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Conference Call Transcript

CEDU - Q1 2008 CHINAEDU CORP Earnings Conference Call

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KIT - Analyst

PRESENTATION

Operator

Thank you for joining us for ChinaEdu Corporation's First Quarter 2008 Results Conference Call. Joining the call today are Ms. Julia Huang, Chairman and CEO, and Mr. Shawn Ding, President and COO. This conference call is also being broadcast on the internet and is available through the Investor Relations section of the Company website. A copy of the presentation that will be used for today's call is available on the Company's IR website at www.ir.chinaedu.net.

Before the management's presentation, I would like to refer to the Safe Harbor statement in connection with today's conference call. This call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including certain plans, expectations, goals, and projections, which are subject to numerous assumptions, risks, and uncertainties.

Forward-looking statements involve known and unknown risks, uncertainties, and contingencies, many of which are beyond our control, which may cause actual results, levels of activity, performance, or achievements to differ materially from any further future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements.

The Company's actual results could differ materially from those contained in the forward-looking statements, due to a number of factors, including those described under the heading Risk Factors in the company's final prospectus filed with the Securities and Exchange Commission and in documents subsequently filed by the company from time to time with the Securities and Exchange Commission. Unless required by law, the company undertakes no obligation to update or revise any forward-looking statements, rather as a result of new information, future events, or otherwise.

Following management's opening comments, you will have the opportunity to ask questions. I would now like to turn the call over to ChinaEdu's Chairman and CEO, Ms. Julia Huang. Ms. Huang, you may begin.

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

Thank you. Good morning and good evening, everyone. Thank you for joining us today for our 2008 first quarter results conference call. This is our second set of results since our IPO in December last year. I'm pleased to report that we beat our top line guidance by delivering 24% of revenue growth over the same period in 2007. The steady revenue growth in the first quarter of 2008 is driven by the robust student enrollment growth in our core business line, the online degree programs.

Before I get into more details of the number, our President and COO Shawn Ding will first walk you through the business highlights. Once our remarks are concluded, we will be happy to take your questions. As the operator mentioned, the presentation is available on our website. Now I'd like to turn the call to Shawn.

Shawn Ding - ChinaEdu - President, COO

Thank you, Julia. Good morning and good evening, everyone. And thank you again for joining us for our results conference call. Before I go through out Q1 operating highlights, I would like to quickly reiterate ChinaEdu's growth strategy.

As you may know, the education market in China is nothing short of excitement and dynamics. There seems to be plenty of opportunities and attractions. For ChinaEdu, our overall strategy is organic growth. In terms of acquisition, we are opportunists. And we have a set of stringent criteria. We believe this is a much better approach for our business and for our shareholder values.

We have been and will continue to focus on executing the set of identified growth drivers for the four business segments. We believe taking advantage of and further strengthening our strong market position is the best approach for our growth.

Specifically for the online degree business, the core business of ChinaEdu, the three key growth drivers have always been identified as growing existing programs, including more university partners, and expanding learning center networks. The result of Q1 is likely (inaudible) the execution of our strategy.

Despite challenges, like the snowstorm and the adverse timing of Chinese New Year, our online degree program revenue grew over 37% in the first quarter, representing approximately 78.9% of our total revenue. While we cannot guarantee that we will be able to maintain such a substantial growth rate over the long term, we are extremely pleased with these results, given that the market demand, the remarkable efforts in sales and marketing, as well as our continuous effort of improving our service quality.

On building more university partners, in the first quarter, we successfully reached our joint venture agreement with Beijing Forestry University with an exclusive contract of 20 years. With that, we now have exclusive contracts with 12 of the country's leading universities.

As of the end of Q1, all ten learning centers are in operation. And our new learning center operations have started to contribute to our business, despite the impact of the snowstorm, the short recruiting seasons, and the short operating history. All things considered, the first recruiting season for the learning center network was quite successful. And we are satisfied with the progress.

In our online tutoring business, the 101 online school, we acquired the remaining 20% equity stake from its previous owner. Revenue for this business accounted for about 4.7% of our total revenue. We released a new product targeting the school's customers in the first quarter. We continuously focus on streamlining the sales and marketing team and channels.

Our site-based delivery business of international curriculum programs and private schools together accounted for about 16% of the revenue. We remain optimistic about our strong long-term growth potentials as the Chinese education market and demand continue to grow.

