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CEDU - Q4 2012 CHINAEDU CORP Earnings Conference Call

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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 & Co. - Analyst*

PRESENTATION

Operator

Hello, and thank you for standing by for ChinaEdu's Fourth 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. Thank you. Please go ahead.

Helen Plummer - *ChinaEdu Corporation - Senior IR Coordinator*

Hello, everyone, and welcome to ChinaEdu's fourth quarter 2012 earnings conference call. The Company's fourth quarter earnings results were released earlier today and are available on the Company's investor relations website at 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 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 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. I will now turn the call over to ChinaEdu's Executive Chairman, Julia Huang.

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, bringing the full year of 2012 to a fitting close. Throughout the year, we remained focused on growth in our online degree program, expanding enrollment to approximately



400,000 revenue students in 2012. Our online degree program remains at the core of what we do each day at ChinaEdu. We continue to grow and optimize our learning center network.

There were very exciting developments in other areas of our business in 2012 as well. Several continued education non-degree training programs for teachers were launched in 2012 and have already shown impressive results. Additionally, our recently expanded K-12 online interactive tutoring and question and answering programs have already gained traction and are showing encouraging results.

Enrollment at our private schools grew beyond expectations during the year. Our familiar brand name and strong scores continue to draw our talent pool of students to each of our private schools. We remain committed to technological innovation and will continue to develop next generation technology platforms and interactive and mobile learning applications. Acceptance of online learning and availability for mobile devices and tablets continue to grow across China.

By leveraging our expertise in this area, we plan to penetrate the market further, applying our technological advantages across all areas of our business service platform. With that, I will turn the call over to Shawn Ding.

Shawn Ding - ChinaEdu Corporation - CEO

Thank you, Julia. Ladies and gentlemen, thank you for joining us today. Rounding out a successful 2012, our business lines in the fourth quarter were on track, and we saw steady growth. We are very pleased with our results for the full year as well.

I will first address our online degree programs. As Julia just mentioned, our online degree programs reached approximately 400,000 revenue students in 2012, which is an increase of about 12.4% from 2011. We have been working closely and very well with all of our collaborative joint venture technology services and recruitment university partners.

As a dominant player in the online degree education market, ChinaEdu's brand name has been widely recognized nationwide in China. Together, with our business partners, we believe this will continue to translate into healthy future growth for our business.

We are seeing a great percentage of our online degree program revenue being contributed through our learning centers network. Net revenue generated from learning centers increased by 34.2% in 2012, exceeding the total net revenue increase of 12%. Contributing to the top line by learning centers increased from 7.7% in 2011 to 9.3% in 2012.

Gross margin of the learning centers network greatly improved from 5.8% in 2011 to 22.1% in 2012. This indeed lowered our overall gross margin slightly, as the learning center business has a lower gross margin than our core online degree business. However, by increasing the number of learning centers in our network, we increased our overall addressable market and leveraged an opportunity to extend our top line. We are confident that this is the right strategy for future growth, and we will continue to move in this direction.

In line with what I'm announced our last earnings call, as of December 31, 2012, ChinaEdu's learning center network was providing recruiting services for 22 universities, with 118 operational learning centers, of which 57 were proprietary centers and 61 were contracted centers. As Julia mentioned, as we did in 2012, we will continue to execute a strategy of focusing on operational efficiency and profitability as we explore our learning center network expansion.

The net increase of learning centers in 2012 was 13. We set up 25 new learning centers and closed 12 underperforming ones. We plan to add 20 to 25 centers in 2013.

On the non-degree side, our business continued to gain traction in the fourth quarter. Among the different initiatives, continuing education teacher training program reported a larger number of teachers receiving training via our joint ventures. As reported previously, we consider ongoing career training to be a strategic direction for ChinaEdu, and we kick off a new initiative in this direction in the third quarter.

Our K-12 private schools in operation each had a successful quarter and full year of 2012. Total net revenue student counted -- total revenue student count increased from 6,226 in 2011 to 6,545 in 2012. Overall, all operational metrics in the two schools exceeded our expectation in 2012. Our Anqing school increased tuition by 20%, resulting in a 21% increase in tuition revenue.

