

QuantaSing Group
Q3 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

Steve Silver, Argus Research

Howard Halpern, Taglich Brothers

Hunter Diamond, Diamond Equity Research

Michael Kopinski, Noble Capital Markets

Jack Sun, Gelonghui Research

BJ Cook, Singular Research

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 the management's prepared remarks. Please note that today's event is being recorded.

I 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 third 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 give a business overview for the quarter; then Tim will discuss 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 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 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 we 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: Hello, everyone, and thank you all for joining us today. This quarter, we continued to expand our course offerings to better serve the growing elderly learning market. While continuing to provide learning courses for our customer base, we are offering a wider range of targeted products to our users. These efforts put us in a good position to monetize our user base, boost engagement, and drive revenue in addition to our diverse educational offerings.

Our revenue declined slightly by 3.6% from the last quarter, but grew by 17.1% year-over-year. Considering the nature of our business model, as revenue will be impacted by financial recognition rules, we believe that gross billings better represents our business growth.

During this quarter, our gross billings from individual online learning services were RMB981.5 million, representing 3.9% quarter-over-quarter growth and 22.1% year-over-year growth.

Now, let's take a look at our courses for elderly users. We are gaining more elderly users by improving our course offerings for this group. A recent industry report shows that 77.2% of middle-aged and elderly people are interested in learning for personal interest. Paying for classes has become a common way to learn, with 78.5% of learners in older cohorts mainly choosing online platforms for interest courses. Elderly users are especially interested in unique Chinese regimen theories, for example, in traditional exercise, diet, and Traditional Chinese Medicine, or TCM.

In addition, these users often have more free time and are willing to learn through more systematic guidance of traditional health regimens and TCM. Based on our experience, we have also found that elderly users are eager to try out a wide variety of different courses.

To meet the focus on fitness among our elderly users, we have launched more recreational TCM-related courses. One new course is Ba Duan Jin Exercise. It combines physical movements with controlled breathing. This helps the flow of vital energy and makes blood circulation better. To cater to older users' willingness to try a bit of everything, we also launched a series of mini-lectures. Each of these lectures is smaller in scope, making them easier to approach. One example is our 6-day program introducing TCM theory. It focuses on how vital energy and blood work in the body. This course uses exercises to help cure common issues like being unable to sleep.

Our mini-courses have shorter learning periods and lower prices, which makes them accessible to more people. The new TCM courses are also good additions to our existing courses, like standing meditation, calligraphy, and piano, giving our users a wider range of options.

In addition to working with local communities, we launched an educational tour program in April to expand our revenue streams. This program allows users to learn outdoors, giving them a unique experience. The program is especially appealing to our elderly users, who embrace the opportunity to venture into the world and learn. It also connects our online and offline services. Online activities lead to offline engagement, and vice versa. This fully meets the learning and

social needs of middle-aged and elderly users. Our approach makes the overall learning experience more dynamic and interconnected.

At the same time, we have worked closely with local communities. We do this to provide a more meaningful experience for our users and help them feel a greater sense of belonging. For example, in March, we offered free offline courses to communities in Beijing. We received positive feedback. People said our activities, especially standing meditation and calligraphy, greatly enriched the spiritual lives of elderly residents.

Local communities value the elderly highly and care for their needs. They recognize the demand for interest-based learning among middle-aged and elderly people. They actively promote the idea of shifting from passive aging to active aging, which aligns with our beliefs.

With more users actively participating in our community, we are building stronger connections among learners. This enhances their sense of belonging to our platform. As this sense of community grows, users are more likely to share their good experiences of our platform with others. The result is a positive cycle which has greatly boosted our course popularity, and drawn in new users. The number of registered users for our recreation and leisure courses has grown rapidly. It has increased from 3.3 million a year ago to 13.1 million.

We are also continuing to build a growing learning platform for our users. Our data analysis and internal market research show that skills upgrading courses, especially short-video courses, remain a popular choice for learning. According to a report, China has over 1 billion online audiovisual users. 98.3% of internet users in China use audiovisual services. The average person watches short videos for 151 minutes per day. This trend is driven by the convenience and ease of access of short-video formats. These allow users to engage with content quickly and efficiently, fitting into their busy schedules. As a result, we have seen a steady increase in user engagement and satisfaction for these types of courses, as shown by an impressive 98.5% satisfaction rate.

Using our test and scale approach, we have increased investment in short-video courses in line with market trends. We continue to use diverse formats to attract users. Building upon the success of our previous training camp offerings, we upgraded our short-video course. Our upgrade incorporates valuable feedback from our dedicated community of learners and our latest observations of the short-video industry.

The enhanced course offering provides a well-rounded and practical learning experience. It covers advanced technical, emerging trends, personalized guidance on overall account positioning, and copywriting strategies. It also provides an immersive learning environment with live sessions, interactive workshops, and a vibrant community of like-minded individuals.

