

# FINAL TRANSCRIPT

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## **CEDU - Q4 2008 CHINAEDU CORP Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Julia Huang**

*ChinaEdu Corp. - Chairman, CEO*

**Shawn Ding**

*ChinaEdu Corp. - President, COO*

**Lily Liu**

*ChinaEdu Corp. - CFO*

## CONFERENCE CALL PARTICIPANTS

**Mark Marostica**

*Piper Jaffray - Analyst*

**Echo He**

*Oppenheimer - Analyst*

## PRESENTATION

**Operator**

Welcome to the ChinaEdu Fourth Quarter and Full-year 2008 Financial Results Conference Call. At this time, all participants are in a listen-only mode. Following management's prepared remarks, we'll hold a Q&A session.

(Operator Instructions)

As a reminder, this conference is being recorded March 19th, 2009. Joining me today are Ms. Julia Huang, Chairman and CEO, Mr. Shawn Ding, President and COO, and Ms. Lily Liu, CFO. After the close of the US markets on Wednesday, ChinaEdu issued a press release announcing its 2008 fourth quarter and full year financial results, which is available on the Company's IR webpage at [www.ir.chinaedu.net](http://www.ir.chinaedu.net).

This call is also being broadcast live over the Internet and a copy of the presentation that will be used for today's call is also available on the Company's website. 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 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, whether as a result of new information, future events or otherwise.

I would now like to turn the call over to ChinaEdu's Chairman and CEO, Ms. Julia Huang. Following the Company's prepared remarks, there will be a question-and-answer period. Please go ahead.

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**Julia Huang** - ChinaEdu Corp. - Chairman, CEO

Thank you, Erica. Good morning and good evening. Thank you for joining us today. First, I would like to give you an overview of our 2008 full-year results. We are pleased to report strong top-line growth for fiscal year 2008 and the fourth quarter, despite a challenging economic environment. The current environment in China, like elsewhere in the world, has been affected by the financial crisis. Although there are uncertainties, China and China's education sector still possess great potential.

I would now like to quickly go over some of the key items for ChinaEdu in fiscal year 2008. We are pleased to report an increase in total net revenue of approximately 20%, from RMB265 million in 2007 to RMB318 million in 2008. Our core business online degree services grew by 26.3% from RMB202 million in 2007 to RMB255 million in 2008. The solid revenue results exceeded our top-line guidance and was primarily driven by the strong growth in revenue students in our core business line, online degree programs.

For the fiscal year of 2008, our adjusted EPS on a diluted basis was \$0.10 per share or \$0.30 per ADS, and also our adjusted EPS for the fourth quarter 2008 was \$0.12 per ADS. Now

let's move to slide four. Our revenue students for fiscal year 2008 totaled 243,000, compared to 192,000, which marked an increase of 27%. The number of revenue students in the fourth quarter grew 29%, from 91,000 in 2007 to 118,000 in 2008. The number of our learning centers grew from 33 to 37 from the third quarter to fourth quarter in 2008. Our CAGR growth for revenue students from 2003 to 2008 is at 39%, reiterating the consistency of our core business growth. Let's now turn to Shawn Ding, our President and COO, for business and operational highlights, followed by Lily Liu, our CFO, for the financial highlights. Shawn?

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**Shawn Ding** - ChinaEdu Corp. - President, COO

Thank you, Julia, and a warm welcome to all of you joining us today. In Q4 2008, we successfully completed the fall recruiting season for our online degree program and kicked off the spring recruiting season of 2009. Even with all the challenges in today's world, we were very pleased to see the online degree programs' recruiting numbers are in line with our expectations, and we made significant improvements internally in many areas. In 2008, as Julia just mentioned, our revenue students increased by 26%, from 192,000 in 2007 to 243,000 in 2008.

This organic growth shows the potential of our online degree programs. Earlier in the year, we signed a joint venture agreement with Beijing Forestry University. The signing marked the 12th collaborative alliance for our core business.

In anticipation of the upcoming challenges of the overall economy, we further aligned our resources in this direction, cut costs where we can, aggressively invested in service, product and technology of our online degree programs for sustainable organic growth, and we continued our effort in developing our online business.