Since we have been focusing on the teaching quality and the improving already outstanding performance of our students, our schools are highly regarded in the local communities. We expect continuous performance improvement in the coming years.

Our online tutoring business was negatively impacted in Beijing, due to new restrictions that disallow on campus marketing. As a result, our net revenue in this business segment decreased by 1% in 2012 compared with 2011. To offset this impact, we are exploring various different marketing strategies and alternatives, such as offering technology platforms to schools to market our products.

We also kicked off a new -- a few other initiatives in this direction of technology driven, teaching quality, service, and mobile learning. All of these new initiatives are aimed as a future trend of learning, and we believe they will bear fruit for us in the near future.

Technology is the core differentiator of our business. We continue to invest in our people and technology to bring our service into the next level for our partners and our students. In 2012, we initiated our next generation technology platform product. We believe this next generation technology platform will further elevate ChinaEdu as the technology leader in our market and enable our business to expand in all aspects. This product is well on track so far.

The management team is confident about the outlook of 2013. We are particularly encouraged by the many new exciting developments in the e-learning sector worldwide in 2012. Even though we have been in the business for 14 years, we believe this true era of e-learning is just about start. We begin to see a greater penetration to on campus education, enterprises and industries, professional training, and many new -- other new markets, in addition to degree programs.

In other words, we are starting to see a much greater market acceptance of e-learning in China. Leveraging this success and experience we have accumulated over the past 14 years, we believe a much larger market is coming within reach.

Now, onto the issue of the Minister of Education and new online degree program approvals, to date, we have not received any definitive information about the timing of the new school approvals. I will now turn the call over to our Chief Financial Officer, Simon Mei. Simon?

Simon Mei - ChinaEdu Corporation - CFO

Thanks, Shawn. Hello, everyone. As Shawn and Julia have mentioned, the fourth quarter of 2012 was an outstanding quarter, with few surprises. Rounding out a successful year, our revenue, net income attributable ChinaEdu shareholders and the EPS tracked ahead of our expectation in the quarter, and we are pleased with our performance.

Total net revenue for the fourth quarter of 2012 was \$21.8 million, a 12.4% increase from \$19.4 million in the corresponding period in 2011. Net revenue from online degree programs was \$17.7 million, an increase of 13.9% from \$15.5 million in the corresponding period of 2011.

Total cost of revenue for the fourth quarter was \$9.8 million, an increase of 13.3% compared with the corresponding period in 2011. The increase was mainly due to staff related costs, as we invest in more technology.

Total operating expenses were \$7.6 million in the fourth quarter of 2012, a decrease of 3.6% from \$7.9 million in the corresponding period in 2012 -- 2011. As a percentage of net revenue, total operating expenses decreased to 34.8% compared to 40.6% in the corresponding period in 2011. The decrease in total operating expense was a result of the following factors --

G&A expenses decreased by 4.8% from the corresponding period in 2011, primarily due to the reversal of some long-term accrued liabilities.



Selling and marketing expenses decreased by 6.8% compared with Q4 2011, primarily the result of a reduction in barter transactions related to online tutoring programs. Research and development expenses increased by 4.6% compared with Q4 2011. The slight increase was mainly due to increased staff costs.

Turning now to the full year, in 2012, our total net revenue was \$78.4 million, a 12% increase from \$70 million in 2011. Net revenue from online degree programs for the full year was \$63.1 million, an increase of 13.3% from \$55.7 million in 2011.

Total cost of revenue in 2012 was \$32.4 million, an increase of 8.9% from \$29.8 million in 2011. The increase was primarily due to an increase in staff costs, resulting from headcount increase across Company, as well as an increase in courseware costs related to new training courses. As Shawn mentioned, the learning centers network's sales and the service-based model results in a higher cost of the sales.

Total operating expenses in 2012 were \$31.3 million, 4.1% increase from \$30.1 million in 2011. The increase was primarily attributable to the following factors --

G&A expenses increased by 6.7% over 2011, mainly the result of an early termination of a lease agreement, as well as an increase in stock related expenses due to the granting of restricted shares for staff and an increase in conference attendance and travel costs.

Selling and marketing expenses decreased by 8.3% from 2011, primarily the result of a significant decrease in marketing activities for our international and elite curriculum programs. Research and development expenses in 2012 were flat, compared with 2011.

