

# FINAL TRANSCRIPT

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## **CEDU - Q3 2009 CHINAEDU CORP Earnings Conference Call**

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## CORPORATE PARTICIPANTS

**Jimmy Xia**

*ChinaEdu Corporation - IR*

**Julia Huang**

*ChinaEdu Corporation - Chairman, CEO*

**Shawn Ding**

*ChinaEdu Corporation - President, COO, Director*

**Lily Liu**

*ChinaEdu Corporation - CFO*

## CONFERENCE CALL PARTICIPANTS

**Jeff Lee**

*Signal Hill - Analyst*

**Ella Ji**

*Oppenheimer & Co. - Analyst*

## PRESENTATION

**Operator**

Welcome to the ChinaEdu Third Quarter 2009 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 on November 24, 2009. I would now like to turn the conference over to ChinaEdu's Investor Relations Manager, Mr. Jimmy Xia. Please go ahead, sir.

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**Jimmy Xia - ChinaEdu Corporation - IR**

Thank you. Good morning and good evening. Thank you for participating in today's call. 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 Monday, ChinaEdu issued a press release announcing its 2009 third quarter financial results, which is available on the company's new IR webpage at [ir.chinaedu.net](http://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 quarterly results section on the Company's IR webpage.

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, which include 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, level 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,

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including those described under the heading Risk Factors in the company's annual report on Form 20-F for the year December 31, 2008 filed with Securities and Exchange Commission and in documents subsequently filed by the company from time to time with the SEC.

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 also like to note the reporting currency ChinaEdu is RMB, but for the convenience of the readers, the amounts are presented in US dollars. All translations from RMB to US dollars were made at the rate of RMB6.8262 to \$1, the noon buying rate in effect on September 30, 2009 in the H.10 statistical release of the Federal Reserve Board.

All percentages are calculated using the numbers presented in the financial statement contained in the earning release presented in RMB. We make no representations that the RMB or US dollar amounts referred could be converted into US dollar at any particular rate or at all. I would now like to turn the call over to our ChinaEdu's Chairman and CEO, Ms. Julia Huang. Julia?

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**Julia Huang** - *ChinaEdu Corporation - Chairman, CEO*

Thank you, Jimmy. Good morning and good evening. Thank you, again, for joining us for today's call. ChinaEdu has once again exceeded Management guidance during the third quarter of 2009. Management continuously focused on business developments for new partnerships, Learning Centers network, new product and service developments for our students in 101 online school programs, as well as driving up regional efficiencies as you can see from our financial.

ChinaEdu's team is inspired by future online education marketing opportunities in China driven by both technology innovation and student demand. We are confident that we are in the best position to capture the market opportunities and strive to deliver sustainable value to both our customers and our shareholders. Now let's turn to slide four.

Our overall net revenue in the third quarter of 2009 grew by 9.3% to \$13.1 million compared to \$12 million in the corresponding period of 2008, which surpassed both Management's guidance and analysts' consensus. Our operating income increased to \$2.9 million in the third quarter of 2009 compared to a loss of \$0.2 million in the same period of 2008.

Our adjusted net income increased by 30.6% to \$1.4 million in the third quarter of 2009 compared to \$1.1 million in the corresponding period of 2008. While our adjusted net margin increased to 11% in the third quarter from 9.2% in the corresponding period in 2008. Our diluted EPS was \$0.061 in the quarter. Our adjusted diluted EPS was \$0.082 in the quarter versus \$0.056 in the corresponding period of 2008.

The improvements from the third quarter of 2008 were due to better operating results, as well as share count reductions. Let's now turn to Shawn Ding, our President and COO for business and operational highlights, followed by Lily Liu, our CFO, for more financial highlights. Shawn?

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**Shawn Ding** - *ChinaEdu Corporation - President, COO, Director*

Thank you, Julia. Good morning and good evening, ladies and gentlemen. Thank you for being with us today. During the third quarter of 2009, ChinaEdu continues to make solid progress through organic growth as well as the development for online education and online degree programs.

