment, or what are the relative revenue levels of these segments?

Peng Li: Okay. (Speaking foreign language).

(Translated). Thank you for your question. For the past 3 years, we have been continuously investing our efforts in the individual online learning service market. We have accumulated a large user base and extensive service experience. We have always focused our efforts in developing our IT system and infrastructure, which empowers our business model to become scalable. We have been exploring all aspects to take full advantage of our experiences, tools, and systems to expand our customer base. We continue to diversify our course offerings for individual customers, upgrade core course services and expand scale.

In addition, we have made several progresses in serving enterprise customers. We continue to invest our efforts. However, we have also to consider the elongated pipeline time and revenue recognition. That's why that we expect a continued growth in our revenue from enterprise services. We also see that the revenues from individual customers will still take the lion's share.

We're not pursuing a specific share target between these two revenue sources, like whether to maintain the current 80% as you mentioned. We focus our efforts on maximizing the synergy between serving our individual customers and enterprise customers in order to create the maximized value for our shareholders.

Okay. That's all.

Tim Xie: Thank you. Regarding your second question, I will answer. In terms of the GP margin for our Group described in your question. And our GP margin, I think, is a pure financial indicator. Generally speaking, due to the different pricing base and cost structure, GP margin will differ between individual learning services and enterprise services. And currently, I think as a whole Group, we take a holistic perspective when allocate resources and performance appraisal for the different business. All are based on the QSG Group as a whole.

We currently do not distinguish between segments at present technically. Because at the current stage, the enterprise businesses still take up a minority part of the total business. And our financial figures are also based on the Group as a whole according to the disclosure requirements from the accounting perspective. According to those financial report figures of the fiscal year 2023, quarter two, the GP margin this quarter on the whole remains stable at 87.4% compared to that of the last quarter for fiscal year 2022.

And lastly, I want to add a point that as a whole, we treat the net profit margin more important than the GP margin because each product mix and each business has its own profit margin characteristic we will trade off, and to achieve a better net profit margin currently. Hope that helps. Thank you.

Jeffrey Chan: Thank you.

Operator: Michelle Fang of Citi.

Michelle Fang: Thank you for the opportunity for me to ask questions. I just have a small question that do we have the repurchase rate for different courses. Could you give us some color on that? Thank you.

Tim Xie: Michelle, your question is about the repeat purchase?

Michelle Fang: Yes, repurchase rate.

Tim Xie: Okay. Thanks much for your question. I think the company is continuously committed to providing users with better courses and services. So, extending the lifecycle value of users on the platform is our major business objective. Our strategy is to expand and deepen the scale of the courses. For example, like for QiNiu, we started the repeat purchase under the QiNiu brand

and the repurchase rate for the past 12 months has risen, and we have been keeping it at a very stable level, above 60%.

Though it just have been months after we introduced our personal interest courses and the JiangZhen brand and QianChi brand, we have made very good progress in the repeat purchase activity because, since the early stage of the two brands, our major objective is to enlarge the scale of the first purchase. And we only started the repeat purchase promotion since the second quarter of fiscal year 2023. And under the current operation strategy and planning, we will carry out the repeat purchase business of our courses in due course.

Though the two brands were launched not long ago, we still adhere to the strategy of continuously expanding and deepening the scale of the curriculum content, and developing and testing the new curriculum in small-scale . At present, the JiangZhen and QianChi business is growing strongly and the launched curriculum is still in the process of interim growth. We have reserved corresponding resources, which will be launched in the near future.

In terms of the repeat purchase, I think in the recent quarter, we have made big progress in terms of the short-video production course and the JiangZhen brand. And we will make more progress in terms of our other personal interest under the two brands. We believe the repeat purchase will become sizable in the future, which will also make a very sizable revenue growth potential in our future business. I hope that helps.

Michelle Fang: Okay. Thank you so much.

Operator: At this time, we will conclude our question-and-answer session. I'd like to turn the conference back over to management for any closing remarks.

Leah Guo: Thank you again for joining our call today. If you have any further questions, please feel free to contact us or 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. We do thank you for attending today's presentation. And you may now disconnect your lines.