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CEDU - Q3 2012 CHINAEDU CORP Earnings Conference Call

EVENT DATE/TIME: DECEMBER 20, 2012 / 1:00PM GMT



## CORPORATE PARTICIPANTS

**Helen Plummer** *ChinaEdu Corporation - Senior IR Coordinator*

**Julia Huang** *ChinaEdu Corporation - Executive Chairman*

**Shawn Ding** *ChinaEdu Corporation - CEO*

**Simon Mei** *ChinaEdu Corporation - CFO*

## CONFERENCE CALL PARTICIPANTS

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

**Ella Ji** *Oppenheimer - Analyst*

## PRESENTATION

### Operator

Hello, and thank you for standing by for ChinaEdu's Third Quarter 2012 Earnings Conference Call. At this time all participants are in a listen-only mode. After management's prepared remarks, there will be a question and answer session. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the meeting over to your host for today's conference, Helen Plummer, Senior Investor Relations Coordinator for ChinaEdu. Please, go ahead.

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### Helen Plummer - *ChinaEdu Corporation - Senior IR Coordinator*

Hello, everyone, and welcome to ChinaEdu's Third Quarter 2012 Earnings Conference Call. The Company's third quarter earnings results were released earlier today and are available on the Company's investor relations website at [www.chinaedu.net](http://www.chinaedu.net), as well as on newswire services.

Today you will hear from our Chairman, Julia Huang, who will talk about our company and strategy, Mr. Shawn Ding, Chief Executive Officer, who will discuss business operations, and Mr. Simon Mei, Chief Financial Officer, who will discuss our financial results in more detail. After their prepared remarks, the team will be available to answer your questions.

Please note that today's discussion will contain certain forward-looking statements made under the Safe Harbor provisions of the US Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties, as such our future results may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is included in our registration statement on Form F-1 and annual report on Form 20-F and in other documents filed with the US Securities and Exchange Commission. ChinaEdu does not assume any obligation to update any forward-looking statements except as required by -- under applicable law.

As a reminder, this conference is being recorded. In addition, a webcast of this conference call will be available on our investor relations website at [www.chinaedu.net](http://www.chinaedu.net).

I will now turn the call over to ChinaEdu's Chairman, Julia Huang.

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

Thank you, Helen, and thank you, everyone, for joining us today. We are pleased to report another successful quarter. Throughout 2012, we have driven organic growth and revenue students in our core online degree programs. More and more students are taking advantage of the opportunity to earn a degree program from a top institution online.

At the same time, we're continually looking for ways to scale our competency in online learning to bring more non-degree programs in the market. There's currently a gap between the skill set of China's workforce and abilities that employers in today's economics need. We are positioned well to create online programs that narrow the gap. These programs fit well with our core competencies and are also highly scalable.

The way that people around the world are communicating and learning is changing, due to technological innovations, such as social networking and mobile applications that bring communication to life. We are committed to staying ahead of emerging trends and adapting quickly to integrate new technology into our online offerings, especially in our K-12 programs.

By doing so, we ensure that very [latest] mobile and social applications give us advantage, allowing us to offer the best possible experience to our satisfied student customers. As we learn from our integration of emerging technology into our K-12 programs, we will be looking for the technologies that are most successful at integrating those into our adult programs where possible.

Recently, the 18th party congress met in Beijing. During the meeting, President Hu Jintao set a goal of doubling per capita income over the next 8 years. In a culture where spending on child's education is a systematic priority, we are encouraged by this national goal and will continue to work hard to capitalize on strong growth in household disposable incomes across China.

With that, I will now then turn the call over to Shawn Ding.

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**Shawn Ding** - ChinaEdu Corporation - CEO

Thank you, Julia. Ladies and gentlemen, thank you very much for joining us today. In the third quarter of 2012, all of our business lines were on track and steady. Let me first talk about our online degree programs. We concluded our fall recruiting on September 30. Details of the fall recruiting numbers will be reported in the next earning release. However, based on preliminary results, we believe it was another successful recruiting season.

On the operational side, we continue to improve all aspects of the business, aiming to attract more students and improve the quality of the education they receive. As Julia mentioned, the technology is the cornerstone and a key enabler of our business, and our technology team achieved several major milestones in the third quarter. On an ongoing basis, we will continue to invest in technology. According to our strategic plan, our next generation technology platform should be operational in 2013, and we are on track to make that happen.

As of September 30, our learning center network consists of 116 learning centers, of which 55 were proprietary centers, and 61 were contracted centers. As of yearend 2012, we will have 118 learning centers, of which 57 are proprietary, and 61 are contracted. As we continued to optimize our learning centers network during 2012, we opened 30 centers and closed 6 underperforming centers, with a net increase of 24 centers.

