Noah Holdings Limited [NOAH]
Second Quarter 2020 Results Conference Call
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Company Representatives
Jingbo Wang, Co-founder, Chairlady, Chief Executive Officer
Pan Qing, CFO

Analysts
Daphne Poon, Citi
Xue Yuan, CICC
Ethan Wang, CLSA
Daqi Jiao, JPMorgan

Presentation

Operator: Welcome to the Noah Holdings Limited Second Quarter 2020 Earnings Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note this event is being recorded.

I would now like to turn the conference over to Chairlady Wong. Please go ahead.

Jingbo Wang: Thank you, operator. (Speaking Foreign Language).

(Translated). Regarding the teleconference agenda today, I will start with my viewpoint on macro level, then summarize Noah's overall performance in the second quarter of 2020, the developments of major business segments, as well as a settlement we hope to reach with our clients on the Camsing incident. Then, Grant will present financial results of the second quarter. This call will be concluded after a Q&A in the end.

The wealth management industry has been experiencing underlying transformation in China, which has been accelerated by the COVID-19 epidemic. In my view, 2020 is the critical year for the transformation of Noah. Through organizational capacity building, client insight, and process restructuring, Noah is changing to be more adaptable to the new environment of wealth management and asset management in China.

With the "deleveraging" in 2018 and the rectification of chaos in financial industry in China in 2019, the tightening of supervision and the impact of the epidemic, NAV-based products promoted by the new Guidance on Standardizing Asset Management Business of Financial Institutions have quickly developed into the mainstream products in China's wealth management industry. The renewed demands from clients soar beyond industry expectations. We believe that further investor education and updated client "perceptions" are the keys to NAV-based wealth management.

For the segment of wealth management, we have made much efforts to train product-driven relationship managers as investment consultants, we launched our self-developed mutual funds investment consultancy platform. For the segment of asset management, we have strengthened our investment research and direct investment capabilities, and promoted direct sales and multi-channel institutional sales, all of which have made progress to some extent.

Next, I will report the second quarter results from the aspects of wealth management, asset management and operational efficiency:

Starting from the third quarter of 2019, Noah has ceased the offering of "non-standardized single counterparty private credit" products and made thorough transformation to standardized products, for which RMB 17.97 billion was distributed in the second quarter of 2020, up 198.5% year-on-year. The transaction value of standardized products in the first half of 2020 reached RMB 37.08 billion, increased more than three times over the same corresponding period last year. Excluding non-standardized single counterparty private credit products, transaction value rose by 45.2% year-on-year.

This data indicated a preliminary success of the transformation, and the share of non-standardized single counterparty private credit products in transaction value before the transformation has been completely replaced by that of standardized products. In the field of standardized products, our new capabilities are being developed and we expect more potential for growth in the future.

In the second quarter of 2020, Noah achieved net revenues of RMB750 million, up 0.2% quarter-on-quarter, and non-GAAP net income attributable to shareholders of RMB307 million, up 20.1% quarter-on-quarter, which is also the second highest record since our listing. The impact of COVID-19 epidemic on the revenue of the overseas insurance sales has been offset by the prominent rally of the A-share market and more successful exits of primary market products, revealing our long-term product screening and direct investment capabilities and once again illustrating the countercyclical feature of our business.

In the second quarter, the net revenue of overseas sectors was RMB180 million, down 21.0% year-on-year and down 11.0% quarter-on-quarter, accounting for 24.7% of the Group's total net revenue.

In the second quarter of 2020, including mutual funds, there were 14,703 active clients, up 48.7% year-on-year, of which 11,336 were active clients of mutual funds, up 183.0% year-on-year; while the number of black card clients was 900 as of the end of June 2020, up 5.4% year-on-year.

A new compensation scheme was implemented for the team of relationship managers in the second quarter. As of June 30, the turnover rate of elite relationship managers remained at the industry's lowest level of 1.4%. The online mutual fund workstation for relationship managers was launched, providing more tools for their business development.

