

## YOUDAO 1Q 2021 CONFERENCE CALL SCRIPT

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### **Operator introduction**

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Good day and welcome to the Youdao 2021 first quarter earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Jeffrey Wang, investor relations director of Youdao. Please go ahead.

### **Jeffrey Wang**

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Thank you, operator. Please note the discussion today will contain forward-looking statements, related to future performance of the Company, which are intended to qualify for the Safe Harbor from liability, as established by the US Private Securities Litigation Reform Act. Such statements are not guarantees of the future performance and are subject to certain risks and uncertainties, assumptions and other factors. Some of these risks are beyond the Company's control, and could cause actual results to differ materially from those mentioned in today's press release and this discussion.

A general discussion of the risk factors that could affect Youdao's business and financial results is included in certain filings of the Company with the Securities and Exchange Commission. The Company does not undertake any obligation to update this forward-looking information, except as required by law.

During today's call, management will also discuss certain non-GAAP financial measures, for comparison purposes only. For the definitions of non-GAAP financial measures, and reconciliations of GAAP to non-GAAP financial results, please see the 2021 first quarter financial results news release issued earlier today.

As a reminder, this conference is being recorded. Besides, a webcast replay of this conference call will be available on Youdao's corporate website at [ir.youdao.com](http://ir.youdao.com). Joining us today on the call from Youdao's senior management is Dr. Feng Zhou, our Chief Executive Officer, Mr. Lei Jin, VP of Operations, Mr. Peng Su, our VP of Strategy and Capital Markets and Mr. Wayne Li, our VP of Finance. I will now turn the call over to Dr. Zhou to review some of our recent highlights and strategic direction.

## Feng Zhou

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Thank you, Jeffrey. And thank you all for participating in today's call. Before we begin, I would like to remind everyone that all numbers are based on Renminbi.

We achieved sound and sustainable growth across our business in the first quarter of this year. Total revenue in Q1 was RMB1.3 billion. Net revenue from K-12 of RMB639 million, up 217.6% year-over-year. Meanwhile, gross billings from K-12 reached RMB442 million in this quarter, up 130.2% year-over-year. Paid student enrollments from K-12 climbed to 306 thousand, up 100.3% year-over-year.

With larger scale we also achieved higher operating efficiency. Gross billings from K-12 and adult segments reached approximately RMB742 million. Brand and performance advertisement spending on courses amounted to approximately RMB556 million. Compared with Q3 2020, the last quarter with mostly new student acquisition and almost no renewals, our Return on Investment, or ROI, improved by more than 30%.

Gross billings from the adult segment reached RMB299 million in the first quarter this year, up 17.8% year-over-year. Remember that the outbreak of COVID-19 in Q1 2020 led to a high base, and thus more moderate year-over-year growth of the adult segment.

Margins were also improving. Gross profit margin from learning services reached 65.6% in the first quarter this year, up from 51.9% in Q1 2020. It is the best level since we became public. Operating loss margin narrowed down to 23.9% in the first quarter this year, compared with 32.5% in Q1 2020.

With that financial overview, I would like to review some business highlights.

Looking at our K-12 segment, we launched the industry's first localized version of junior high school Chinese with two instructors, during the spring semester in Q1. One instructor covers nationwide content and the other covers localized content. More than 50% of our junior high school Chinese course students opted for the localized version of junior high school Chinese, reflecting high interest in this course format. Course participation and satisfaction data were also promising. As for high school and primary school segments, we continued to polish courses and offered more tailor-made Math content to students of different learning levels. Gross billings of high school Math increased by over 210% year-over-year in Q1 2021. We had 197 instructors, and 4,093 tutors at the end of Q1 2021.

For our extra-curricular segment, Youdao Weiqi, or Youdao Zongheng in Chinese, we maintained the strong momentum from the last quarter and achieved more than 100% quarter-over-quarter growth in gross billings. In the meantime, Youdao Zongheng sponsored the Jiangsu Weiqi Youth Team and we signed Ke Jie, eight-time Weiqi world champion, as our brand spokesperson.