Now I would briefly -- I would like to briefly talk about our strategic achievements related to our learning center network. We have been actively expanding our network of learning centers. We have talked to you before, we currently at this point have 16 proprietary learning centers and 31 franchise learning centers, giving us altogether of 47. We signed two more service contracts in the fourth quarter. One is University of Electronic Science and Technology in Chengdu, and the other one is Jilin University.

So, all together, our learning center networks are serving 14 universities in total in terms of providing recruiting services to them. Overall, we are targeting profitability for 2009 for our learning center network and we expect significant contribution in 2010 from this business line.

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Now, turning to slide seven, for our online tutoring business, we acquired the remaining 20% of 101 Online Tutoring earlier part of this year, 2008, giving us 100% control of this business. After that, we have made significant operational and management changes in order to realign the business.

Even though we have not seen significant sales increase from this business, we are very, very happy to see the improvements for many indicators, such as channel sales, student satisfaction, page view numbers, et cetera. We have launched several new products and we have enhanced our current business products and services, and we are very confident about the future of this business.

Slide eight, give you some ideas of our two other, smaller business lines. Generally speaking, our private schools are well on track. Phase one construction of the Anqing school was completed in 2008 and the new campus was in operation as planned, now hosting approximately 1,200 students. Phase two construction is slated to be completed sometime in this summer and will be ready for the fall recruitment in September.

The PingDingshan school has made many operational improvements as well, and is performing very well. As we reported before, our Jingzhou school construction was suspended. For our international curriculum business, even though growth in the business was impacted by regulation, the business was steady. We also signed a new partnership agreement with Howe Sound, the secondary school in British Columbia, Canada.

Now, next page, 2.5 months into 2009 we remain optimistic about the outlook of online education, but we are also a little uncertain about the possible impacts of the economic environment. Regardless, we will execute a set of initiatives to ensure the short and long-term growth of our business.

Number one, ChinaEdu will increase the business development effort in the online degree business. We have a very strong business development team right now and we have a number of initiatives going on in that area. We will continue to improve operational efficiency, develop technology and product and raise the quality of products and services. This is going to be our theme for 2009, and we will continue the expansion of our learning center network.

As you can see, our learning center network was growing very well in 2008. Finally, ChinaEdu will also expand our online tutoring. To conclude our remarks, I would like to share with our investors that in 2008 we have clearly set online education as our core and strategic direction. The management team is committed to executing in this direction and we are seeing many exciting opportunities.

We believe this commitment will further strengthen the fundamentals of the business and generate solid revenue growth, thus providing the best value to our shareholders. Now Lily will review some of the key financial information from this quarter. Lily?

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**Lily Liu** - ChinaEdu Corp. - CFO

Thank you, Shawn. I will now go over our financial highlights and a more detailed review of the financials in the following slides. Let's turn to page 11. Fourth quarter and full-year highlights. I will quickly go over the key metrics here first before launching into a more detailed analysis of our financial results. The revenue students growth and net revenue growth for the year have already been reviewed by Julia, so let's focus on the fourth quarter '07 versus fourth quarter '08 growth here for a second.

If we're looking at just the fourth quarter, total net revenue grew by 9% from last fourth quarter to this fourth quarter. Net revenue from online degree programs grew by 8%. However, the percentage increase here is not a true reflection of the actual revenue growth from operations. There was a one-time revenue item of RMB8.4 million in the fourth quarter of 2007. Also, in both quarters, both fourth quarters, we have included a value-added tax refund of RMB3.5 million and RMB6 million, respectively. Excluding the above non-operational items, total net revenue grew by 19% from fourth quarter '07 to fourth quarter '08, and net revenue from online degree programs grew by 21% from quarter to quarter.

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Page 12. As you can see from this slide, in the fourth quarter, cost of revenue and expenses both increased significantly. It's actually due to investments, the Company's investments in several areas, which I will go through in more detail. Adjusted EBITDA margin was down in 2008 compared to 2007, also due to these investments in the growth areas. However, adjusted net income and adjusted net margin grew in 2008 from 2007, primarily due to a tax benefit recorded in the fourth quarter.