The course meets the evolving needs of our users and helps our learning platform remains competitive and innovative in the market. As a result of these efforts, we are seeing the growth of gross billings from individual online learning services, and we expect to see revenue growth in the next fiscal quarter. Our strategic focus on skills upgrading courses, especially short video, is in line with market demand. This positions us for continued growth and success in the learning and development space.

Our commitment to innovation and growth goes beyond our core educational offerings. We now have a large customer base of middle-aged and elderly users for our learning business. We are in a great position to cross-sell additional products and services to them. We aim to encourage these engaged learners to use our e-commerce business, to extend the LTV of our paying users and leverage our registered user base. We will offer them a full range of learning materials and related products. To do so, we also leverage our established online infrastructure, including our WeChat mini-program and our existing livestreaming system. This will minimize our e-commerce product's operating costs, and optimize the margin.

By truly understanding what our users want and need, we can give them a smooth, customized experience that will benefit both our learners and our business. To be more specific, there is growing demand from this group of users for healthcare offerings. We are leveraging this user base to expand our product offerings. Recently, we released a series of healthcare products targeting the elderly market. At the same time, we continue to provide them with learning courses. These healthcare products generated a gross -- a GMV of RMB9.5 million in March and RMB10.2 million in April.

We have used our existing users' profiles to help us to develop private label products that we sell through live e-commerce, for example Chinese liquor. Using our deep industry experience and the user feedback and data we've gathered, we are developing new products that match changing customer likes and wants. By using data to guide us, we plan to make innovative and high-quality private label products that appeal to our customers and drive growth in this promising segment.

At the same time, to better serve our elderly customers, we have created a separate business team. This team focuses on developing and marketing customer products specially designed for the middle-aged and elderly. We made this decision based on our experience interacting with this demographic group. We noticed that middle-aged and elderly individuals show willingness to purchase products and services. This aligns with China's large population and rising living standards, making the silver economy a sunrise industry.

Now let's turn to our overseas development. Our Kelly's Education platform in Hong Kong is a testing area before we expand more broadly into the learning market overseas. Kelly's allows us to test market conditions, how engaged users are, and how effective our offerings are, all in a controlled environment before scaling up to larger markets.

On May 27, Kelly's Education opened its first offline school in Tsuen Wan, Hong Kong, combining online and traditional learning methods. The interactive learning center offers high-quality educational resources and teaching, and an engaging experience for children. Kelly's is now positioned as a premier children's English learning platform in Hong Kong.

We also plan to open an office in Hong Kong this June to extend our reach to the overseas market. This expansion represents our growing commitment to expand our business overseas. Our Hong Kong office will serve as a base for us to pursue our ongoing M&A efforts. It will also function as a launch pad for our company to enter new markets around the world.

During the quarter, we improved our courses for the elderly learning market and invested in popular short-video courses. This helped grow our user base and set the stage for future revenue streams. For our private-label Chinese liquor products, we used a data-driven approach to guide innovation. We further leveraged our existing user base to expand into consumer product sales.

We have made good progress with Kelly's Education, further solidifying our business presence in the Hong Kong market. By continuously enhancing learning experiences and offering comprehensive ecosystems, we are well-positioned for sustained growth across both education and e-commerce.

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

Tim Xie: Thank you. Before I go to the details of our financial results, please note that all amounts are in RMB terms, that the reporting period is the third 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 third quarter of fiscal year 2024, we achieved total revenues of 945.6 million, a year-over-year growth of 17.1%, mainly driven by the growth in revenues from skills upgrading courses.

Among our revenues, revenues from individual online learning services grew by 14.3% year-over-year to 828.1 million, or 87.6% of total revenues, mainly due to continued demand for skills upgrading courses. Our gross billings of individual online learning services increased by 22.1% year-over-year to 981.5 million.

Revenues from enterprise services were 65.1 million, a change of 19.8% from a year ago, and representing 6.9% of total revenues, primarily due to a decline in revenues from related party transactions.

Gross profit was 799.7 million, representing a gross margin of 84.6%, compared to 87.5% in the same period last year.

Total operating expenses were 804.9 million, compared to 729.3 million in the same period last year.

To break this down, sales and marketing expenses were 729.6 million, representing a change of 15.6% year-over-year, mainly because we increased our spending on outsourcing labor and marketing efforts. As a percentage of total revenue, non-GAAP sales and marketing expenses, which excluded share-based compensation, remained stable at 76.9%, compared to 76.7% a year ago.

Research and development expenses were 38.8 million, representing a decrease of 21.7% year-over-year, primarily driven by our more selective decisions regarding our R&D initiatives. As a percentage of total revenue, non-GAAP R&D expenses, which exclude share-based compensation, decreased to 3.7% from 5.1% a year ago.