Now let me provide you with some operational outlook. For the private schools, two out of the three schools we have are very well on track. We've successfully mitigated the impact of the snowstorm and completed the Anqing campus construction. It is already in operation.

However, we were not able -- we were not quite as lucky when it came to the Jinzhou school construction. We discussed our concerns with this particular school construction in the last earning call. Despite our best effort to get the schedule back on track, this new campus will now be able to receive new students in September.

On the positive side, ChinaEdu is evaluating the possibility of penetrating the vocational training sector. We believe ChinaEdu can leverage our online education technology, education know how, and our university partnerships to establish a strong brand name in this area. We also believe the timing is right. ChinaEdu can capitalize on the unique opportunity that China is shifting from a labor-intensive economy to a knowledge-driven economy.

In addition, this training program will increase the efficiency and the utilization rate of our learning center network. We are continuously making progress in the expansion of learning center networks.

In addition to the 10 learning centers, we have also developed 12 franchise learning centers. And they have received provincial-level approval. Up to now, ChinaEdu have also signed 11 service contracts with universities to operate learning centers for their online degree programs. This further supports the value of our learning center network.

I'm sure you're all very concerned about the possible impact of the recent earthquake. First of all, the employees of ChinaEdu are all very concerned about the losses and the sufferings of the Sichuan people. Collectively, the employees have donated close to RMB1 million to various foundations.

As a responsible member of society, ChinaEdu will contribute to the reconstruction of the disaster area in the next three to five years. In our opinion, the year 2008 will be remembered in the Chinese history for both extraordinary events and the spectacular challenges. The snowstorm, the earthquake, the Olympic summer games, along with the slowdown of global economy will impact the Chinese economy in many ways.

These events will also impact ChinaEdu in many ways. Since we are an anti-cyclical education service company, we do not see significant direct or immediate impacts. However, it would be too early for us to speculate or quantify the midterm positive or negative impacts from these events.

We are concerned about the possible challenges, for example, possible delays of certain [garment] decision-making processes. But at this time, from a bigger picture, we also see many opportunities. And we remain optimistic and confident. The fundamental of the business remains very strong. With that, I now direct your attention to Julia.

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

Thank you, Shawn. As I mentioned, the first quarter of 2008 was another strong quarter if you go back to revenue growth. Net revenue for the quarter was RMB69.7 million, an increase of 23.8% year over year. This healthy top line growth was driven primarily by the online degree programs.

Now our net income amounted to RMB2.1 million, and increase of 71 times compared to RMB0.03 million in the same period of 2007. Diluted earning per share was RMB0.03 in the first quarter of 2008, while our non-GAAP net income for the first quarter of 2008 increased by 100.4% to RMB4.6 million from RMB2.3 million.

Now move to slide eight. During the period, we had 91,000 paying students in the online degree programs we served. It represents a 23% increase from approximately 74,000 over the first quarter of 2007. Net revenue from online degree programs rose 37.1% to RMB55 million from RMB40 million for the period of last year. This substantial growth rate was primarily due to strong market demand and our continuous effort in improving service quality.

On the following slide, you will see that online degree programs make a larger contribution to the total revenue. In the first quarter 2008, our online degree programs accounted for 78.9% of the total revenue, compared with 71.2% in the same period of 2007.

Revenue from other business decreased by 9.3% to RMB14.7 million in the first quarter. This decrease was attributable primarily to declining revenue from oversea student (inaudible) in the first quarter of 2008 as compared to the corresponding period in 2007.

And now our gross margin has been seeing consistent improvement as you will see on the slide ten. Overall gross margin was improved to 65.3% for the first quarter of 2008 as compared to 60.4% in the same period of last year. In particular, gross margin for the online degree programs also continue to improve to 72.2% in the first quarter of 2008 from 70.4% in the corresponding period in 2007, reflecting the scalability of our online service model.

During the first quarter, we're able to take our cost of revenue growth slower than revenue growth, which supports our margin strength. Total cost of revenue grew moderately by 8.5%. Cost of revenue for online degree programs during the quarter was RMB15.3 million, representing our 28.8% increase from the same period in 2007. The increase was primarily due to increase in (inaudible) services necessarily to support our university partners online program as a result of increase in [new] students during the first quarter of 2008 as compared to the corresponding period in 2007.