Now let's go through and analyze our financial statements for the fourth quarter as well as the full year in detail, line by line. Let's turn to page 14. Again, page 14 is a slide that summarizes our top line growth for the online segment. This has been reviewed by Julia before, so I will not repeat here and let's go directly into slide 15. Slide 15 shows the revenue growth for the other three business lines and the top-line growth for these three business lines have performed in line with our expectations.

For 101 Online Tutoring business, particularly since the second half of the year, the management has spent focused energy to revive the growth in the business, as Shawn has mentioned just earlier. We are very confident that online tutoring for K through 12 has significant growth potential in the future and since we are already a dominant player in this market, we intend to capture that growth in the coming years.

Year-over-year, net revenue growth for 101 business declined by 12%. However, if you noticed, in the fourth quarter, we actually stopped loss and net revenue for the fourth quarter '08 was actually flat from the fourth quarter '07. For the international curriculum business, not surprisingly, net revenue declined year-over-year, as well as fourth quarter over fourth quarter. As you can see from the results, we have taken significant goodwill and intangibles impairments for the business during the fourth quarter. Our FEC program has been negatively impacted by adverse regulatory changes since late 2007.

Towards the end of 2008, we officially terminated our previous overseas partner and in February we actually signed a new partner with a Canadian school, as mentioned by Shawn. However, the renewal of local partners and the associated regulatory approval process will take time and in the meantime, in the short term, our revenue will be impacted.

Having said that, we actually have cut down costs in running the business to maintain positive cash flows from the business. For the private school segment, our Anqing school completed a Phase I construction by September 2008 and as a result recorded strong fourth quarter over fourth quarter revenue growth of 86%. Cost of revenue associated has also risen, but at a slower pace compared to revenue growth. We're pleased to report a gross margin expansion from 7% to 15% for the private schools.

Let's turn to page 16. As you can see from the financials, in terms of gross margin, our gross margin declined for the online degree segment and online tutoring segment, but actually expanded for international curriculum due to cost-cutting measures and private schools, due to Anqing School's significant enrollment growth. For the online degree business, the primary reasons for the increased costs of revenue are our investments in the learning centers network and investments in courseware development. At the end of 2007, we had only one operational learning center. At the end of the third quarter, we had 33 learning centers, and at the end of the fourth quarter we had 37, and as of current date we have 47.

During the fourth quarter, the learning centers incurred increased costs, corresponding to our fall recruiting period. Also in the fourth quarter, the Company decided to invest in a new courseware development. Typically, courseware development happens in the fourth quarter. This year in particular we decided to invest in developing a number of so-called elite courses. These courses are publicized in the industry and are ranked. We believe investing in these courses will not only bring benefit to the students but also further with our profile and brand in the industry.

If you look at the full year's increase in cost of revenue, there was another investment area worthy of mention. One of our collaborative alliances established a new subsidiary in the second half of 2008 to develop non-degree offerings. Related total cost of revenue was approximately RMB1 million. So, in conclusion, for the full year 2008, if you exclude increases due to the three investment areas, or the three areas that were not in place in 2007, total cost of revenue increased by only 18%. This is actually keeping in track as the overall revenue growth.

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Now let's turn to page 17. Page 17 shows a summary of our general and administrative expenses. Our G&A expenses increased both for the fourth quarter and full-year 2008, but the increases have been well within control. Although we paid more in employee bonuses for 2008 due to a strong revenue growth, several of the businesses actually experienced tight G&A expense control, including, for example, our on-on-one online tutoring business.

General cost control is something the management team will continue to strive for in 2009, particularly in the tough economic environment. Next slide, on selling and marketing expenses.

Our selling and marketing-related expenses increased significantly compared to 2007, again, primarily due to our investments in the learning centers networks, the 101 business, as well as the exploration of non-degree online education.