In the second quarter, transaction value of our insurance business fell by 17.8% year-on-year and 25.2% quarter-on-quarter due to the global epidemic and travel restrictions. However, more pre-orders have been arranged in response to client demands, and we expect once the travel restrictions is lifted, overseas revenues will surge significantly.

For the segment of asset management, as of June 30, 2020, the asset under management of Gopher was RMB159.4 billion, down 1.4% quarter-on-quarter and down 11.8% year-on-year, mainly due to our voluntary early redemption of single-counterparty private credit funds, resulting in a net decline of RMB 5.8 billion in size.

Excluding the impact of early redemption of those credit funds, the asset under management of other asset classes increased by RMB3.52 billion quarter-on-quarter, of which private equities and public securities increased by RMB2.0 billion and RMB2.6 billion respectively; overseas asset under management was RMB25.77 billion, accounting for 16.2% of the Group's total asset under management, remaining at the same level of the previous quarter.

Gopher is a global multi-asset class asset management company. We have been continuously improving its asset allocation capability. An independent fixed-income division has been established to meet high net worth clients' demand for stable returns. As of June 30, 2020, this specific asset category had AUM of RMB4.66 billion, up 42.5% year-on-year and up 10.4% quarter-on-quarter.

Meanwhile, Gopher has been strengthening its credit rating and investment research capabilities. The focus of primary market is still on FOFs, S secondary Fund and co-investment funds, which AUM reached RMB107.71 billion at the end of the second quarter, up 3.2% year-on-year and up 1.9% quarter-on-quarter.

For real estate investment, the strategy is to focus on preferred equities of residential projects, which AUM reached RMB 17.24 billion at the end of the second quarter, down 10% year-over-year and down 5.4% quarter-on-quarter. For public securities, the focus is on funds of target returns, with a total of RMB11.83 billion under management at the end of the second quarter, up 45.1% year-on-year and up 28.4% quarter-on-quarter.

In 2020, Noah and Gopher’s key recommended configuration products for high net worth clients are equity and equity-debt hybrid products with 3-year lockup term. It is not an illusory rhetoric to believe in the value of the best portfolio managers and long-term value. Noah's research has found that through a 3-year average holding period, while partially sacrificing some liquidity, the level of positive returns is adequate to meet and serve the needs of wealth management clients.

In the second quarter of 2020, for the business management, we initiated the design of a new organizational structure, conducted senior management team building, co-created new evaluation criteria of senior management, and reached a preliminary consensus. Meanwhile, the importance of technology in driving business has been upgraded to an unprecedented level, compared with its previous supporting function. We believe that the investment philosophy of wealth management and asset managers cannot just stay as theory, and some instrumental measures should be provided, by which relationship managers and clients can gradually reach a consensus. All of these can be achieved through technological means.

Supported by technology tools, clients can identify exactly whether the product drawdown is beyond the originally set risk preference. A candid communication is formed among the asset manager, the relationship manager and the client. The previous requirement for wealth management was focused only on duration and expected returns, and the client wealth management was focused only on whether the distribution institution has the ability to provide implicit guarantee, whether implicit guarantee is promised, and investment return was the only criterion for measuring client satisfaction. Transforming into NAV-based wealth management products, the biggest difference for relationship managers is that not only are investment results important, but so are investment strategy and process.

In June 2020, we submitted an application for the license on mutual fund investment advisory in China, and in the same month, our overseas mutual fund platform, iNoah, was launched on schedule. We are gradually building Noah's global open mutual fund platform.

The epidemic has accelerated the company's digitalization and online transformation. From January 16, 2020, Noah hosted the "Virtual Investment Strategy Summit"; "Noah's Staying at Home" online daily conference in February and March, and from April 1, 2020, five other online marketing programs were launched, including Fortune Life, Top Investor, Noah Live Time, Noah International Zero Distance, covering all asset classes. We invited 65 fund managers to share industry dynamics, market trends and investment strategies with clients. By the end of June, 8 series of investor education sessions generated a total of 152,500 page views, covering 30,300 clients.