Income from operations increased 10% to RMB12.8 million. This increase is primarily attributable to our investment expenses establishing and expanding our learning center network. Our investment expenses for expanding learning centers drove up selling and marketing expenses by 107.2% to RMB5.9 million in first quarter 2008.

In addition, our G&A expenses went up 33.5% due to additional expenses associated with being a listed company. R&D expenses meanwhile increased by 53.2% to RMB5.9 million due to increased R&D personnel and activities in our joint ventures.

Although our ongoing investment in establishing our learning center network for our online degree programs impact our operating profit growth this quarter, we believe the value of learning center network will be paid off over the longer term.

Now our net income during the quarter, you can see a significant increase of about 71 times to RMB2.1 million. Our non-GAAP net income, including stock comp and amortization of intangible assets was RMB4.6 million in first quarter 2008.

Our net income impact was mainly driven by two external or unforeseen factors. First is primarily due to our minority interest increase from RMB5.3 million in first quarter 2007 to RMB8.1 million in first quarter 2008 as a result of adoption of higher profit earned by some of the joint ventures.

Secondly, our interest income was impacted by the [Fed] interest cut. And it was lower compared with our management estimates. So on the slide four, you can see our balance sheet remains strong.

And now moving onto what we expect in the second quarter of 2008, we estimate that net revenue should be in the range of RMB70 million to RMB73 million, which represents a growth rate of 9.9% to 14.6% over the same period in 2007.

Before handing back to operator for the Q&A session, I would like to give you an update on the recruitment of our new CFO. We have been actively searching and identify a qualified CFO. We are in the process of finalizing a couple of candidates. We would like to get it done as soon as possible. With that, we would now take your questions. Operator?

QUESTION AND ANSWER

Operator

Thank you, Ms. Huang. We will now move onto the question and answer session. (OPERATOR INSTRUCTIONS). Your first question comes from the line of [Scott Shermanberger] with Oppenheimer. Please proceed.

Scott Shermanberger - Oppenheimer - Analyst

Thanks very much. Hello. I guess first question would be could you speak a little bit about your pricing growth in the core online degree business and your outlook on that? Thank you.

Shawn Ding - ChinaEdu - President, COO

Hi, Scott. This is Shawn. We did not have across-the-board tuition increase in the first quarter. Throughout 2008, in certain areas and in certain programs -- what I mean is selectively, tuitions will be increased. And in most of the increase probably will happen for the fall recruiting season.

Scott Shermanberger - Oppenheimer - Analyst

Okay. Thanks. For learning centers, is there much of a revenue impact yet from the new learning centers? Or are we still just in the very initial stages? And if there is much revenue there, could you provide a breakout of that from the online degree line? Thanks.

Shawn Ding - ChinaEdu - President, COO

Okay. I'll answer the first part. Yes, there are students recruited in the first quarter. And I don't know how the accounting has been accounted if the revenue has been accounted for in the first quarter. Jason, can you help me on that?

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Scott, we just confirmed the learning center revenue because of the U.S. GAAP will be recorded in the future quarters.

Scott Shermanberger - Oppenheimer - Analyst

Okay. Thanks, Shawn. You mentioned going into the vocational sector. Could you just elaborate a little bit more on that? That sounds interesting.

Shawn Ding - ChinaEdu - President, COO

Okay. As I mentioned earlier in my highlights, China is going through some very significant and dynamic changes, particularly in some of the cities in the eastern coast. The labor-intensive economy are being changed or shifted toward more knowledge-driven economy. I have visited several software or high-tech parks, where there used to be manufacturers. And all the manufacturers have been relocated to some other parts of the country.

So these "richer" areas are really looking forward to upgrade the economy and upgrade the workforce to a more BPO or software development type of economy and type of business.

So ChinaEdu consider this as a very interesting opportunity and very historical in some ways, that we should take advantage of the opportunity and align with the local government with the companies in the knowledge economy to provide quality training to them. And that's our intention.

Scott Shermanberger - Oppenheimer - Analyst

Okay. Great. Thanks. And then you mentioned with all the monumental events that are occurring in China this year, obviously, a lot of distraction with the government. Can you give us any type of update on university approvals for online degree programs and how that's progressing?

Shawn Ding - ChinaEdu - President, COO

That is -- there is a certain uncertain there. It's very hard for us to speculate on that at this point, Scott.