Please note that the numbers -- from the numbers that the majority of the additional or increased selling and marketing spending for these areas actually occurred in the fourth quarter, due to a timing corresponding to the fall recruiting season. More learning centers went operational in the fourth quarter recruiting season, hence, increased selling and marketing expenses. Similarly, the busiest season for our 101 Online Tutoring program usually occurs in the July and August months.

In the fourth quarter, we also incurred some additional promotional and advertising activities for the sector. So, for the full-year 2008, if we exclude increases in S&M expenses due to the above three investment areas, total selling and marketing expenses only grew by 17% from 2007 to 2008, again, well keeping in pace with the general revenue growth.

Page 19, research and development expenses. R&D expense increase for the 2008 tracked well with our overall net revenue growth. On the ongoing basis, we will continue to invest in R&D in order to maintain our competitive advantage, as well as positioning us for future growth.

Now on page 20 I'd like to highlight our adjusted EBITDA margin, which is a measure that we internally focus on as a Company. As we have discussed in full regarding the impact of investments on costs and expenses, you can see that our adjusted EBITDA margin actually decreased from 31% to 27% from 2007 to 2008.

However, as I have discussed earlier, if we exclude investments in these areas, for the ongoing businesses that were in place in 2007, cost and expense increases are on par and actually slightly below our revenue growth. Now, on page 21, a page on our net income and adjusted net income, as you can see, our GAAP net income was negatively impacted by a RMB52 million goodwill and intangibles impairment for the fourth quarter. Out of this amount, only RMB2 million was related to the goodwill writedown of the JingZhou school. Since we have suspended construction for that school indefinitely and currently we have no definitive expected time for starting the construction or enrollment, so we decided to write off the goodwill for that school.

For all of the goodwill intangibles impairments, we do not believe this will be a recurring item in 2009 or beyond. On an adjusted basis, our adjusted net income on margins, which were also impacted by cost and expense increases, due to our investments in various areas, however was offset by an income tax benefit recorded in the fourth quarter. In the fourth quarter, our subsidiaries received the qualification for preferential tax treatment under the new and high-tech enterprises status. This new tax law became effective since January 1st, 2008, and in the fourth quarter we finally received a qualification. That was the summary for our income statement lines.

Now let's take a look through our balance sheet. I have highlighted on the page the main items of change. First, you can see that our intangibles and goodwill balance have been reduced significantly.

Secondly, post the recruiting season, deferred revenue increased by RMB70 million from the end of third quarter to the end of year. At the same time, our amounts due from related parties, that is, amounts due from our university partners, increased by RMB23 million. Thirdly, to highlight it here, amounts due to related parties decreased in the fourth quarter from the end of third quarter by RMB33 million.

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Page 23, I just want to quickly highlight our cash balance position. As of year end 2008, our cash, which includes cash and term deposits, remained approximately the same as that of the end of third quarter, at approximately \$60 million. Please note that at the end of the first quarter 2009, our cash provision will be further reduced by \$11 million, which was our second payment for the share repurchase from Tiger Global.

Lastly, I want to quickly mention the main reason behind a reduction of cash flow from operations for the quarter, as it was noticed by some investors. The main reason is because our cash collection from university partners was slightly lower than our payment due from selected university partners. So the decrease in cash flow from operations was about RMB6 million for the quarter.

Finally, on page 26, I just want to mention again that our revenue guidance for the first quarter of 2009 is of a range from RMB75 million to RMB78 million. So this concludes my review of the financial results. I'd like now to open the call to questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). And your first question comes from the line of Mark Marostica from Piper Jaffray. You may proceed.

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### Mark Marostica - Piper Jaffray - Analyst

Thank you. I just wanted to first ask a question related to the softening of the economy and I think, Shawn, you mentioned some concern in that regard. It doesn't appear that that's impacting your enrollment in the higher ed area as of this point. Would that be true, or are you seeing anything that's at least got your antenna up that we may be seeing some slowing in enrollment growth?

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### Shawn Ding - ChinaEdu Corp. - President, COO

Thank you, Mark, for the question. I was going to use the word concerned, but I quickly changed that to uncertain. I think a concern is probably a little bit too strong at this point. What we are seeing right now is that we see some areas -- since our spring recruiting season is not over yet.