As for our adult segment, in March 2021 we established Adult Education Business Unit. This put several teams under the same umbrella, including the adult-oriented courses in Youdao Premium Courses, NetEase Cloud Classroom and China University MOOC. New courses will be released under the NetEase Cloud Classroom brand, concentrating our investment in a single brand. According to our data, the Extraordinary Memory (非常记忆) course has become the No.1 memory-oriented course in the industry, only three quarters into its operation.

Our intelligent learning devices also grew at an accelerated clip in Q1. I'd like to highlight that gross profit margin hit 44.1% in the first quarter, a record high for our devices, compared with 25.6% in Q1 2020. In March, we introduced Youdao Dictionary Pen 3 Pro, further supporting bilingual translation of Japanese and Korean to meet the demand of more language learners. We shipped over 297 thousand units of our Dictionary Pen series in Q1, up 198% year-over-year.

We are only getting started. We have more device products in the pipeline for 2021, and our teams are very excited about them.

As for our mobile learning apps, we launched a short-video feature called "WOW Community" (WOW 圈) in Youdao Dictionary. Users and content creators could finally share short videos about learning and fun things in Youdao Dictionary. This led to users staying much longer on Youdao Dictionary and that is more ways for us to engage with our users down the road.

This, along with other improvements of our apps, facilitated organic traffic growth. In the first quarter this year, 26% of all newly enrolled students' gross billings came from organic traffic. Gross billings from the K-12 segment generated by organic traffic increased by 129% year-over-year.

Let us quickly discuss the potential additional regulations on the AST market. The new regulation is not out yet. Obviously, we will not know the details until it is out. With that said, we continue to hold a cautiously optimistic attitude towards business operations under the new regulatory environment. We believe the purpose here is to curb "unorderly competition" and promote healthy development of the industry. This will ultimately benefit highly-compliant players of scale in the mid-to-long term. We

believe our product and strategy are very competitive with our high-quality content and increasingly advanced application of AI technology. And our diversified business lines, including learning devices and adult courses, could help us better navigate the evolving online education industry.

Now let us turn our attention to other aspects of the company. We pay attention to fulfilling social responsibilities while we operate our business. In Q1 we made several donations, including to Leibo Middle School in Liangshan (四川雷波中学), Sichuan province. NetEase donated RMB 66 million to the Yau Shing-tung Science Foundation (丘成桐科学基金会) to support its math research, and we are looking forward to further cooperation with Mr. Yau's team in AI and basic education areas.

As we are still working towards profitability, in Q1 we secured additional funding to support our long-term plan. We raised approximately US\$232 million through a follow-on offering in February. NetEase recently offered us a US\$300 million loan facility agreement. In addition, a bank group provided a commitment letter in April with a three-year US\$150 million revolving loan facility under the guarantee of NetEase. In total, that is over US\$680 million of additional funding.

Looking ahead, we are confident we can build on our position as a top-quality course provider and producer of industry leading intelligent learning services and products to meet our customers' needs. Our diversified business model, along with products and technologies that truly improve learning efficiency, will help us navigate the evolving AST and EdTech market.

With that overview, I will now turn the call over to Su Peng to review our financial results. We will then open to questions. Su Peng?

## Peng Su

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Thank you, Dr. Zhou and hello everyone.

Today I will be presenting some financial highlights from our 2021 first quarter. We encourage you to read through our press release issued earlier today for further details.

We started the year with a robust first quarter with multiple operational and financial achievements. Total gross billings from our online courses reached RMB808.7 million for the first quarter, up 55.9% from Q1 2020. And gross billings from our Premium courses rose to RMB741.5 million, up 66.2% year-over-year. Our K-12 segment continued to lead our growth, reaching RMB442.2 million in gross billings in the first quarter, up 130.2% year-over-year.