Driven by new market environment and Noah's paradigm transformation, we are bound to initiate and develop management styles that can adapt to the new market. First of all, we will further clarify that global open products and distribution channels should act as two-wheel drive. Product wise, we will establish screening criteria and quantitative data platforms for mutual funds and private equity; client wise, we will better understand client needs and build a complete database of client requirements.

Noah's future depends on the improvement of organizational capabilities. We will be guided by client needs led by strategic planning, to create a platform-based and mission-oriented organization, with two-wheel drive of qualifications and performance management. Noah aims to achieve the evolution from individual leadership to organizational leadership.

Recently, we have also learned that the regulators might introduce new management measures for independent fund distribution companies, reaffirming the focus on the sale of mutual funds by distribution institutions, for which we have also prepared, and the operation platform for mutual fund sales has been launched. There will be no direct impact on our business after the new measures comes into effect, and we will still focus on cooperating with leading private equity funds through Gopher's FOF and feeder fund models. Our clients will continue to have access to investment opportunities in outstanding private equity products.

Finally, we announce a settlement plan that has been approved regarding the Camsing incident.

Noah has been in business for 15 years and we are grateful for the trust our clients placed in us. We respect the market, respect common sense, and have attracted a group of clients with mature investment concepts. Encountering the Camsing incident in 2019 and experiencing the COVID-19 pandemic in 2020 are indeed huge challenges for Noah.

However, on the basis of continuous trust of clients, Noah still achieved the initial success of paradigm transformation under the difficult environment. Clients continued to trust us, employees remained united to push Noah's transformation forward with a stronger posture. In the most difficult moment, when the salary of all employees was cut, we still maintained the lowest turnover rate in the industry. Every one of us has adhered to Noah's mission and values and clients have continued to give us trust, which have really moved and inspired the management team.

As of August 20, 2020, more than 54% of Camsing clients have continued to place orders with a total amount of nearly 5.1 billion. This is a difficult choice, but it is an active settlement plan. Although we are confident in the victory of this case, we are also very clear that this will be a protracted battle. The management team, upon receiving the approval from the board of directors, proposes a settlement plan with clients. This plan will last for 10 years. In the future, clients will be on the same side as our shareholders and work with us to promote Noah's progress and long-term sustainable development.

After experiencing the Camsing incident and the COVID-19 crisis, the spirit of all Noah's employees has been refreshed. "Never waste a good crisis" is our belief. There are still difficult times ahead, but all Noah's employees will do their best and work harder than before.

Thank clients for their patience, and thank the team for their dedications and services.

Next, our CFO Mr. Pan Qing will present the financial report.

Pan Qing: Thank you, Chairlady Wang. Dear shareholders, analysts and investors, as you might recall, we had anticipated a difficult second quarter as COVID-19 prolonged the recovery of economies, travel restrictions continued to worsen, and the real impact on domestic economy, especially in global export/import situation continued to put pressure on small and mid-businesses. But today, we are very encouraged by the delivery of strong financial results for the second quarter of 2020 on the backdrop that Covid-19 has been ravaging the world's major economies.

First of all, we are not only ahead of the schedule to meet the full year guidance of RMB800 million to 900 million non-GAAP net income target, as we ended up with a non-GAAP net income of 307.2 million for this quarter, and 563.1 million for the first half of 2020, but also reported a record-high income from operations of RMB319.5 million.

Our operating profit margin also improved to 42.7%, attributed to higher performance-based income, and continuously improved operating efficiency.

But first, let me walk you through the revenue and transaction value of the second quarter. Although we are happy with the overall income and margins, we have to admit that the COVID-19-caused travel restrictions continued to impact the overseas business, especially new insurance transactions, which led to a declined one-time commission of RMB126.9 million for the quarter, even when we managed to achieve second consecutive 20 billion mark in transaction value quarter following our transformation of products in 2019. However, we have accumulated over 1,000 overseas insurance pre-orders that are readily convert upon the lift on travel ban.

Although our transformation of product offering is continuing to put structural pressure on one-time commission rate, standardized products' transaction value remained strong, which was close to 18 billion for the quarter, bringing total transaction value to 21.4 billion.