In slide six, in the third quarter we kicked off our online degree programs fall recruiting. So far, we are pretty pleased with the number of applicants and the level of interest in our online degree programs. Final enrollments and tuition collections are still underway. The recruiting numbers will be finalized shortly.

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In our efforts to build an efficient nationwide learning center network, as of September 30, 2009, we have had 33 contracted and 23 proprietary Learning Centers, making a total of 56 Learning Centers. Comparatively, we had 25 contracted and 10 proprietary Learning Centers at the end of the third quarter in 2008.

We will add a few more Learning Centers to complete the 2009 fiscal year. By the end of 2010, we are expecting to have around 100 Learning Centers across the nation. Now, for our 101 Online Tutoring business, we have seen positive steps from our new initiatives put in place in 2008. For a second straight quarter, we have seen the business grow as expected. We can see -- we have seen a 60% increase in net revenue in the third quarter compared to the same period of 2008.

We will continue to improve product offering with service levels and increased nationwide sales efforts. We will also make more technology improvements to provide better services. For our private school business, our Anqing School has successfully increased enrollment numbers after the completion of Phase II construction.

Altogether, we increased the number of in-school students from both Anqing and Pingdingshan schools by over 1,300 students. As a result, net revenue for our Private Schools business increased by 58% in the third quarter compared to the same period last year.

In the third quarter, the Management team is still focusing on developing new business, improving operational efficiency, developing technology and products and has raised the quality of services. To echo Julia's message, we are very optimistic about the launch prospective of online education in China. We believe we can achieve long-term, healthy growth by capturing a bigger market share and continue to invest in building our core competency. I would now like to turn over to Lily for a review of the financial information. Lily?

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**Lily Liu** - ChinaEdu Corporation - CFO

Thank you, Shawn. I now would like to go over the financial results for the third quarter in more detail. As mentioned by Julia in the financial highlights section, our net revenue for the online degree programs reached \$10.5 million which grew approximately 9.4% from third quarter of 2008. This is still driven by strong 2009 spring semester enrollments with revenue students' number increasing from 125,000 to 147,000

As I mentioned in the call during our previous quarter's earnings release, for 2008 spring semester, our students' number of 125,000 did not include student numbers from Lanzhou University, Nanjing University or our Learning Centers. Therefore, the student number of growth of 18% appears higher than our net revenue growth. Our total net revenue for the quarter reached \$13.1 million, which also represents a 9.4% growth from the third quarter of last year.

Now on to page nine, with net revenue breakdown for the other three business segments, combined, our three other business segments reached a total net revenue of \$2.7 million or 20% of our total net revenue. This represents a 9.5% growth from third quarter last year. As expected, our 101 Online Tutoring and private school has recorded at strong growth compared to third quarter of last year.

101 Online Tutoring's net revenue grew by 60% to \$0.8 million, which is 6% of our overall revenue. This segment is expected to continue to grow at a healthy rate. Summer season, which usually corresponds to our third quarter, is typically a strong season for 101 Online Tutoring and there was a onetime revenue item in the current quarter, so 60% growth is not foreseeable going forward.

Private Schools net revenue grew by 58% to \$1.1 million, which is 9% of our total net revenue. The growth is driven by Anqing School's new campus. International curriculum programs, as we have indicated in the past quarter, net revenue declined by 42% to \$0.7 million, which is currently a 5% contribution to our total net revenue this quarter. Our business development efforts are continuing with our new SCC program.



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Page ten is an overview of our gross margins. Gross margins for the online degree programs was 67% this quarter, which decreased the one compared to a 70.5% in the third quarter of 2008. Learning Centers have a different and cost and expenses structures than our traditional online degree programs. Most of the expenses incurred by the Learning Centers is considered directly related to revenue generation, therefore, recorded as cost of revenue.