Paid student enrollments from our K-12 group reached 306 thousand in Q1, up 100.3% year-over-year. Paid student enrollments for premium courses were up by 75.6% year-over-year. 29% of K12 newly enrolled students' gross billings came from organic traffic for Q1, which grew 129% year-over-year.

This growth shows not only our determination, but our ability to quickly expand our business, and that our model is working.

For the first quarter total net revenues reached a record RMB1.3 billion, or US\$204.5 million. This represents an increase of 147.5% from the first quarter of 2020. Looking at this growth by segment:

- Net revenues from our learning services were RMB998.9 million, or US\$152.5 million, up 156.8% from the same period in 2020. We attribute this growth to the increased revenues generated from our online courses, which were further driven by a substantial increase in the paid student enrollments for K-12 courses of Youdao Premium Courses.
- Net revenues from our learning products were RMB201.9 million, or US\$30.8 million, up 279.8% from the same period in 2020, driven by increased sales of our Youdao Dictionary Pen of over 297 thousand units in the first quarter; and
- Net revenues from our online marketing services were RMB139.1 million, or US\$21.2 million, representing a 40.1% increase from the same period in 2020.

For the first quarter of 2021 our total gross profit greatly improved, reaching RMB767.5 million, or US\$117.1 million, up 225.6% compared with the first quarter of 2020.

- Gross margin for learning services increased to 65.6% for the first quarter of 2021, up from 51.9% for the first quarter of 2020. The growth was primarily attributable to better economies of scale, and further optimization of our faculty compensation structure.
- Gross margin for learning products increased to 44.1% for the first quarter, from 25.6% for the same period in 2020. The growth was driven by tremendous growth in sales of our Youdao Dictionary Pen 3.0, which carries a higher gross margin profile than other learning products.
- Gross margin for online marketing services was 16.4% for the first quarter of 2021, compared with 20.5% for the same period in 2020. The decrease was mainly due to the increase in performance-based advertisements through third parties' internet properties, which carried lower margins.

For the first quarter, total operating expenses were RMB1.1 billion, or US\$166.1 million, compared with RMB411.7 million for the same period last year.

We continue to invest in our future and top line expansion, specifically, technology, acquiring talented teachers, and sales and marketing efforts focused on student acquisition and expanding our brand awareness. In Q1, brand and performance advertisement spending on courses amounted to approximately RMB555.9 million.

With that, for the first quarter, our:

- Sales and marketing expenses were RMB883.9 million, compared with RMB299.2 million in the first quarter of 2020.
- Research and development expenses were RMB155.1 million, compared with RMB84.1 million in the first quarter of 2020.

Our operating loss margin was 23.9% in the first quarter of 2021, compared with 32.5% for the same period of last year.

For the first quarter of 2021, our net loss attributable to ordinary shareholders was RMB325.8 million, or US\$49.7 million, compared with RMB169.4 million for the same period last year. Non-GAAP net loss

attributable to ordinary shareholders for the first quarter was RMB307.8 million, or US\$47.0 million, compared with RMB161.9 million for the comparable period last year.

Basic and diluted net loss per ADS for the first quarter was RMB2.75, or US\$0.42. Non-GAAP basic and diluted net loss per ADS for the first quarter was RMB2.60, or US\$0.40.

Our net cash used in operating activities for the first quarter was RMB517.8 million, or US\$79.0 million.

Looking at our balance sheet, as of March 31, 2021, our contract liabilities, which mainly consist of deferred revenue for our online courses, were RMB1.2 billion, or US\$186.5 million, compared with RMB1.4 billion as of December 31, 2020. At the end of the period, our cash, cash equivalents, time deposits and short-term investments totaled RMB2.2 billion, or US\$333.7 million.

This concludes our prepared remarks. Thank you for your attention. We would now like to open the call to your questions. Operator, please go ahead.

**Operator**

And that concludes the question and answer session. I would like to turn the conference back over to management, for any additional or closing comments.

**Jeffrey**

Thank you once again for joining us today. If you have any further questions, please feel free to contact us at Youdao directly, or reach out to TPG Investor Relations in China or the US. Have a great day.