

Gaotu Techedu Inc.
Fourth Quarter and Fiscal Year 2023 Earnings Conference Call
Tuesday, February 27, 2024, 8:00 AM ET

Operator

Good day, and welcome to the Gaotu Techedu Inc. Fourth Quarter and Fiscal Year 2023 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 Ms. Catherine Chen, Head of Investor Relations. Please go ahead.

Catherine Chen

Thank you, operator. Good evening, everyone. Thank you for joining Gaotu's fourth quarter and fiscal year 2023 earnings conference call. My name is Catherine, and I will help host the earnings call today. Gaotu's earnings release for the quarter was distributed earlier, and is available on the company's IR website at ir.gaotu.cn, as well as through PR newswire services.

Joining the call with me tonight from Gaotu's senior management is Mr. Larry Chen, GOTU's Founder, Chairman and Chief Executive Officer, and Ms. Shannon Shen, Gaotu's Chief Financial Officer. Larry will first provide the business highlights for the quarter, and then afterwards, Shannon will discuss our financial performance in more detail. Following their prepared remarks, we will open the floor to questions from analysts.

Before we begin, I'd like to remind you that this conference call will contain forward-looking statements made under the safe harbor provision of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are based upon management's current beliefs and expectations, as well as the current market and operating conditions. And they involve known or unknown risks, uncertainties and other factors, all of which are difficult to predict, and many of which are beyond the company's control, and may cause the company's actual results, performance or achievements to differ materially from those contained in any forward-looking statements. Further information regarding these and other risks is included in the company's public filings with the U.S. SEC. The company does not undertake any obligation to update any forward-looking statement except as required under applicable law.

During today's call, management will also discuss certain non-GAAP measurements for comparison purpose only. For a definition of non-GAAP financial measures and reconciliation of GAAP to non-GAAP financial results, please refer to our fourth quarter and fiscal year 2023 earnings release published earlier today.

As a reminder, this conference is being recorded. In addition, a live and archived webcast of this conference call will be available on Gaotu's IR website.

It is now my pleasure to introduce our Founder, Chairman and Chief Executive Officer, Larry. Larry, please.

Larry Chen

Good evening and good morning, everyone. Thank you for joining us on Gaotu's fourth quarter and fiscal year 2023 earnings conference call. I would like to take this opportunity to express my gratitude to all of you for your interest in and support of Gaotu.

Before I start, I would like to remind everyone that all financial figures discussed today are quoted in RMB, unless stated otherwise.

During the past quarter, we continued to bolster our core business strengths while simultaneously pushing the boundaries of new initiatives. We observed a notable uptick in demand for high-quality educational products and learning services, and we remained focused on addressing this demand by enhancing our product offerings and channels across key business lines, including non-academic tutoring services, traditional learning services, and educational services for college students and adults.

Investing in emerging technologies, such as artificial intelligence, allows us to acquire a more profound and holistic insight into the fundamental needs of users and students, enabling us to provide precise and personalized offerings and services, thereby elevating user experiences and improving learning outcomes. Our deep industry insights, exceptional organizational capabilities and well-established teacher recruitment and training systems have provided a robust foundation for the sustainable development of our business.

Now I am pleased to report our results for the fourth quarter of this year and share our expectations for future business endeavors.

Our net revenues increased 20.9% year-over-year to 761 million, exceeding our expectations.

Our gross billings grew 28.1% year-over-year to approximately 1.3 billion, indicating an accelerating growth trend compared to prior quarters. And we expect this growth momentum of our business to continue.

In the fourth quarter, our cash flow from operating activities was 491.5 million. And our net operating cash inflow in the full year 2023 increased by approximately 5.5 times year-over-year, a strong testament to the ongoing improvement of our operating efficiency.

As of December 31, 2023, our deferred revenue reached over 1.2 billion, laying solid groundwork for our further growth in 2024.

Our cash balance, which includes cash, cash equivalents, restricted cash, withdrawable cash balance on third-party payment platforms, as well as short and long-term investments, totaled over 4.0 billion, ensuring lasting and stable support for our business development.