Those Learning Centers have a lower gross margin than our traditional online degree programs. However, Learning Centers also incur less operating expenses. Therefore, we believe on a normalized based, our Learning Centers should still generate a healthy net margin.

At the end of this quarter, we have a total of 56 Learning Centers. As mentioned by Shawn, 23 were proprietary and 33 were third party affiliated. The total number did not expand due to busy fall recruiting preparations. Our 101 Online Tutoring programs gross margin remains relatively stable compared to last year at 75%. Our Private Schools gross margin improved to 8% due to revenue growth.

Page 11, total operating expenses were \$5.1 million this quarter which when compared to third quarter of 2008 of \$5 million, excluding good will and intangible asset impairment of \$2.6 million, remained nearly flat. Our general and admin expenses were \$3.1 million for the quarter, compared to \$3 million in the third quarter of 2008.

Our sales and marketing expenses were \$1 million for the quarter, which decreased from \$1.3 million in third quarter of 2008, as we focused on recruiting efforts at our Learning Centers, rather than general advertising and promotional activities. Therefore, our cost of revenue increased while our sales and marketing expenses decreased, which were also offset by sales and marketing expense increased for our online degree programs and 101 Online Tutoring program.

Also, as we wrote off intangible assets related to sales and marketing last year, corresponding amortization expense included in the sales and marketing expenses also decreased compared to the third quarter of 2008. Third quarter 2008 sales and marketing also included conference related expenses, which occurred in the fourth quarter of this year rather than in the third quarter.

Our R&D expenses were \$1.1 million this quarter, which increased from \$0.8 million in the third quarter of 2008. Our R&D efforts continue to focus on online degree technologies platform, as well as products and services for our 101 Online Tutoring program.

Page 12, we will take a look at our adjusted operating income. Our adjusted operating income is GAAP operating income with amortization and share-based compensation added back for this quarter. Last year's adjusted operating income also added back goodwill and intangible assets, impairment expense and a onetime exchange loss.

Adjusted operating income increased slightly to \$3.3 million for the quarter and adjusted operating margins declined slightly from 26% to 25%. Improved operating results were offset by lower gross profits due to expansion of Learning Centers. For your information, our share-based compensation was \$218,000, which remained flat from third quarter of last year.

Our amortization expenses for the quarter were \$185,000, compared to \$335,000 in the third quarter of last year. A similar trend holds for adjusted operating income and adjusted operating margins for the nine months ended September 30, as show on the page.

Page 13, if we look at our adjusted EBITDA, which is an important operating metric, our adjusted EBITDA reached \$3.9 million for the quarter and adjusted EBITDA margin remained flat at approximately 30%, compared to third quarter of last year. On the nine-month basis, our adjusted EBITDA reached \$12 million and adjusted EBITDA margins also remains relatively stable at approximately 32%.

Page 14 shows our adjusted net income results. Again, adjustments for this quarter's adjusted net income include adding back share-based compensation and amortization expenses. For third quarter of 2008, it also included a good will and the intangible assets impairment and a onetime exchange loss.



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Our adjusted net income reached \$1.4 million and adjusted net margin was 11% for the quarter, and 13.6% for the first nine months of 2009. Both measures improved from the same period in 2008. Our EPS rose significantly compared to last year, primarily to a lacking of goodwill and the intangible assets impairment, as well as a reduction in share counts. Our diluted EPS was \$0.06 for the quarter, compared to a loss of \$0.11 for the third quarter last year, similarly, for the nine months of 2009, our diluted EPS totaled \$0.216, compared to a loss for the nine months in 2008.

Page 15 is a quick overview of our balance sheets. There have been no significant changes in the quarter. Our total cash and term deposits at the end of the quarter were approximately \$45.8 million. Part of our cash was also used for certain higher yield, but still principal protected investments, totaling approximately \$1.6 million as shown on the balance sheet.