For the second quarter, recurring service revenues reached RMB474.3 million, up 9.7% year-over-year and 5.5% quarter-over-quarter driven by increased AUM in public securities and PE/VC products. We also booked in performance based income of RMB90.6 million which was the second-highest record for us since listing, arising from private equity products as well as standardized funds we placed for our clients; demonstrating increasing capabilities our product selection and investment.

Operating margin also set a historical record for the Company since listing, a combination of attributing factors from increased operation efficiency and also a 50 million government subsidy. But even with the excluding government subsidies, the operating margin is 35.2%, which is at an optimal level we expect to maintain in the coming quarters.

By segment, net revenues from the wealth management business contributed 72.6% of the total net revenues with RMB542.8 million, down by 13.2% year-over-year and flat from last quarter showing impact by the weak performance in overseas insurance sales. Net revenues from the asset management business amounted to RMB181.6 million, up 6.2% year-over-year and 9.8% quarter-over-quarter, which made up 24.3% of the total net revenues.

Our lending business is still under strategy shift from direct lending to loan facilitation. The new business model bears minimum credit risks, as we only provide facilitation services to other financial institutions. It accounted for 3.1% of the total revenues. We will continue to restructure and upgrade this business segment.

As Chairlady Wang has mentioned, we are delighted to see the clear switching in product mix that is in line with our transformation to standardized products. Comparing to the same period last year, 9.75 billion out of 24.4 billion transaction value was the single-counterparty private credit products, while standardized products only took up 24.7% of the pie. After one year of persistent efforts, standardized products now account for 83.1% of the total financial products distributed. We are determined to put clients' needs first and to source and supply safer products. We are committed to diversification and asset allocation.

With the launched of our overseas mutual funds mobile APP, iNoah, together with its parallel onshore mutual funds version, Fund Smile, the Company has built up a global mutual funds platform offering carefully selected products to our clients around the world. And we have reached the RMB10 billion AUM in mutual fund. For the first half of 2020, we have incurred approximately RMB100 million in IT-related expenses.

Moving to our balance sheet. We continue to maintain a healthy financial position and recently Standard and Poor's reaffirmed our investment grade rating. The debt/asset ratio has been lowered to a historical low of 15.9%, with no interest-bearing debt on our book. We believe it is a blessing to maintain a strong balance sheet, which can take us through this cycle of economy that is still filled with unknown challenges. But with that said, we are also closely monitoring the market for strategic opportunities that may help us with the growth of our business and capabilities in the next stage of development.

Moreover, Noah has been increasingly paying attention to responsible investment. As a practitioner of long-term value investment and sustainable development, Noah Holdings Limited and Gopher Asset Management both become signatories of the UN-supported Principles for Responsible Investment, or PRI, investor initiative in April this year. Noah is the first independent wealth management firm from China to participate in this initiative, in line with international standards.

Meanwhile, Noah's MSCI ESG rating was upgraded. We also just released the sixth annual "Noah Sustainability Report", which is available on our newly launched ESG website.

We also feel blessed that our employees remained safe since the breakout of COVID-19, thanks to the effective management by local governments, paired with more online interactions, which ensured our continuously and orderly operations for the past 2 quarters. The well-being of our employees, clients as well as our community has been our top priority, and we also had emergency procedures in place if any infected cases in the Company caused workplace shut-down.

When it comes to the Camsing settlement plan, we believe it is "the second shoe dropping" that is associated with this matter that will allow us to move forward with lighter luggage. It is also a plan that reserves cash flow for the company and also comes with relatively manageable dilution to the stock price. In the meantime, it is also critical for us to be able to secure a group of important existing clients to continue to invest with us. As Chairlady Wang has mentioned previously, the group of client's new investment have reached over RMB5 billion, and we are confident this number would only grow once the plan is accepted by our investors.