I will now discuss our business highlights from the fourth quarter across four aspects.

First, we're diligently focusing on both our educational products and services to boost learning efficiency and optimize the overall learning experience. Throughout this process, we remained laser-focused on user needs and potentials, and expanded our range of products and services as needed. We established an integrated online-offline offering by launching on-the-ground boot camps and learning centers.

To give an instance for our educational services for college students and adults, such offline exam prep boot camps can better address students' needs in areas such as postgraduate entrance exams, civil service exams and overseas study preparation.

In addition, through collaborations with renowned publishing houses such as Foreign Language Teaching and Research Press, we developed textbook series that have achieved major breakthroughs as comprehensive educational solutions covering instruction, learning, practice, assessment, and evaluation. Certain of these publications are currently used as textbooks by several major universities and high schools in China.

For our traditional learning services, we saw a significant increase in retention rate during the 2023 fall semester compared to the same period last year, thanks to our ongoing efforts to refine course content and improve delivery quality. At the same time, we proactively communicated with regulatory authorities at all levels, seeking guidance on relevant policies and compliance, and iterated our educational products and learning services accordingly.

Second, we continued our efforts to explore diversified customer acquisition channels and enhance operational efficiency. Leveraging our high-quality content and efficient operations, we have expanded into innovative channels, including livestreaming and short-form video platforms, as well as offline avenues, establishing our competitive edge in these channels.

In the livestreaming space, the substantial overlap in skill sets between online teachers and livestream hosts gives us a competitive advantage in customer acquisition. We have grown to be a leading influencer on Douyin, particularly in certain educational categories for college students and adults. Meanwhile, we actively expanded our offline channels to boost regional brand visibility.

The comprehensive channel mix not only ensures sustained business growth, but also allows us to engage with customers through diverse channels, gaining insights into their needs, fostering deep interactions, and bringing down customer acquisition costs. As a result of the measures, our customer acquisition efficiency remained at a high level in the fourth quarter, demonstrating the success of our enhanced investment in customer acquisition.

Third, we leveraged our organizational capabilities and talent pool to drive consistent business growth. We believe that education is the process of outstanding teachers positively influencing students. Therefore, one of Gaotu's most crucial strategies is to enhance organizational capabilities to systematically nurture top-tier educators at scale and to high standards. By cultivating a team characterized by a passion for learning, resilience, and strong cohesion, we ensure the effective and efficient operation of our organization.

While the booming business has resulted in rapid organizational expansion, we continue to maintain a consistent standard of hiring the best-in-class instructors and tutors in the industry. Taking our postgraduate entrance exam prep business as an example, the percentage of our tutors with a master's degree has increased to over 70%, positioning us at the forefront of the industry. Teachers with firsthand experience in postgraduate entrance exams can provide students with full support, including professionally, psychologically, and emotionally, therefore enhancing the overall effectiveness of the test preparation.

Fourth, we remained committed to fulfilling our social responsibilities and actively creating social value. In the fourth quarter, we organized the Gaotu-Hope Project Rural Primary School Principals Online Forum in partnership with the China Youth Development Foundation. Over 600 rural primary school principals and teachers from 11 provinces attended the event, engaging in insightful discussions on rural education in the era of artificial intelligence.

In addition, we donated RMB10 million to the China Next Generation Education Foundation, aiming to improve family education and the mental well-being of young children and adolescents.

We will remain steadfast in our commitment to our original educational aspirations, striving to enhance equity and accessibility in education. We have full confidence in Gaotu's prospects for 2024, and for the further future, we are prepared to devote our full efforts to executing on our strategy. With a robust talent pool, a highly cohesive organization and strong cash flow, we believe that we can achieve promising top line growth while enhancing profitability by consistently delivering top-notch educational products and learning services, thus generating long-term value for both our shareholders and the society.

Thank you very much. This is the end of my prepared remarks.