In 2013, we will continue to execute this strategy, focusing on operational efficiency and profitability as we explore learning center -- expand learning center network. It should be noted that we plan to add 20 to 25 centers in 2013.

On the non-degree side, business continued to gain traction in the third quarter. Teachers' training programs reported a larger number of teachers received - receiving training via our joint ventures. As reported before, we consider ongoing career training to be a strategic direction for ChinaEdu, and we kicked off a new initiative in this area in the third quarter. We believe this will be an important business line for us in the coming years.

Our two K-12 private schools in operation each had successful third quarters, contributing to what will be a successful full year for both. In Q3, our students performed very well on the Gao Kao, the national college entrance exam, and Zhong Kao, the high school entrance exam. This [bolstered]



an already successful recruiting year, despite a nearly 20% increase in tuition at our Anqing school. Overall, in operational metrics - all operational metrics in our schools met or exceeded our expectations.

In addition to sales and marketing efforts, as well as content and product developed improvements, 101 online made encouraging progress in B2B partnerships with major IT and mobile operators. We believe this is another important source of revenue, as well as a brand name building opportunity for us in the long-term.

Now, on the issue of the Ministry of Education and the new online degree program approvals, to-date, we have received any definitive information about the timing of new program approvals.

With that, I will now turn the call over to our CFO, Simon Mei. Simon?

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**Simon Mei - ChinaEdu Corporation - CFO**

Thanks, Shawn. Hello, everyone. As Shawn and Julia have mentioned, the third quarter of 2012 was another steady quarter with a few surprises. Our revenue tracked according to our expectation, and we are pleased with our performance.

Total net revenue for the third quarter of 2012 was \$19.7 million, an 8.7% increase from \$18.1 million in the corresponding period in 2011. Net revenue from online degree programs was \$15.8 million, an increase of 9.4% from \$14.5 million in the corresponding period of 2011.

In the third quarter, we focused on optimizing resources and made some important strategic decisions about business lines, as mentioned by Shawn. As always, we carefully managed our costs. Total operating expenses were \$9 million in third quarter of 2012, representing a 16.3% increase from \$7.7 million in the corresponding period of 2011. More details are discussed as follows.

General and administrative expenses in the third quarter were \$4.3 million, an increase of 16.6%, compared to \$3.7 million in the third quarter of 2011. The increase was mainly the result of an early termination fee related to a lease agreement and increases in conference and travel expenses. As a percentage of net revenue, general and administrative expenses increased slightly to 22%, compared with 20.5% in the same period of 2011.

Selling and marketing expenses were \$2 million in the quarter, a decrease of 13.7%, compared to \$2.3 million in the corresponding period in 2011. The decrease was primarily due to the result of a significant decrease in marketing activities surrounding international and elite curriculum programs. As a percentage of net revenue, selling and marketing expenses decreased to 9.9%, compared with 12.5% in the same period of 2011.

R&D expenses for the current quarter were \$1.7 million, flat with the corresponding period of 2011. As a percentage of net revenue, R&D expense was 8.8% in the current quarter, down slightly from 9.5% in the same period in 2011.

As noted in our press release issued earlier today, the Company incurred an intangible asset impairment charge in relation to the British Columbia Institute of Technology and the Friendly Experimental Class programs in the international and elite curriculum division in the third quarter. The result was an aggregate non-cash charge of US\$0.9 million. We do not plan to enter into new cooperative agreements as such in the near future.

Due to the projection that demonstrated the operation from the FEC program and the continuing losses from the BCIT programs, we came to the conclusion that the intangible assets carrying amount associated with the BCIT and the FEC programs may not be recoverable, as such the fair value for the intangible assets of these programs is less than the carrying value as of September 30th of 2012. This has resulted in impairment of these two programs in the current quarter. The excess carrying value of the intangible assets over its fair value is recognized as impairment loss.

Turning now to guidance, we expect total net revenue in the fourth quarter of 2012 to range from RMB124 million to RMB129 million, or US\$19.7 million to US\$20.5 million, representing a 3% to 7% increase compared to the corresponding period in 2011. This forecast reflects our current and preliminary view and is subject to change.

At this time, we would like to open the call up to your questions. Operator?



## QUESTIONS AND ANSWERS

### Operator

Thank you.

(Operator Instructions)

And our first question comes from the line of Mark Marostica, Piper Jaffray. Please, ask your question.

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### Mark Marostica - Piper Jaffray - Analyst

Yes. Thank you. My first question relates to Shawn's comments about the approvals of online degree programs in China. And understand, Shawn, you mentioned that there's no update -- I'm just curious whether you expect 2013 to engender more positive discussions around actual approvals, or if your opinion is that we shouldn't hold our breath on that point.