The Company incurred an intangible asset impairment charge in relation to our BCIT and FEC programs in the international and the elite program division in the third quarter of 2012, resulting in an aggregate noncash charge of \$0.9 million.

Share-based compensation in 2012, which was allocated to the related cost of sales -- cost of revenue and operating expense line items, was \$1.3 million, 27.4% from \$1 million in 2011.

Recognizing our success in 2012 and the opportunities ahead, as well as the Board of Directors and the management's continued commitment to enhancing shareholder value, in the first quarter of 2013, the Company reinvested in the business by negotiating a share repurchase. The repurchase program was completed at the end of February 2013.

We repurchased 19,695,552 ordinary shares, or, 6,565,184 ADSs equivalent. This is equal to 36.9% of the total issued ordinary shares of 53,428,219 prior to the transaction. Other factors being equal, the stock repurchase will increase the Company's earnings per share significantly.

Turning now to guidance, ChinaEdu management expects total net revenue in the first quarter of 2013 to range from RMB116 million to RMB120 million, or \$18.6 million to \$19.3 million, representing a 1.8% to 5.3% increase from RMB114 million, or \$18.3 million, compared to the corresponding period in 2011 -- sorry, 2012. At this time, we would like to open the call up to your questions. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Mark Marostica, Piper Jaffray.

Mark Marostica - Piper Jaffray - Analyst

Yes, my first question relates to Shawn's comment about the approvals of new schools. Understand you've not received any new information about the timing of new approvals. Can you give us a sense of the posture of the Ministry of Education? As we head further into 2013, if, in your minds, you think there's the opportunity for this to occur or if it's still something that is a ways out.

Shawn Ding - ChinaEdu Corporation - CEO

Mark, thanks for the question. In my mind, I think that the opportunity is definitely there for 2013, but, as always, there's not really a lot that I can tell you, in terms of specific time or what the process is going to be and how the -- exactly what time they're going to hold the approval. And so, there's really not a whole lot I can tell you on that, but I do -- I really do think and I hope that the possibility is going to be there.

Mark Marostica - Piper Jaffray - Analyst

Okay. And also, remind us again how many schools are awaiting?

Julia Huang - ChinaEdu Corporation - Executive Chairman

Five in the pipeline, waiting for approval.

Shawn Ding - ChinaEdu Corporation - CEO

We have five in the pipeline waiting for approval.

Mark Marostica - Piper Jaffray - Analyst

Okay. Switching gears, on the learning center network, I was curious if you can walk us through the profitability of a typical learning center. As it grows in age, give us a sense of what a mature learning center's profitability looks like, and I suppose the answer would be different for a proprietary versus contracted learning center. Trying to get an idea of -- as the base of learning centers grow, and, presumably, the base tends to get more mature, how we should look at overall gross margins for that business going forward.

Julia Huang - ChinaEdu Corporation - Executive Chairman

Mark, the learning center, because it's mostly having upside loaded, so, last year, our learning center gross margin is -- last year, 2012, is 22%, and we're expecting the gross margin improving on -- up to -- close to 26% this year. And, on a steady state basis, we believe the range of -- gross margin should be in the range of 30% to 40% when we grow more learning centers.

Shawn Ding - ChinaEdu Corporation - CEO

Mark, were you asking about the timing of a learning center to be profitable? Let me just answer that --

Mark Marostica - Piper Jaffray - Analyst

If you looked at your -- yes, what I was trying to get at -- and that's -- and thank you, Julia, for the answer here. That's helpful on an overall basis. I was trying to look at just an individual learning center -- your typical learning center. In the first year, I imagine, it's probably not reaching profitability until the end of the year, and then, kind of walk us through when it gets to a mature margin, what that mature margin would be for a typical learning center.



Shawn Ding - ChinaEdu Corporation - CEO

I don't think we have seen a learning center to be in the mature stage yet. I think, the -- even the learning centers we have established for the -- or, we had, for a number of years, they are still growing significantly in 2012, and we are expecting them to continue to grow in 2013. So --

Julia Huang - ChinaEdu Corporation - Executive Chairman

Yes, the -- Mark, normally, once the learning center up to the healthy stage, the net margin should be around 20% or so -- net margin, not gross margin. Net margin should be around 15% to 20% range. The gross margin should be in the range of 30% to 40%. Normally, it really depending on the size of the learning center.