Finally, I would like to give our Management guidance for the fourth quarter total net revenue which is expected to range from RMB88 million to RMB92 million, or \$12.9 million to \$13.5 million. This represents a 1.7% to 6.3% growth from total net revenue in the fourth quarter of 2008. However, I would like to mention that 2008 fourth quarter has a onetime VAT, or value added tax refund impact of approximately \$0.9 million, or actually, RMB6 million. Excluding that onetime VAT refund, our net revenue guidance, in fact, represents a 9.3% to 14.2% growth. This concludes my review of the financial performance. I now would like to open the call to questions, and afterwards Julia will make a conclusion.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions)

And your first question comes from the line of Jeff Lee with Signal Hill. Please proceed.

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**Jeff Lee** - Signal Hill - Analyst

Hi, good evening. I have a question. How much was the onetime item in 101 online school segment that you mentioned for this quarter?

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**Lily Liu** - ChinaEdu Corporation - CFO

101 Online Tutoring -- I think, otherwise, without the onetime item grew by about 20% compared to last year.

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**Jeff Lee** - Signal Hill - Analyst

Okay, and --

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**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

Was that your question, Jeff?

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**Jeff Lee** - Signal Hill - Analyst

And maybe you could talk about what type of seasonality is there in this segment and what you attributing to strength, the 20% growth to, given the declines you've had the last three, four quarters?



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**Lily Liu** - ChinaEdu Corporation - CFO

I'll talk about the seasonality and Julia can supplement regarding the overall operating improvements in the 101 Online Tutoring segment. 101 Online Tutoring typically is strong for during the summer vacations or summer holiday and winter holiday. Summer holiday is longer and there is a clear pattern of seasonality during the summertime when parents don't want their kids to play idle and they would like to make sure that the kids also do some studying during the summertime. The same effect, although to a lesser degree happens during the winter vacation time.

**Julia Huang** - ChinaEdu Corporation - Chairman, CEO

Yes, that's about the case.

**Jeff Lee** - Signal Hill - Analyst

Okay, and on it looks like if the Learning Centers -- what kind of contributions Learning Centers make in the quarter and then what percentage of revenue to you expect them to account for during 2010?

**Lily Liu** - ChinaEdu Corporation - CFO

The Learning Centers contribution was actually less than 5% for the third quarter's revenue, but we believe the contribution from Learning Centers will grow over the future quarters.

**Jeff Lee** - Signal Hill - Analyst

Okay, great, and then are there -- have there been any challenges so far in getting, opening up your proprietary or franchised Learning Centers as quickly as you would like to?

**Lily Liu** - ChinaEdu Corporation - CFO

Yes, the expansion of our Learning Centers is on track. The number, 56, looks like it did not expand compared to last quarter. That is mainly because -- that's mainly due to the Learning Centers typically slow down at the opening or the expansion of new Learning Centers during preparation for the fall recruiting season.

So in the coming quarter, we should see the number expand more than -- to more than 56. We are still on track to project at 100 Learning Centers at the end of 2010.

**Jeff Lee** - Signal Hill - Analyst

Okay, great, and then the conference sales and marketing expense that you mentioned that was in Q3 of '08 and is going to be in Q4 '09 this year, maybe you could break out how much that expense is expected to be?

**Lily Liu** - ChinaEdu Corporation - CFO

I don't have the number for Q4 yet, but the -- it's mainly due to in October, the Minister of Education hosted a, held a large conference for the distance education industry. Most of our universities, partner universities, as well as we, participated. So it generated a strong, a conference-related expenses in the fourth quarter.



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**Jeff Lee** - Signal Hill - Analyst

Okay, so I guess then the expectation is that sales and marketing will be up on a sequential absolute basis next quarter?

**Lily Liu** - ChinaEdu Corporation - CFO

Yes.

**Jeff Lee** - Signal Hill - Analyst

Okay, and then also for G&A, I assume you have a pretty strong seasonal pattern for G&A increasing during Q4 also?

**Lily Liu** - ChinaEdu Corporation - CFO

Correct.