Scott Shermanberger - Oppenheimer - Analyst

Okay. Thanks very much. Appreciate it.

Shawn Ding - ChinaEdu - President, COO

Thank you.

Operator

Your next question comes from the line of Mark Marostica with Piper Jaffray. Please proceed.

Mark Marostica - Piper Jaffray - Analyst

Thank you. A few questions -- first of all, could you give us a sense if you saw any material enrollment from (inaudible) learning centers? I think you mentioned ten are in operation right now.

Shawn Ding - ChinaEdu - President, COO

Material enrollment in terms of how many students and what percentage of the students? Is that what you mean, Mark?

Mark Marostica - Piper Jaffray - Analyst

Yes, if you have that information, or just give us a sense if the quantity is material or not.

Shawn Ding - ChinaEdu - President, COO

Okay. In the -- well, I don't know how the students are divided between Q1 and Q2. What I can tell you, Mark, is for the first recruiting season, the learning centers -- our learning centers because only some of them was operating in the entire recruiting system -- some was only operating, like for example, three weeks or four weeks. So for the first -- for the entire recruiting season, the ten learning centers accumulated -- we have received applications of over 1,000 students. And because of the short season and we were able to convert over 800 of them to be paying students.

So we did have a -- we did lose some of the applicants. But that's primarily because of the seasonality. And some of these applicants will continue to be with us and join the program for the fall season. So in other words, we're not losing the other 20%, 30%. Some of them are just getting delayed.

Mark Marostica - Piper Jaffray - Analyst

Shawn, on that point, is that a typical conversion rate that you see with the third-party learning centers? Is this conversion rate better experience for you than a third-party learning centers?

Shawn Ding - ChinaEdu - President, COO

Well, we are expecting higher conversion rate with our learning centers. For the third-party learning centers, that varies very -- it's all over the map. And some of them do a very good job and can convert over 80%. Some of them would have a lower conversion rate. It's very hard to analyze.

Mark Marostica - Piper Jaffray - Analyst

And that -- it looks like these ten in that first category, if you assume that some of the students in that 20% are ready to move over to the next recruiting period.

Shawn Ding - ChinaEdu - President, COO

Yes, and also considering the short operating history, I think for the Fall recruiting season, we do expect to have a significant improvement in the total level of student enrollment as well as the conversion rate, of course, in terms of service quality as well.

Mark Marostica - Piper Jaffray - Analyst

Great. And then to follow up on a previous question regarding the new joint ventures where you're seeking licenses on the online degree business, could you give us a sense of when you would need to get those licenses finalized in order for ChinaEdu to be able to have those particular joint ventures up and running to post enrollments for the fall?

Shawn Ding - ChinaEdu - President, COO

Okay. I think, obviously, the earlier the better. But if by, let's say, August or September we still have not received the approval, then it's going to impact the fall recruiting season obviously. But what I also want to say is that we're not just sitting there and waiting for the approval. All these three joint ventures we have waiting for approval are aggressively developing programs that does not require license.

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In other words, one of the joint ventures has been doing like a second degree or second diploma type of programs in 2007. And another joint venture is doing that -- the one in Shanghai is doing that now. And the recruiting of that program is going to start very shortly.

The new joint venture we signed up in the first quarter, at this point, there's very little CapEx on that. And we have a team already kicked off the operation. We are trying to design similar programs so that we can have other type of revenues for the joint ventures.

Mark Marostica - Piper Jaffray - Analyst

Okay. And then as well on the vocational training strategy, what is your go-to-market approach? Would you consider making an acquisition to enter the market? How would you build the business? Any color on what particular verticals you may be interested in as well?

Shawn Ding - ChinaEdu - President, COO

Mark, it's probably a little bit too early for us to talk about that to give you a definitive answer. But what I can tell you right now is that we're looking at different opportunities. And we are looking to do the programs ourselves to start with. And in the particular areas, we are looking at some of the IT training areas and some of the other things as our first so-called breaking-the-ice type of initiatives.

Mark Marostica - Piper Jaffray - Analyst

Okay. Great. Then last question -- as Julia had mentioned, minority interest came in a little bit higher than what we were looking for. And we're curious if you can give us any color on how we should model that going forward. Thank you.

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

The minority interest from some of our joint ventures generates more profitability than we expected. We probably should follow the same percentage as we see in this quarter. But we do -- but we will go back to do more calculations before we confirm the percentage.