The learning center, like in Shanghai, now is very profitable, because they have a few thousand students in the learning center, but there are learning centers -- with a few hundred students.

So, there's large scale learning centers; there's small scale learning centers, but cost base is different as well. So, for our good ones, you should take the -- a year or two to make profit, but for the ones which we don't have a good management, could take two to three years or even longer. If we don't see, with good management or good profitability, we could close out, or we have to change new management for the learning center.

And also, Mark, for the question you mentioned the schools' approval -- waiting for approval, we have five (inaudible) waiting for approval and three technology service contracts. So, total is eight.

Mark Marostica - Piper Jaffray - Analyst

Okay. Also, on the online degree programs business, excluding the learning centers, can you give us an idea of what gross margins were for that business in the fourth quarter? And then, how you should -- how we should expect gross margins to trend.

Julia Huang - ChinaEdu Corporation - Executive Chairman

Mark, the gross margin for the online degree program is pretty stable in the last few quarters. Last quarter, online degree program -- online degree margin is 67.3%, and for the whole year, we're -- we should see improving gross margins for 2013. For the whole year, we are -- we're expecting gross margin -- 70% to 71% gross margin for the whole year. So, you will see the quarterly fluctuation.

So, the -- normally, the fourth quarter is relatively low. The second quarter, usually, is relatively high, from our historical pattern, you can see. But, overall, 2013, we should see the margin improvement, one point or slightly -- around one point.

Mark Marostica - Piper Jaffray - Analyst

Okay. Great. And then, on the strategic side of things, walk us through your mobile strategy (technical difficulty) any of your mobile initiatives. When do you think that will occur and any other thoughts regarding your build out on the mobile side?

Julia Huang - ChinaEdu Corporation - Executive Chairman

Right now, we have mobile applications mostly for K-12 products. Also, we have some preliminary product for online adult learners. And we have seen a very significant number of mobile users log on to our K-12 Q&A services in the last 12 months. Especially last half year -- last six months, the numbers are increasing significantly.



So, what we are doing is this year we're going to do the mobile team to develop a Q&A mobile applications, both the IOS and the Android. From that, what we are trying to do is to do the platform for users who are going to get a interactive question and answering services and gradually do the social network around that.

Eventually, our long-term is we're trying to connect learning institutions, as well as our students, to both mobile and internet platforms, so that -- because learning -- LCS services, where, initially that could expand our market for these services -- learning services to expand our market for the students and learning institutions, like training schools.

Mark Marostica - *Piper Jaffray - Analyst*

Great. Thanks for the information and color. I'll turn it over.

Julia Huang - *ChinaEdu Corporation - Executive Chairman*

Yes.

Operator

Thank you. Ella Ji, Oppenheimer.

Ella Ji - *Oppenheimer & Co. - Analyst*

Thank you. Good evening, everyone. So, my first question is that you have 20 to 25 learning centers to open next year, and what's the mix of proprietary and franchise the learning center?

Shawn Ding - *ChinaEdu Corporation - CEO*

We are planning to add 15 to 20 proprietary and 10 or more contracted.

Ella Ji - *Oppenheimer & Co. - Analyst*

Okay. And I think -- a couple of years ago, I think management had a much more aggressive plan for learning center opening. So, I just wondered if you can talk about this change in strategy. Is it because of the consideration of bottom line growth, or is there anything else that caused you to lower the annual learning center opening target?

Shawn Ding - *ChinaEdu Corporation - CEO*

Well, I think we're pretty consistent in the planning of the number of learning centers open. We're always in the ballpark of 20 to -- around 30, maybe, in the previous years. 20 to 25 is probably a conservative number that I'm talking about. We've -- we, in fact, could probably do more, but, as always, we're being conservative here, maybe, a little bit.

We are not really changing the strategy. We are just focusing on -- or balancing, rather, the profitability or the efficiency, the outcome of the learning centers. So there's a lots of work are put in to improve the overall process -- the IT system, the recruiting and the marketing efforts. We're also moving in non-degree products, in addition to the degree products.