**Jeff Lee** - Signal Hill - Analyst

It would --

**Lily Liu** - ChinaEdu Corporation - CFO

Although G&A, generally, G&A expenses tend to go up slightly in the fourth quarter to a lot of yearend related expenses. But we are, obviously, we are -- we have pretty expense controls at headquarter levels. So we don't expect G&A expenses as percent of revenue to increase that much.

**Jeff Lee** - Signal Hill - Analyst

Okay, was there anything last year, Lily, in Q4 of '08 in G&A expense that made it so much larger than the other quarters, on an absolute basis? Last year --

**Lily Liu** - ChinaEdu Corporation - CFO

I think 2008 and 2007 included some discretionary bonus payments which made the G&A expenses appear more volatile in the historical years.

**Jeff Lee** - Signal Hill - Analyst

Okay.

**Julia Huang** - ChinaEdu Corporation - Chairman, CEO

Historical years Q4 G&A tended to revenue slightly higher than other quarters like Q2 and Q3, but we have done some, planning ahead of time this year, but there are, could be some recruiting related bonus happens in Q4.



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**Jeff Lee** - Signal Hill - Analyst

Okay, great, and then R&D expense we expend this quarter, should Q4 should be sort of roughly in the same area?

**Lily Liu** - ChinaEdu Corporation - CFO

Yes, roughly the same percentage as percent of revenue.

**Jeff Lee** - Signal Hill - Analyst

Okay, great, okay, great, that's all my questions. Thank you.

**Lily Liu** - ChinaEdu Corporation - CFO

Thank you, Jeff.

**Operator**

(Operator Instructions)

And your next question comes from the line of Ella Ji with Oppenheimer. Please proceed.

**Ella Ji** - Oppenheimer & Co. - Analyst

Hi, this is Ella Ji from Oppenheimer. I want to follow up on the Learning Centers question. Can you clarify your execution plan on to reach 100 Learning Centers by 2010? What's the mix between proprietary and franchised Learning Centers? And were just grow it organically or will you seek some M&A opportunities there?

**Lily Liu** - ChinaEdu Corporation - CFO

Ella, I'll take the question first and then Julia can supplement. The expansion will -- most of the expansion will come from third party affiliated Learning Centers. It's a faster way of expansion, although we do expect to add to the number of proprietary Learning Centers going forward.

**Julia Huang** - ChinaEdu Corporation - Chairman, CEO

For the second question for the acquisitions, if there are good Learning Centers we could acquire, we definitely we do it. And but, that is not going to be -- we are not going to be depending on acquisitions. It is really by opportunity.

**Ella Ji** - Oppenheimer & Co. - Analyst

So your 100 Learning Centers target is just based on your organic growth plan for now?



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**Julia Huang** - ChinaEdu Corporation - Chairman, CEO

Right, yes, that's right.

**Ella Ji** - Oppenheimer & Co. - Analyst

Okay, and also I want to ask about your force in master enrollment. Can you give us a rough range of what percentage of year-over-year growth will that represent?

**Lily Liu** - ChinaEdu Corporation - CFO

Well, our revenue guidance is generally, as you can see, is about 9% to actually to 14% growth compared to last year. So that's because last year's fourth quarter a VAT refund. So the fall enrollment is tracking that. We are expecting approximately 10% revenue growth for the Online Degree segment for the fall enrollment.

**Ella Ji** - Oppenheimer & Co. - Analyst

Okay, thank you. And I also want to ask about can you update your competitive landscape in the Online Degree services market. I understand that one of your competitors have recently added a new contract at a relatively lower revenue split. So do you think -- how do you think that will impact the industry in general? And will you also aggressively seek to add more university partners? Thanks.

**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

Ella, I'll take the question. This is Shawn. First of all, we are definitely aggressively seeking to add new partners to our Online Degree programs. And as to the specific case you mentioned, I don't think that's going to in any way impact our existing relationships. And whether that will impact our long-term renewed contracts, from what we have seen so far, we are not expecting any impact from that as well.