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### Shawn Ding - ChinaEdu Corporation - CEO

Mark, I personally do believe that certain things will happen in 2013, and I certainly hope so, but, as you know, there's -- it's not something that we can point to a specific date or even a quarter whether it will happen at all. So, from a -- past experience that we -- or from the -- or the conversations we had with the related officials and the experts in this field that we believe there will be certain activities happen next year in 2013.

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### Mark Marostica - Piper Jaffray - Analyst

Okay, great. Thanks for the color. And, Julia, you talked about mobile or social in K-12, particularly. Can you give us more details on your strategy there? Any progress or milestones, in terms of the implementation [of the strategy]?

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### Julia Huang - ChinaEdu Corporation - Executive Chairman

We have a tutoring -- we have a one-on-one tutoring site, and that site right now there -- by end of the year, the daily unique visitors are over 100,000, and the peak unique visitor is sometimes over 400,000. And the page views, in peak time, daily, is over 1.5 million page views.

We -- although we have been doing some work in the past 3 years, but, in the coming year, we plan to invest more in the mobile and Web 2.0 applications. As we are learning from the use experiences, we find out that -- if we make any motivations in the social networking or some mobile applications, the traffic pick up very quickly.

And we -- our goal is really to build a platform with more and more K-12 students coming to answer questions -- to do the question and answerings, testing assessment, and practices to build the platform for more traffic. And after we build a critical mass, we'd like to add small classes online.

We also -- right now, currently, we have one-on-one tutoring. We have small classes and also, synchronized and non-synchronized group classes. So, it's more internet model. We believe it's something we have to do and also agree the technology more readily happens today versus 2, three3

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**Mark Marostica** - Piper Jaffray - Analyst

Thank you. And then, on the topic of one-on-one tutoring, the third quarter revenue for that business line came in a bit below our estimate. I know there's been some difficulties in Beijing with the restrictions on marketing at the primary schools. Can you give us a sense if you've seen some improvement in the fourth quarter in one-on-one, or is that business still somewhat challenged, given the (inaudible)?

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

There - the one-on-one online's revenue coming from three streams. One is the revenues coming from outside of Beijing is still grow healthily. Secondly, the revenues from our partners, like (inaudible) the learning devices, big IT players, and those big partnerships' revenues are actually increasing.

For the Beijing -- the decreasing revenue, actually, is coming from Beijing, because their new restrictions going into -- on campus for marketing. So we're trying to find other alternatives by selling the technology platform, or offering free technology platforms to schools to offer other opportunities to get into school to market our products.

And the other reason the revenue versus last year - there's a difference -- is also we have a --

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**Simon Mei** - ChinaEdu Corporation - CFO

Barter transaction.

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

We had a barter transaction happen last year, same quarter. This year doesn't have this kind of transaction, so that's why there is a decrease between there.

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**Mark Marostica** - Piper Jaffray - Analyst

Okay. And Beijing accounts for what proportion of one-on-one again?

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

Probably 30% to 40% of revenue.

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**Mark Marostica** - Piper Jaffray - Analyst

Okay. And then, my last question is in regards to fiscal '13. I know we're not in that year yet, but you must be going through some budgeting exercises around fiscal '13. Can you give us a sense of what you think, generally, we should expect on the top line, terms of revenue growth, and then, operating margin in fiscal '13? Thank you.

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

We think that operating margin should be consistently similar to this year. We may give more investment in technology innovations, so technology spending, in terms of revenue percentage might increase, but other items, in terms of G&A, cost of goods, and gross margin, should be consistent to this year's number.

In terms top line, we think it should be similar, but, at this point, we want to be more conservative. I believe you can keep your model as it is right now. After the next quarter, when we do our quarterly reviews, we probably can give you more clear picture.

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

Okay. Thank you, very much. I'll turn it over.

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**Julia Huang** - *ChinaEdu Corporation - Executive Chairman*

Yes. Thank you, Mark.

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**Operator**

Thank you. And the next question comes from the line of Ella Ji from Oppenheimer. Please, ask your question.

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**Ella Ji** - *Oppenheimer - Analyst*

Thank you for taking my questions. So, a few follow-ups. First, Julia, when you said that you are going to build the mobile and the social functions for the one-on-one tutoring and aiming to increase the traffic, I'm just wondering if you've thought about how would you monetize, even after your website's traffics goes up. Is there any concrete plans of monetizing different?

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**Julia Huang** - *ChinaEdu Corporation - Executive Chairman*

Yes, we have some plans, because other users coming for a question and answering practicing, testing, assessment they are all the K-12 students who want to get the trainings, or after school trainings. So we're trying to do the platform where we are going to host our current 101 online programs.

We're also adding the one-on-one online tutoring, where students and teacher -- one-on-one basis they can be done online, which we have -- we already have a pilot study. It's -- the satisfaction rate is relatively better than we expected.