Now, I will pass the call over to our CFO, Shannon, to walk you through the financial and operational details of the quarter.

Shannon Shen

Thank you, Larry, and thank you, everyone, for joining our call today. I will now walk you through our operating and financial performance for the fourth quarter and fiscal year 2023.

During the quarter, our business entered a healthy phase of rapid and sustainable expansion. We witnessed accelerated growth in the gross billings of our core business lines, while our new initiatives also demonstrated promising growth potential.

In the fourth quarter, net revenues increased by 20.9% year-over-year to 761.0 million, topping the upper end of our guidance by 10.6 percentage points. The better-than-expected performance was driven by the surge in gross billings, which increased by 28.1% year-over-year to approximately 1.3 billion.

Benefiting from ongoing improvements in operational efficiency, our net operating cash inflow reached 491.5 million, while our cash, cash equivalents, restricted cash, withdrawable cash balance on third-party payment platforms, as well as short and long-term investments, exceeded 4.0 billion, laying solid groundwork for the long-term growth of our business.

Next, I will walk you through the progress we have made during the quarter.

Learning services contributed over 95% of net revenues. Breaking it down, more than 70% of total revenues came from non-academic tutoring services and other traditional learning services, representing over 35% year-over-year growth and solidifying this segment's role as a key driver of our business.

Our new initiatives center around non-academic tutoring. Over the past few quarters, we have been diligently designing and developing educational products tailored to students' learning needs. By sparking students' interest in learning, we aim to enhance their fundamental critical thinking skills and learning abilities while fostering healthy study habits and self-motivation. Our course offerings undergo constant iteration and refinement, and have shown to be popular and satisfied with our students.

Underpinned by a combination of top-notch educational products and high-caliber learning services, gross billings of our non-academic tutoring services increased by triple-digits year-over-year. While maintaining our competitive edge in instructors, we have also consistently enhanced our tutors' service capabilities. Additionally, by diversifying our educational products and learning service formats, we have established a comprehensive product matrix to meet users' varied and personalized learning needs. Our ongoing refinement of products and teaching capabilities has also contributed to further improvement in retention rates.

In the meantime, we have closely monitored regulatory policy developments and engaged proactively with authorities at different levels to seek compliance guidance for curriculum content and frameworks. This ensures that we can plan for long-term, healthy business growth within regulatory boundaries.

Our traditional learning services continue to maintain a leading edge in the online space. In terms of educational products, we have developed a more targeted and personalized curriculum by taking a tiered approach to design and develop holistic learning journeys. We have also carefully curated and cultivated the most influential and reputable instructors in the industry and established a highly competitive team of tutors.

For customer acquisition, we have developed channels driven by high-quality content and efficiently gathered user feedback to derive valuable insights for our business. By seamlessly integrating front-end and back-end processes, we have consistently enhanced our customer acquisition efficiency. In the fourth quarter, we achieved rapid growth in gross billings from new enrollments while simultaneously reducing the unit acquisition cost.

The other crucial component of our learning services is educational services for college students and adults, which accounted for around 25% of total revenues during the quarter. Benefiting from a refined strategic focus and optimized educational products, gross billings of this segment rebounded to grow by more than 10% year-over-year in the quarter, setting the stage for its contribution to our revenue growth in 2024 and beyond.

Driven by robust market demand and improved operational efficiency, both our domestic exam prep business and overseas study-related business are charting a more promising growth trajectory. Particularly in the quarter, our overseas test prep business saw year-over-year growth of more than 200% in both revenue and gross billings, thanks to our ongoing innovation and expansion efforts in the short-form video and livestreaming space.

Furthermore, our post-graduate entrance exam prep business generated positive cash flow for the second consecutive quarter, while our civil service exam prep business achieved quarterly profit.

For the full year 2023, our net revenues grew by 18.5% year-over-year to approximately 3.0 billion, while gross billings grew by 31.7% year-over-year to over 3.3 billion.

Gross margin was 73.3%, 1.4 percentage points higher than the same period of last year.