General and administrative expenses were 36.4 million, representing a decrease of 24.7% year-over-year, primarily due to decreases in share-based compensation and office expenses. As a percentage of total revenue, non-GAAP G&A expenses, which excluded share-based compensation, decreased to 3% from 4% a year ago.

Net income was 14.6 million. Excluding share-based compensation, adjusted net income was 31.9 million, representing an adjusted net margin of 3.4% during the quarter.

Basic and diluted net income per share were RMB0.09 during the quarter. Adjusted basic and diluted net income per share were RMB0.19 during the quarter.

Turning to our balance sheet. As of March 31, 2024, our company held 1,149.9 million in cash and cash equivalents and short-term investments, compared to 930.6 million as of June 30, 2023.

Finally, I want to provide some color on our outlook. For the fourth 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 8.7% and 12.3%. These projections take into consideration the current market conditions prevailing in the industry.

During the quarter, while we diligently monitored our learning business and focused on maintaining profitability, we strategically allocated our cash flow into new initiatives with our test-and-scale approach, ensuring the creation of enduring value for our shareholders. Moving forward, our strategic trajectory will continue to be guided by our commitment to sustainable and profitable growth.

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

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Steve Silver from Argus.

Steve Silver: My question is given the economic challenges being seen in China right now, and the continued strength and growth of QuantaSing's balance sheet, just wondering if there's an opportunity to potentially accelerate the expansion of the e-commerce business offerings, or whether it really just takes time more than money to build scale in order to introduce new offerings more quickly?

Peng Li: Okay. Thank you for your question. I'll take the question. I will answer in Chinese and Leah will translate for me. (Speaking foreign language).

(Translated). We have already recognized the great potential of the buying power of the silver cohort, which we are already serving. Compared to the newborns in China, clearly, this silver cohort represents a greater population, and this trend will continue for the next 30 years. While

our strong balance sheet provides with our solid foundation, we think this is a very good foundation for us to start the new business. But as we all know, it not only takes a strong, solid financial foundation to initiate a success in the new business; we also need to fully understand and comprehend the demands of the customers and their buying behaviors and we need to test and then scale our business model.

We have been observing and also trying to find the real demand of the silver cohort, which we are serving right now. And we are trying our best to provide the products that cater for their demand. So you may have already noticed that we have already presented a few results that we can further discuss in terms of the Chinese liquor and also in the health management sector. We are also developing our private label products. But of course these efforts will take more time to deep-dive into this sector. When we have more progress, we will be ready to share with you.

Okay. Thank you all for the questions, thank you.

Steve Silver: Thank you.

Operator: Howard Halpern from Taglich Brothers.

Howard Halpern: Congratulations on a productive quarter and opening of your first offline education from Kelley Services. That's where my question comes in. Will you be expanding the offline education services of Kelley Education over the next couple of years?

Tim Xie: Thank you, Howard. I will take this question. Yes, actually, we continuously assess the opportunities to enhance our service offerings, and meet the evolving needs of our students. And for Kelly, that is the local Hong Kong students. While our primary focus has been on online learning, we also recognize the value of offline learning in certain scenarios to consider the needs of the local students, the local market characteristics, the features of the local market.

The recent opening of our inaugural offline school shows that we are actively exploring avenues to expand our offline presence. This milestone marks a significant step forward in our commitment to providing holistic learning experiences that cater to diverse learning preferences and needs, especially with the support of our business partners from the local market. And also, I think we are continuously to take every effort we can do to serve the local actual needs of our customers.

For Kelly's, I think not only it performs well in the online, but also, I think we may see new opportunities offline, so we will do that.

Howard Halpern: Okay. Thank you. Keep up the great work.

Operator: Hunter Diamond from Diamond Equity Research.

Hunter Diamond: So in the recent quarters, you emphasized the application of AI technology and other AI-related areas. Can you explain how this will impact your offerings, and additionally, how it might impact your financials in the long run, for instance, the course offerings or the cost reductions?

Peng Li: Okay. I'll take the question. (Speaking foreign language).

(Translated). We have been using and integrating AI technology into our online learning platform. This is one of our strategic moves. Right now, we use AI to optimize our platform's efficiency and also user experience. First of all, AI allows us to personalize each learner's learning journey. We can offer tailored recommendations and adaptive learning paths based on the individual strengths and weaknesses and learning preferences. This approach can boost engagement and improve learning outcomes. In addition, AI plays a crucial role in the content regulation and quality assurance. It can help us to efficiently monitor and assess the relevance, accuracy and effectiveness of the content available on our platform. And this also ensures that it meets the highest educational standards and reflects the latest development in each area.

In terms of the financial perspective, we anticipate several positive outcomes in the long run. First of all, implementing AI-driven efficiency measures is expected to lead to cost savings through streamlined operations and resource optimization. Second, the enhanced user experience resulting from the AI-powered personalization is likely to drive increased user engagement and retention, ultimately, contributing to the revenue growth.