Mark Marostica - Piper Jaffray - Analyst

Okay. Thank you.

Operator

Your next question comes from the line of [Brian Winter] with [KIT]. Please proceed.

Brian Winter - KIT - Analyst

Thank you. My first question is can you talk about Q2 sequential growth rate? I think you said, Julia, from 9% to 14% year-over-year growth, given that one of the K through 12 schools we won't be able to be expecting students at September. Just trying to understand what sort of organic growth rate on a pro forma or 2008 basis we can expect going forward.

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

You mean sequential growth --?

Brian Winter - KIT - Analyst

One for Q2 and then the outlook for 2008, given -- or if you could quantify the impact, the revenue impact in Q3 or Q4 of the K through 12.

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

K through 12 Q2, Q3 will be the same. What we're doing is every year the student came in, in September. So the revenue will be fixed from September to next August. So the revenue will amortize for 12 months. So the impact will be from the Q4. So our capacity will be increased for the one campus Anqing, which the students number will be significantly increased.

But on the other hand, the Jinzhou school because of delays, there will be no students enrolled for the full semester starting with September. So that'll impact on our financials such as revenue.

Brian Winter - KIT - Analyst

Okay. Well, with respect to Q2, why don't we just focus on that? Maybe some of it fell into Q1 with more seasonality than expected. I'm just trying to understand the growth rate is a little slower. Q1 looked a little higher. So how do we expect maybe the online program growth rate going forward on an annual basis?

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

Online programs will be -- online combined with the online degree programs and also our [venues] interest. Our online -- existing online program will have organic growth from 10% to 15%. And our learning center will be the key growth driver. When learning center getting more mature, it will increase the growth rate of the current online growth rate -- online degree program growth rate.

The learning center -- the ramp-up speed was a little bit slower than we expected originally. But we have -- we're very confident that it will build up our steady growth from this Q4 onward.

Brian Winter - KIT - Analyst

And can you talk about the operating margin assumptions going for the rest of the year?

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

Brian, I don't have -- the operating margin will be similar across the quarters. But I definitely will double check when I look into the models.

Brian Winter - KIT - Analyst

Okay. With respect to the vocational strategy and given that I know you're still looking for a CFO and given all the disruptions you've talked about from the Olympics and the snowstorm, with respect to strategic areas of focus, how do you view the K through 12 business going forward, given that you're looking to do -- you're ramping up your learning centers as well as the vocational strategy? Are you concerned at all from a management perspective about being spread too thin?

Shawn Ding - ChinaEdu - President, COO

Brian, we have always considered the K-12 business as our opportunity play. And it's a long-term annuity business. It's going to generate healthy profit to us. And we're not spending -- from management resources perspective, we're not spending a lot of resources on that business.

Brian Winter - KIT - Analyst

I guess I was just more concerned from a CapEx perspective given the operating leverage and your technology platform. And I guess it's my last question with respect to your cash balance, how do you feel from a capital structure any stock purchases going forward, given the fall in the price?

Shawn Ding - ChinaEdu - President, COO

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I'm sorry I didn't catch -- there was a --

Brian Winter - KIT - Analyst

A stock buyback, have you -- given your cash balance a share buyback?

Shawn Ding - ChinaEdu - President, COO

We have not -- well, we have discussed this with our bankers. But we have not discussed this with our board. So at this point, Brian, there's nothing I can definitively say.

Brian Winter - KIT - Analyst

Okay. Thank you.

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

Brian, just give you operating margin estimation -- across the whole year, it's going to be -- so the overall, it will be similar rate as the first quarter, the margin. But quarter to quarter, there will be some fluctuations. The Q2 probably will be slightly higher. But Q3 will be lower depending on some expenses occur in the quarters. But across the board, it will be similar rate. There are some fluctuations there quarter to quarter.

Operator

We have no more questions. And I would like to turn the call back over to Ms. Julia Huang for closing remarks.

Julia Huang - ChinaEdu - Chairman, CEO, Interim CFO

Ladies and gentlemen, thank you again for joining us today. We appreciate you taking time to listen to our earning call. We would like to ensure you the management team's commitment to executing our strategy and delivering better results. We look forward to updating on our business progress in the near future. Thank you. Have a good day and a good night.

Operator

Thank you for your participation in today's conference. This concludes our presentation. You may now disconnect. And have a good day.

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