Non-GAAP net income was 51.1 million, and non-GAAP net income margin was 1.7%.

These robust operational and financial results are attributable to our year-long efforts to diversify our customer acquisition channels, upgrade our teaching and service offerings, and enhance organizational and execution capabilities. By strengthening our core competencies, we were able to swiftly deploy resources based on changes in the market environment and user demand, proactively meeting diverse customer needs while remaining compliant with regulatory requirements.

Looking ahead to 2024, we will further unleash the untapped potential across our business lines and embrace emerging opportunities as they arise. Leveraging our diversified product matrix and service formats, along with efficient customer acquisition and operational capabilities, we remain dedicated to providing students with exceptional learning experiences and excellent learning results.

I will now present our financials in more detail.

Our cost of revenues this quarter was 227.7 million.

Gross profit increased 13.4% year-over-year to 533.3 million, and gross profit margin was 70.1%.

Total operating expenses during the quarter increased 49.1% year-over-year to 721.2 million.

Breaking it down, selling expenses increased 60.7% year-over-year to 465.7 million, accounting for 61.2% of net revenues. This was primarily attributable to our increased marketing investments to address the robust demand during the winter season.

Benefiting from our expanded operations in a diverse range of innovative customer acquisition channels, especially in the short-video and livestreaming space, our selling expenses ROI in the quarter remained at the high level observed throughout the year.

Moving on, research and development expenses increased 22.1% year-over-year to 136.0 million, accounting for 17.9% of net revenues.

General and administrative expenses increased 45.0% year-over-year to 119.5 million, accounting for 15.7% of net revenues.

Loss from operations was 187.9 million, and operating margin was negative 24.7%.

Non-GAAP loss from operations was 172.2 million, and non-GAAP operating margin was negative 22.6%.

Net loss was 119.6 million, and net income margin was negative 15.7%.

Non-GAAP net loss was 104.0 million, and non-GAAP net income margin was negative 13.7%.

Our net operating cash inflow was 491.5 million.

Turning to our balance sheet, as of December 31, 2023, we held 741.7 million in cash, cash equivalents, restricted cash and withdrawable cash balance on third-party payment platforms, along with around 2.3 billion in short-term investments and around 1.0 billion in long-term investments. This comes to a total of over 4.0 billion, 256.9 million higher than at the same time point last year.

As of December 31, 2023, our deferred revenue balance was around 1.2 billion, which primarily consisted of tuition received in advance.

As of December 31, 2023, we have repurchased an aggregate of approximately 4.9 million ADSs on the open market for approximately USD12.4 million. We will continue to execute stock buybacks in accordance with the guidance of the board of directors, and create long-term value for our shareholders.

Before I provide our business outlook for the next quarter, please allow me to remind everyone that this contains forward-looking statements, which involve risks and uncertainties, which are beyond our control and could cause the actual results to differ materially from our predictions.

Based on our current estimates, total net revenues for the first quarter of 2024 are expected to be between 908 million and 928 million, representing an increase of 28.4% to 31.2% on a year-over-year basis.

This concludes my prepared remarks. Operator, we are now ready for the Q&A session. Thank you, everyone, for listening.

Questions and Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions). The first question comes from Timothy Zhao with Goldman Sachs.

Timothy Zhao

Congratulations on the very strong results. I have two questions. One is about the student acquisition history for the upcoming or the ongoing winter vacation. Could management share some color on the customer acquisition progress, and also the related customer acquisition cost?

And secondly, in your prepared remarks, you mentioned comprehensive channels to acquire customers, including the short-form videos, livestreaming and offline avenues. I think specifically on offline, could you share some color on your plan for 2024 in terms of the number of learning centers, or any color on your projected revenue or profit contribution? That will be very helpful.

Shannon Shen

Sure. Thanks, Timothy, for your question.

First, we're very happy to share the most recent updates for our winter vacation performance. And in terms of the customer acquisition cost, let's revisit the winter vacation performance from both supply and demand perspectives.