Hunter Diamond: Okay. That's all for the question, thank you.

Operator: Michael Kopinski from Noble Capital Markets.

Michael Kopinski: Can you talk a little bit -- you talked a little bit about some of your new initiatives. Can you talk about how you plan to build brand strength and/or awareness for your private label products?

Tim Xie: Yes, thank you for the question. I think, first of all, we are committed to ensuring that our private label products reflect our brand values, and meet the highest standards of quality, reliability and innovation. That's all for our users. Our goal is to consistently deliver exceptional products that foster trust and loyalty among our customers. In addition, we recognize the importance of effective marketing and communication strategies to drive brand awareness.

We leverage a combination of digital marketing channels, social media platforms, influencer partnerships and focused advertising campaigns, which we have also built a solid infrastructure, and we have accumulated massive operating experiences in this area. And this approach allows us to reach our target audience and customers and showcase the unique value proposition of our private label products. So that's all we are doing, our most offers recently.

Also, for customer engagement and feedback, I think they are integral components of our brand-building efforts. By actively soliciting and responding to feedback, we demonstrate our commitment to customer satisfaction and the continuous improvement of our business. And this is a data-driven process, I think. And also by doing so, we further enhance brand perception and loyalty. As we continue to execute on our brand-building initiatives, we remain agile and responsive to evolving market trends and we will monitor the data and customer preferences.

Our goal is to establish our private label products as trusted and preferred choices within their respective categories, which will ultimately, drive long-term brand strength and success, and also our long-term value to both to our customers and shareholders. Thank you.

Michael Kopinski: Thank you for the color.

Operator: (Operator Instructions). Jack Sun from Gelonghui Research.

Jack Sun: Congratulations on a strong quarter. I'm Jack Sun from Gelonghui Zhonggai Yanjiuyuan. On behalf of global investors, I would like to ask management a question on the registered users and the quarterly revenue. Registered users for QuantaSing reached 121 million with significant growth on quarterly revenue. What will be the outlook for future registered users? And could you give us some color on the future quarterly revenue? We look forward for the future performance of the company.

Tim Xie: Thank you for the question. I think first, QuantaSing is a relatively new company. We just launched our business in July 2019. So during the past nearly 5 years of operation, we have experienced a rapid growth in this unique interest-based online learning market for adults. So most of our adults are the middle-aged and elderly people in China, which is a growing population, the demographic. So that's why during the past 5 years, we have experienced rapid growth, both for the number of strategies users and also for the revenue.

So I think in the future, because our aim is to provide quality services, that is online learning and also other services, and also maybe like the private-label products, maybe provide the -- we will develop and launch and provide the quality products to our customers. So based on this solid and large user base, I think we have set up a very good start for our value delivery, and also for the revenue growth in the future by leveraging our capability for the cross-selling among the courses, among the online courses, and also for our extension of the value of the existing customers.

Some of them may be the paid users and some of them may be just registered users. So we have a great potential to extend the lifetime value of our existing users. So I think this is a real start for the revenue growth and for the platform growth in the future, because we have a solid base of the customers and also a solid base of the infrastructure, the technology. For example, the livestreaming e-commerce platform, the livestreaming online course delivering platform. So all of this sets up solid base for the customers' value in the future, both for customers themselves and for the platform. Thank you.

Jack Sun: Okay. Thank you.

Operator: (Operator Instructions). BJ Cook from Singular Research.

BJ Cook: I was just curious if you have any plans to deploy cash on the balance sheet?

Tim Xie: Yes, actually I think considering the macro environment and also the business expansion in the future, we should have a house balance sheet to set up a solid base for our expansion. For example, actually, we are considering and developing our private label products, and we will do some marketing and we will do some product and supply chain development. That means we may have some assets and we may have some -- we have to deploy some of our balance sheet, for example, the cash in the new area to increase our new initiatives.

So that is maybe one of the -- one way to deploy the cash, which is a major part of the assets on our balance sheet. And also, we are actually considering for some maybe share repurchase for our capital market activities. And also, we are considering and maybe in the next following period, we will discuss with the Board for some new initiatives for the cash management. So I think during the past 5 years of operating, we always adopt a very conservative methodology for our business goals.

So that during the past time, we have achieved sustainable and profitable growth in the recent years. So I think that's the business methodology and principle for our operation. So I think actually, we will do our best to try to make the most use of the balance sheet assets to achieve a greater value for our shareholders. Thank you.

BJ Cook: Thank you.

Operator: Thank you. (Operator Instructions). As there are no further questions, I would like to hand the conference back to the management for closing remarks.

Leah Guo: Thank you for joining our call today. If you have any further questions, please 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.