Overall, we are pleased with our first half results in a year full of uncertainties and challenges. Despite challenging headwinds, considering we have achieved 70% of the floor of the initial 2020 profit guidance and have the confidence on business development for the coming quarters, I am happy to report that we will revise our 2020 non-GAAP net income guidance upward by 100 million, and the new range is RMB900 million to RMB1 billion. This revision reflects our stronger transaction value and performance-based income expectation for the remaining year.

I will now open the floor for questions. Thank you.

Questions and Answers

Operator: (Operator Instructions). [Stephanie] Poon at Citi.

Daphne Poon: So I think maybe two questions for me. First is regarding your operating margins. We have seen very meaningful improvement in your operating margin in the second quarter. So just wondering in terms of the outlook, do you think it can sustain at this relatively high level? I recall previously, your guidance for the full year margin is about 30%. So do you think actually like you can exceed this guidance? And what is your outlook for the full year?

And the second question is regarding -- just want to get some color on your transaction volume trend in July and August. So we have seen a pretty strong Asia market performance, and the demand for the whole mutual fund market has also been picking up quite strongly. So if possible, can you share what is your product sales run rate like in the past 2 months?

Pan Qing: Thank you, Daphne. Yes, the second quarter actually is a little bit higher than expected, as the government obviously is supporting entrepreneurs through the difficult period, and we have received about 50 million in government subsidies. It's about 40 million higher than average subsidy we normally see in the past quarters. So without that number, the second quarter operating margin will be around 35%.

We're still maintaining the 30% operating margin guidance for the rest of the year, as you would imagine that some of the investments, especially in IT, and strategic investment actually tend to show their impact towards the second half of the year. Some of the hiring actually is taking place slowly. So I believe it will be a little bit over 32%, but probably around 32% for the full year’s margin.

And in terms of transaction volumes, from the numbers we have seen from our sales team in August, it continued the momentum. I think without too much surprise, it will be at least close to the first quarter’s level. And also the mix of the transactions will be mixed with more private equity products, as the actual arrangement for the launch, especially, they are moving focus onto Gopher's own product, in the product, as I just mentioned, the secondary market, as well as some of the U.S. dollar PE funds.

So I'm pretty happy with what we have seen for the first 2 months in the third quarter, and I'm hoping the momentum will continue, especially in light of some of the news that Hong Kong might lift the travel ban before the national holiday, which will be a strong boost in transaction values as well.

Daphne Poon: Okay. Understood.

Operator: Xue Yuan at CICC.

Xue Yuan: (Speaking Foreign Language).

Pan Qing: (Speaking Foreign Language).

Jingbo Wang: (Speaking Foreign Language).

Pan Qing: Okay. I'll try to -- it's okay -- try to translate for Noah, and also throw in some of my insights here.

First of all, in terms of the carry income, it basically consists of two parts. One is from the private equity; the other is from the public security funds. We believe that with AUM that we have in PE, especially the government's policy, as well as the activity on the STAR Board, for example, the exiting of the existing AUM will actually become more and more apparent going forward. There will be a statistic on the market that there is about cumulatively 230 billion fund raised for top general partners, and Noah actually accounted for about 80 billion of that. So obviously, we are enjoying the position of the leader in this industry.

And also we have about 50 or so portfolio companies that's been either in the process or already listed on the STAR Board. For example, two recent examples: one is the Cansino Bio Company, we had original investment about at the cost of 50 million. And on paper, it has 100 multiple return, as well as the KE holdings company, a real estate agency in China, we also have investments in it.

And for the secondary market funds, obviously, work with the top GPs, for example, the Hillhouse, GaoYi, Greenwoods. So we have a statistic that says some of the clients actually have been making money since the beginning of the investment. So we are working with the top GPs, also give us pretty good advantage in terms of helping the clients to gain, and also for us to make performance fee.

In terms of fee rates, obviously, at the market level, it's actually quite different, depending on the different products and different managers. So it's hard to put a number to it.

In terms of smoothing out the volatilities, especially in transaction values, I think we still have a pretty good private equity long-chain distribution pipeline for the rest of the year, as I just mentioned before, as well as some of the insurance and oversea trust business that's being suspended temporarily because of travel ban. And we expect that to actually pick up for the rest of the year once the travel ban is alleviated. Also obviously, with the strengthening on the public security products will help smooth out the volatility.