Starting with the supply side, the current operating environment imposes relatively-high requirements on institutions' capability of delivering high-quality products, including the ability of continually refining the curriculums, faculty reserves and cash positions, and also very important to meet all compliance standards. Therefore, the supply of high-quality courses in the winter is very limited.

On the demand side, we have perceived a strong demand from the students. The scarcity of supply, coupled with strong demand, presents an excellent growth opportunity. Also, we were fully prepared for the winter peak season. Therefore, our winter vacation gross billings have maintained quite a high year-over-year growth rate.

If we exclude the cash collection from retentions in the same period of last year, doing an apples-to-apples comparison, we foresee a high end of high-double-digit year-over-year growth of our traditional learning services and non-academic tutoring services, actually quite impressive.

Behind all this fast growth is our highly-efficient customer acquisition.

We deployed certain new channels, especially for the short video, livestreaming platforms, as well as our new exploration to some offline channels.

Both these channels have high requirement for the operations, especially for the collaboration between the front end and the back end. We need to have the ability to precisely target our customers and fulfill their needs in a very short time. That needs our back-end team, which means our tutors, to further facilitate parents and students timely and meet their learning demands. Based on our observation, we do observe a meaningful customer acquisition cost decline in the winter vacation.

Also, you asked about our offline channels and offline operations. Basically, these are two different businesses.

First, to facilitate our online business, we have some offline channels to support our online business growth. On the other hand, we do start to deploy our operations for our offline learning centers. And we're more than happy to share with you some perspectives and insights into our offline operations.

The reason why we start to enter the offline space is because in the post-pandemic era, we've keenly observed a diversification in students' learning needs. While many have adapted well to learning online, there is a growing desire among students to return to offline classrooms for more connections, interactions and engagements with the teachers and their classmates. Currently, numbers of parents opt for a hybrid approach, with some courses taken online and others offline, aiming to enhance learning efficiency and cater to a diverse learning need.

As an educational institution, one of our most important missions is to continually meet customer demand. With such a demand rise, we naturally extend our operation to offline, and adapt the educational products accordingly. On the other hand, we dedicatedly evaluate our management team's background and capabilities. Our Founder, Larry, brings years of experience in offline business operations, very profound industry insights, and considerable personal influence, which can all contribute to attract all those top talents in the space, especially after the double reduction.

When customer demands align with our organizational capabilities, we embark on the exploring and expanding our offline operations. That's the reason why we started to enter the offline space.

When we operate or in the selecting process of locations, or when we start to plan for expansion of our offline operations, we employ more of a dynamic approach.

While we're continuously optimizing and adjusting, we need to consider a few factors like market demand, Gaotu's brand influence and penetration in certain areas, the acceptance of teaching products by the students and teachers in that specific area, and most importantly, our ability to recruit and nurture outstanding principals and teaching faculties locally.

Development of offline operations also entails a long cycle, requiring sustained investment from user cultivation to word-of-mouth referrals, which is the reputation for the local offline learning centers. We will be extremely patient and wait for the sprouting and growth of our offline business. Ultimately, no matter it's online or it's offline, students always care most about the suitable teachers, fitting curriculum and the outstanding services. We will continue to strive tirelessly to meet those expectations.

In the past quarter, and in the full year of 2023, offline business showed a very limited impact on our financials. We will update you every milestone of our offline operations in the future.

Hope that addressed your questions, Timothy.

Timothy Zhao

Sure, very clear and very helpful. Thank you, Shannon.

Operator

The next question comes from the line of Alice Cai with Citibank.

Alice Cai

Firstly, congratulations on the company's strong performance in 4Q. And I have two questions regarding the guidance provided.

And the first one, regarding the guidance for Q1, which seems slightly conservative, could your management team share your perspective on this? Do you consider the guidance to be on the cautious side?

And second, could you please share with us about a general idea of the guidance for the full year 2024?

Shannon Shen

Sure, Alice, thank you for your question.

Let me take your second question first, so we can give the audience a whole picture of our plan for the full year of 2024.