**Ella Ji** - Oppenheimer & Co. - Analyst

So you would expect the revenue split for your potential new contracts to remain in the range of your existing levels?

**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

Generally speaking, yes. Each individual contract has its each specialty, special items in it. So there -- if we -- one -- in the case of joint venture, we are actually do a revenue plus profit sharing. So it's -- our contracts are structured very differently from other contracts. And I don't know the details of other contracts as well, so all I can say is our business developments are still following the same general business model and business pattern that we have done before in terms of signing up new college partners.

**Ella Ji** - Oppenheimer & Co. - Analyst

Okay, thanks. That's helpful. And also, I wanted to ask about an update on the regulatory front with the Minister of MOE. Do you think that will provide enhanced visibility in terms of when the new additional universities will be approved in online degree services?

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**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

I think it's a little too early for us to gain a clear timeframe where, in your word, visibility, at this point. He was just appointed recently and obviously he has his hands full and there's lot of issues and questions and there is news in the -- news related to the Minister of Education every day and he has been talking about different things, so once again, we are going to keep a close contact with the Minister of Education and keep talking to them about what's happening. As soon as we have anything definitive we can disclose we will definitely tell you in the first minute.

**Ella Ji** - Oppenheimer & Co. - Analyst

Great. I just want to switch gears a bit and talk about the Private Schools. What is the current -- with Anqing School's new phase tool project completed, what is the current capacity utilizations for the two schools for now?

**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

Well, one of the schools, the Pingdingshan School utilization rate is about -- I don't know the exact percentage. I think we can have, we could have another 800 students or something like that in that new school. For the Anqing School, our current -- the new campus -- Anqing School has two campuses. One of the campuses is always filled up. The new current we currently have about 2,200 students and we could have somewhere around 4,200 to 4,500 students, somewhere around in that ballpark.

**Ella Ji** - Oppenheimer & Co. - Analyst

Okay, and just for next year, where do you think you can grow the enrollments at those two schools?

**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

We're -- other than keeping improving our education quality and keep building our brand name, I think one of the important things is because for the Anqing School. There are several grades we have filled up and there is a general trend for that city to move forward to the new developed, somewhere in the new developed area. That is where the school is at so there is a great potential for us to have more students in the new campus.

**Ella Ji** - Oppenheimer & Co. - Analyst

Okay, great. Lastly, I wanted to ask about the gross margin at your Private Schools. What is the normalized gross margin for the Private Schools, just a normalized run rate? What rate should we expect?

**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

I don't think we have that number with us at this point. We can probably send it to you later. On the other hand, the new campus is just built and we don't have enough track record or history to give you a normalized or number that we can comfortably project at this point.

**Ella Ji** - Oppenheimer & Co. - Analyst

Okay, thank you very much, guys, and a nice quarter.

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**Shawn Ding** - ChinaEdu Corporation - President, COO, Director

Thank you.

**Julia Huang** - ChinaEdu Corporation - Chairman, CEO

Thanks.

**Operator**

And at this time there are no further questions. I would like to turn the call over to Management for closing remarks.

**Julia Huang** - ChinaEdu Corporation - Chairman, CEO

Ladies and gentlemen, thank you again for participating in ChinaEdu's third quarter 2009 earnings call. Over the last quarter ChinaEdu has consistently delivered solid financial results. We have and will remain focused on executing results for our shareholders.

We recently celebrated ChinaEdu's 10-year anniversary. Looking back, we have built a solid track record and a leadership position in the online education sector in China. The unique assets that ChinaEdu has built are a large network of university and school partnerships and a large number of student bases.

This has built a strong presence for us in the industry, given more and more users will adopt Internet as a tool to get what they like to learn, we believe the future 10 years for ChinaEdu could be even brighter. Thank you and have a good day or a good night.

**Operator**

Thank you for your participation in today's conference. This concludes our presentation.

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