So, there's a lot of things that we're doing centered around the learning center expansion. It's not just the number of centers that's going to drive the expansion, so, the organic growth of the learning centers is also a much more important thing for us in driving up the growth. So, as you can see, the growth we had in 2012 is not really because of the new centers. It's really because of the expansion or the organic growth of the existing centers.

Julia Huang - ChinaEdu Corporation - Executive Chairman

Ella, to add to your point, now we focus more on the profitability of each learning center. So, you see the neg numbers from end of 2011 to end of 2012. Actually, we opened more than 20, but we also closed out some nonperforming or non profit earning learning centers. So, we're still continuing the expansion, but along the process, we also look closely at the profitability and the utilization of each learning center.

Ella Ji - Oppenheimer & Co. - Analyst

Sure. I don't know if I missed it. What's the learning center revenue growth in 2012, and what do you expect --?

Shawn Ding - ChinaEdu Corporation - CEO

34%.

Ella Ji - Oppenheimer & Co. - Analyst

34%? Okay. What's your expectation for --?

Shawn Ding - ChinaEdu Corporation - CEO

34%.

Ella Ji - Oppenheimer & Co. - Analyst

Okay. What's your expectation for 2013?

Julia Huang - ChinaEdu Corporation - Executive Chairman

2013, we're expecting the growth rate over -- from 35% to 45%.

Ella Ji - Oppenheimer & Co. - Analyst

Great. Great. And then, regarding the online K-12 tutoring, I think you also -- you have things like a one-on-one online tutoring. I just wonder if you can provide a -- like, a revenue mix or course hour delivery mix. What's the mix between, say, one-on-one tutoring and the other formats of online tutoring? I don't know if there's any details that you can share with us.



Julia Huang - ChinaEdu Corporation - Executive Chairman

We don't have a detailed number. The majority of our revenue is called all corners, all subjects, annual packages. That's most the revenue we have, and probably around 80% or more are coming from the all subject all corners, all of them -- K-12 products, which is help students to pre-study the course to be. And, the course will give them a lot of tutorials, so this is a lot of database, a lot of practices.

So it's a package help students to study their courses from grade three to grade 12. We have probably less than 10% in the one-on-one tutoring, both offline and online, but, ongoing basis, we probably will expand more on the one-on-one online part, because we have -- we don't see a good profit margin on the offline one-on-one business.

Ella Ji - Oppenheimer & Co. - Analyst

Sure. How's your teachers' resources been ramping up if you are entering the online one-on-one? Do you think -- yes, have -- will you need to go out and recruit more teachers, or you think your current teachers' headcount would be sufficient?

Julia Huang - ChinaEdu Corporation - Executive Chairman

Yes, we should have sufficient teachers to support our services, because we have over 10,000 online full-time school teachers, who register for our services to provide tutoring service for our students. So, if we have increased demand in the online one-on-one services, we can utilize our registered teachers, who are currently full-time working for their schools, but they have spare time to teach online.

Ella Ji - Oppenheimer & Co. - Analyst

Great. And then, regarding your margins, good job in cost controls this year. Then, in 2013, I understand you will probably be more aggressive in learning center sales in the marketing, and also, you mentioned some technology platform upgrade. So, can you talk about the margins outlook for 2013?

Julia Huang - ChinaEdu Corporation - Executive Chairman

For the 2013, our gross margin overall should be improving 1.5 to 2 points, overall, for 2013, and for G&A as percent of revenue, we also should be improving for one point. And sales marketing, we should improve .5 point from last year, and R&D, we will increase .5% to 1%, as we are investing in our third generation learning management systems and other learning technologies.

Ella Ji - Oppenheimer & Co. - Analyst

Yes. Okay, great. That's all my questions. Thank you.

Operator

Thank you. (Operator Instructions). As there are no further questions at this time, I will now hand the call back to Helen Plummer, Senior Investor Relations Coordinator for ChinaEdu.

Helen Plummer - ChinaEdu Corporation - Senior IR Coordinator

Thank you again for participating in our fourth 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@chinaedu.net. Thank you very much, and have a good 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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