Looking into 2024, the growth in the education space typically initiates from expansion of gross billings. If we look at our Q4 results, in the fourth quarter of 2023, our gross billings reached approximately 1.3 billion, marking the highest single quarter level in the past 3 years. This metric indicates that our business is on a healthy and rising trajectory of growth.

Furthermore, we have been able to effectively extend the trend of accelerating growth into the first quarter of 2024. Let's dive into each part of our learning services.

We observe that revenue growth, especially in non-academic tutoring, continues to accelerate, given its sound unit economics model. The demand for non-academic tutoring is substantial. With clear compliance and governance guidance in place, our business growth initiates with new enrollments, and subsequently generates incremental revenues through retentions and course extensions, so we have confidence in our operational capabilities and the reputation we have established among students and parents. Therefore, we anticipate triple-digit year-over-year growth in our non-academic tutoring sections.

For our traditional learning services, which is basically a high school business, it continues to maintain a leading edge in the online space. We will leverage our existing competitive advantages to further deepen this moat. We anticipate that the growth rate of our traditional business will far exceed that of 2023.

And regarding learning services we provided for college students and adults, we are glad to see it rebound in Q4 2023. We always prioritize margin improvements over revenue expansion in this sector, and ascertain the profitability at a unit economics level, and then focus on achieving the effective growth as our primary strategy.

Based on all those considerations, we are willing to elevate our targets and goals for both gross billings and revenue growth in 2024, and have confidence in overall growth prospects for the whole year.

Secondly, in terms of growth efficiency, our explorations of diverse customer acquisition channels have effectively lowered customer acquisition costs. From high-quality content generating on short-video livestreaming platforms and to extending into offline customer acquisition paths, our unwavering commitment to creating customer value serves as drivers for our sustainable growth.

In terms of the guidance for the first quarter, we are still in a phase of adjusting the revenue structure in the first quarter, and we have the confidence that in the more near future, like in the second quarter of 2024, we will see an accelerated growth rate for both our gross billings and revenues.

Hope that basically addresses your questions. Thank you, Alice.

Alice Cai

Thank you.

Operator

The next question comes from Crystal Li with CMS.

Crystal Li

Congratulations on the strong results.

I just noticed that your gross profit margin narrowed slightly in this quarter compared to last quarter and last year. Could you please share the reason behind this?

And could you give us more color on your margin outlook going forward?

Shannon Shen

Yes, thanks a lot. It's a very good observation.

We observed a 4.7 percentage points decrease in GP margin on a year-over-year basis. This year-over-year decrease in GP margin was due to a few reasons.

Firstly, in terms of our revenue contributor, to meet diverse user needs, we have constructed a product matrix which primarily focuses on online large live classes, complemented by one-on-one classes and offline small classes. Among these, online large live classes posted the highest level of GP margin.

As our business expands, the proportion of revenue generated from our one-on-one classes and offline small classes is gradually increasing, altering the revenue mix and substantially impacting the GP margin level.

Secondly, in preparation for the peak season during the winter vacation, we have proactively reserved a proportion of teachers and tutors. These teachers and tutors have not yet reached their full capacity levels in the fourth quarter, thus affecting gross profit margins as well.

As always, we need a certain period of time for our new teachers and tutors to gradually adopt our learning methodologies. This will provide sufficient training period for our teachers and tutors to better serve our students. We do see these investments as valuable. Looking forward, in the medium term, as our teacher capacity increases, the GP margin and NP margin are expected to improve.

In the long run, our gross profit margin will depend on the future revenue structure.

Hope that address your question.

Crystal Li

Thank you.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Ms. Catherine Chen for any closing remarks.

Catherine Chen

Thank you, operator. And thank you, everyone, for joining the call today. If you have any further questions, please don't hesitate to contact our Investor Relations Department or our management via email at ir@gaotu.cn directly. You are also welcome to subscribe to our news alert on the company's IR website.

Thank you very much again for your time. Have a great night.

Operator

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