Thirdly, we're trying to build a platform more like to host the -- both online and offline training programs to take the commission fees, and also, we trying to migrate this to the mobile applications, where there are more shops and more training companies. If we -- our traffic reach a certain point, we believe we will draw more interest from the traditional -- both traditional afterschool programs and also online afterschool programs -- more products into the platform.

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**Ella Ji** - *Oppenheimer - Analyst*

Okay. And, for example, if you have the -- if you added the online tutoring, how would the pricing level, comparing to your existing offline tutoring?

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**Julia Huang** - *ChinaEdu Corporation - Executive Chairman*

Actually, right now, we charge around 3,000 per year for our online 101 -- the [as synchronized] programs, for all subjects, for full year. We charge close to RMB150 per hour for our one-on-one tutoring. So, the per person or per student payment is over 100 -- no, is close to 10,000 per year. So, the per person charging rate will be relative higher, but -- given that the data I have now is in a relatively small scale.



**Ella Ji** - Oppenheimer - Analyst

Yes. Okay.

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

But, Ella, it's still in the planning and pilot stage, so the whole development process probably takes 2 to 3 years to really achieve over 2 million unique visit -- daily unique visitors.

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**Ella Ji** - Oppenheimer - Analyst

Yes. Okay. Okay, got it. And then, you also mentioned that you are going to invest in technology. And can you give us some details? In addition to the mobile and the social platform for the one-on-one tutoring, what would be other areas that you are going to invest in?

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

ChinaEdu is an online education company, so learning management systems and other learning tools are critical to our business. So, over the past year -- over 2012 and the coming year, we have a large team right now focused on our learning management systems development, so we're doing generation three learning management systems. So we put a lot of effort to put all the resources, all the functions -- all the social functions into the new generation platform, which will cover both our full degree programs and non-degree programs.

At same time, too, we have a separate team working on the K-12 -- the internet and mobile systems, where we are trying to adding more social and mobile functions to the original tutoring system and platforms.

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**Ella Ji** - Oppenheimer - Analyst

Okay. And then, you mentioned this restrictions to marketing campus in Beijing. How about other major cities in China? Have you heard anything? Do you expect if there's going to be any change in other major cities?

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**Julia Huang** - ChinaEdu Corporation - Executive Chairman

So far, we haven't really heard of anything really [actively] happening, and we have seen our -- the revenue from other cities and provinces have been growing healthily in the -- in 2012. So, we don't expect things happening in other cities and provinces yet.

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**Ella Ji** - Oppenheimer - Analyst

Okay. And then, regarding your new learning center opening in 2013, did I hear it right that you're going to open 20 to 25 centers? And what's the mix between self operation and a franchise?

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**Shawn Ding** - ChinaEdu Corporation - CEO

Ella, if it's 20, then it will be -- we are planning -- well, let me put it this way. We are planning to open 12 proprietary centers in 2013, and we have much more strict guidance, in terms of opening a franchise center. So, between the -- somewhere between 8 to 13 learning centers will be franchise.

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**Ella Ji** - *Oppenheimer - Analyst*

Thank you. And then, lastly, regarding your margins expectation for next year. So, you mentioned that you are going to invest more in tax, so I just wondering if you expect, overall, the operation margin will be similar, or everything else will be similar, except for the investments in technology, which, I think, would be in the R&D expenses. Just want to --

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**Julia Huang** - *ChinaEdu Corporation - Executive Chairman*

Right, right. R&D. Yes. Exactly. Right now, we're in the range of 9% to 10% of technology. Right?

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**Ella Ji** - *Oppenheimer - Analyst*

Yes.

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**Julia Huang** - *ChinaEdu Corporation - Executive Chairman*

So, we expecting to -- that margin probably will be revised, so we should be able to give you a more clear percentage during the next quarter earning call.

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**Ella Ji** - *Oppenheimer - Analyst*

All right. Got it. So, right now, you are expecting R&D to go up, as a percentage of revenue, but other lines to remain consistent with this year.

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**Julia Huang** - *ChinaEdu Corporation - Executive Chairman*

Right. Yes.

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**Ella Ji** - *Oppenheimer - Analyst*

All right. Okay. That's all my questions. Thank you.

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**Operator**

Thank you.

(Operator Instructions)

As there are no further questions at this time, I would now like to hand the call back to Helen Plummer, Senior Investor Relations Coordinator for ChinaEdu. Please, go ahead.

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**Helen Plummer** - *ChinaEdu Corporation - Senior IR Coordinator*

Thank you for participating in our third quarter 2012 earnings conference call. As always, we appreciate your interest and support. If you have any questions, please do not hesitate to contact us at IR at chinaedu.net.

Thank you very much, and have a nice day.



**Operator**

Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all disconnect.

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