And one of the main strategic products that we have is the balanced fund between bond and stock. Also as you may be familiar with, we have been mentioning that this type of product actually have a 3-year lockup for clients to enable them to actually to ride through the tough cycles. We had original target of 20 billion of this fund. Obviously, it's probably not going as fast as we want it to, but we're pretty confident that will this become a basic fundamental layer for clients' allocation of the assets.

And when it comes to the competitions from internet players, I believe we have quite different customer groups as they do. On average, the transactional value that people actually place order on our platform for mutual funds will get, at least in general, is around the million mark for mutual fund purchases. And that will be very, very rare for this type of retail internet platform, as you have mentioned.

So we do have pretty different customer segments, and we're not planning to actually go down to that level to service the real retail clients. I think we're still trying to provide more selections for clients in the mutual fund product.

Operator: The next question comes from Ethan Wang at CLSA.

Ethan Wang: (Speaking Foreign Language).

Jingbo Wang: (Speaking Foreign Language).

Pan Qing: Okay. So let me translate it real quick.

(Translated). For the saving product, we actually have an internal data point that is about 7 billion AUM for our clients who is older than 65 years old; and for the senior clients, especially the ones with age over 70, we have an internal policy that will not recommend, or actually help them to place their investments in risky reward -- riskier products. So this, it's almost like a Fund of Funds for savings products, which is safer. And actually, it does have the guarantee by the bank up to a certain amount of principal. So we believe that's actually a safer choice, and also an alternative for our senior clients that will wish to continue to invest with us.

And in terms of growth of iNoah, it actually did only come online in June. We haven't really put in massive effort in terms of promote that; we're really just opening that up for internal clients for their oversea assets, especially their need of purchase and selection of mutual funds. In the next stage, once iNoah first version stays stable, and we'll actually we'll be launching probably a more massive and concentrated effort in promoting that, probably towards the end of this year or early next year. Currently, we have about 5,000 users and most of them are existing clients of Noah.

Ethan Wang: (Speaking Foreign Language).

Pan Qing: Hi, Amy, do we have any other questions in line?

Operator: We have a question from Daqi Jiao at JPMorgan.

Daqi Jiao: We have a question on the cost. I think we see a lot of cost reduction in the second quarter. But again, since you have like the salary charts and also like the government subsidies, it's rising. But we want to get a sense of what's the portion that was some strategic changes that like moving process online and making your costs going down in the future, like something like that.

Pan Qing: Okay. Yes, we actually -- without the government subsidies, which is about 35% in terms of the operating margin. Obviously, that showed our continuous effort in terms of especially moving some of the conferences online with their clients actually did save quite a bit of traveling expenses. That's part of due to the restriction on travel because of the epidemic situation, but at the same time, also find that sometimes actually, people stay more focused and it's actually more efficient for us to have some conferences online.

Obviously, we're not moving online completely. We still believe the offline seminars are good opportunities for clients to see each other, to shake hands, and to be more personable. But that's part of the effort we have been meeting in terms of cost reduction. And secondly is obviously, we're continuing investing in IT technology and it's increasing the efficiency in terms of our clients, as well as relation managers, to operate in business.

So we'll continue to look for ways to increase the efficiency, and also actually effectiveness, some of the online seminars that we'll be able to use to deliver value and also good investment opportunities for our clients.

Daqi Jiao: Thank you.

Operator: This concludes the question-and-answer session. Would you like to make any closing remarks?

Pan Qing: So I think that will be on very -- it was a challenging quarter, and we're happy to deliver the strong results for this quarter, as well as we maintain a pretty optimistic outlook for the coming quarters. (Speaking Foreign Language).

Jingbo Wang: Thanks.

Pan Qing: Okay. Well, thank you very much for the time of investors and shareholders, and we will be holding some of the conference calls afterwards. Please feel free to reach out to us, and we're happy to talk to you guys. Thank you.

Jingbo Wang: (Speaking Foreign Language).

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