We see some areas that are having some slower-than-expected recruiting numbers, but we also see in some other areas stronger-than-expected recruiting numbers, and this is not something that we have not seen before. We have seen things like this in good years, as well. So we're just saying today we wanted to be conservative and not certain what the economic environment will do to us at this point. That's all we're saying right now.

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### Mark Marostica - Piper Jaffray - Analyst

Understand, understand. You also mentioned that you expect profitability from the learning center network in '09. How long does it take your average learning center to achieve profitability.

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### Shawn Ding - ChinaEdu Corp. - President, COO

It really depends. In some areas, we have seen the learning center to be profitable during the first 12 months, and we have also seen the learning center taking a little bit longer than that. So the best range I can give you is 12 to 18 months.

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**Mark Marostica** - Piper Jaffray - Analyst

Okay, and then at that juncture then, by the end of '09, is it the fourth quarter of '09 you expect to see profitability from the overall network?

**Shawn Ding** - ChinaEdu Corp. - President, COO

Mark, I'm saying the whole-year number.

**Mark Marostica** - Piper Jaffray - Analyst

For the year, the whole-year number. So presumably then, at some point in the second half, and we can probably delve into this post the call, but at some point in the second half of the year we'll start to see it turn profitable, because I understand it's not profitable at this point.

**Shawn Ding** - ChinaEdu Corp. - President, COO

This is not profitable at this point yet, yes, it is true.

**Mark Marostica** - Piper Jaffray - Analyst

Fair enough. Of the collaborative alliances that you have, I believe a dozen, nine only are license. What do you think the timing of licensure of the others will be?

**Shawn Ding** - ChinaEdu Corp. - President, COO

That question comes up every time. We still don't have a specific timeframe we can comfortably provide you with at this point.

**Mark Marostica** - Piper Jaffray - Analyst

And I've asked this before I think on calls, but just to clarify, to hit the window for the fall recruiting season and for you to actually garner revenue from those three relationships in the fall recruiting period, when would those licensures have to be inked or occur?

**Shawn Ding** - ChinaEdu Corp. - President, COO

Sometime in the summer, before.

**Mark Marostica** - Piper Jaffray - Analyst

June-July timeframe?

**Shawn Ding** - ChinaEdu Corp. - President, COO

June-July timeframe.



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**Mark Marostica** - *Piper Jaffray - Analyst*

Good enough. I'm sorry?

**Shawn Ding** - *ChinaEdu Corp. - President, COO*

No, I was just going to add, that will give us a few months of recruiting time.

**Mark Marostica** - *Piper Jaffray - Analyst*

Great. A couple more questions, I'll turn it over. The tax benefit that you accrued in the quarter, I'm not sure if you specifically quantified that. I think you said it was significant, really. Could you quantify that for us?

**Lily Liu** - *ChinaEdu Corp. - CFO*

Well, the tax benefit -- the resulting tax benefit for the quarter is actually RMB19.6 million. That's on our income statement.

**Mark Marostica** - *Piper Jaffray - Analyst*

Right. And then going forward, how should you think about your tax rate, given the new and high-tech enterprise status?

**Lily Liu** - *ChinaEdu Corp. - CFO*

Here's the thing. We have over 20 legal entities. Some of the legal entities are basically companies that have a loss, but I can only give a rough range for the effective tax rate on a going-forward basis. We're estimating that to be between 25% to 30% effective tax rate, even though the statutory tax rate for the profitable legal entities are at 15%.

**Mark Marostica** - *Piper Jaffray - Analyst*

Okay, last question, on one of your last slides, you indicated the cash flow from operations was impacted due to cash collections from parties being below amounts due. Could you explain why that occurred this quarter and then how that should behave in the next coming quarters?

**Julia Huang** - *ChinaEdu Corp. - Chairman, CEO*

Sure. I don't believe that this is a matter for concern, actually. We just finished our fall term enrollment. Typically, the collection process from our university partners tends to be somewhat slow. It's not something that we are actually concerned about, and the reason the cash flow from operations actually went down was in the fourth quarter we actually paid more to some of the selected university partners than we have collected from the other university partners, so the net result was a reduction. So we do not believe that this will be an ongoing trend in the future.

**Mark Marostica** - *Piper Jaffray - Analyst*

Okay, great. Thank you, and I'll turn it over.

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**Operator**

Your next question comes from the line of Echo He from Oppenheimer. You may proceed.

**Echo He - Oppenheimer - Analyst**

Hi. Thank you for taking my questions. Three questions, basically. The first one, could you explain where going forward you expect the margin, including gross margin and operational margin are going to settle at?

**Lily Liu - ChinaEdu Corp. - CFO**

Echo, we actually don't typically give out margin guidance, so I think that that's a hard question for us to pin down on the call right now.

**Echo He - Oppenheimer - Analyst**

That's okay. Okay, the second one is on your balance sheet. I saw the deferred revenue has increased significantly. Could you explain that -- where does the deferred revenue coming from, which business segment? And, also, how are you going to realize them in the next quarter?

**Lily Liu - ChinaEdu Corp. - CFO**

Sure. Deferred revenue typically increases two times a year, corresponding to our spring and fall enrollment period. So our fall enrollment typically starts at the beginning of Q4, literally starts at the very end of Q3 or beginning of Q4. So what happens is we receive a lot of cash from university partners, and the cash will be deferred over the semester, which is six months. So, at the end of the quarter, the year-end quarter, we will generally have recognized half of the cash received as revenue. The rest of the cash is recorded as deferred revenue on the balance sheet.

**Echo He - Oppenheimer - Analyst**

So this deferred revenue will be recognized in the next two quarters?

**Lily Liu - ChinaEdu Corp. - CFO**

In the next quarter, so our first quarter revenue is essentially deferred revenue, recognized as revenue from the falling enrollment.

**Echo He - Oppenheimer - Analyst**

Okay, I understand. And what is the year-over-year increase of deferred revenue line?

**Lily Liu - ChinaEdu Corp. - CFO**

Year-over-year increase in deferred revenue, simply it goes in line with our general cash collection -- or cash received increase, or tuition increase year-over-year.

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**Echo He** - *Oppenheimer - Analyst*

And it's compared to the same period of '07?

**Lily Liu** - *ChinaEdu Corp. - CFO*

Correct. So our total tuition received has increased from last fall enrollment to this fall enrollment, so our deferred revenue, as well as revenue recognized, will both increase as well.

**Echo He** - *Oppenheimer - Analyst*

Okay, so which part is from price increase, which part is from enrollment increase?

**Lily Liu** - *ChinaEdu Corp. - CFO*

Our revenue is almost entirely driven by enrollment growth. I would say that the price increases in very selected cities is minimal in the grand scheme of things.

**Echo He** - *Oppenheimer - Analyst*

Okay, understand. And, last one, do you have any plan of divesting of your assets, like your land-based and international education assets?

**Shawn Ding** - *ChinaEdu Corp. - President, COO*

Can you come again? Can you ask again please? I didn't hear correctly.

**Echo He** - *Oppenheimer - Analyst*

Do you have any plan of divesting your international or land-based assets?

**Julia Huang** - *ChinaEdu Corp. - Chairman, CEO*

Echo, at this point, we are open -- these two businesses are more opportunity driven and resources driven. We're more focused on our online education. If there are opportunities come in, we'll open up to the divesting opportunities.

**Echo He** - *Oppenheimer - Analyst*

Okay, understand. Thank you so much. That's all.

**Operator**

(Operator Instructions). And at this time there are no further questions. I would like to turn it over to management for closing remarks.

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**Julia Huang** - ChinaEdu Corp. - Chairman, CEO

Ladies and gentlemen, let me close by reiterating how much we appreciate your interest and support. To summarize, 2008 perhaps can be regarded as the most challenging, most busy, as well as most fruitful year for us at ChinaEdu. We overcame a lot, learned a lot, strengthened a lot. As a Company and as a team, we believe we are well prepared for our future success. Thank you. Have a good day or good night.

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#### Operator

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

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