



**ATA Creativity Global Second Quarter 2021 Financial Results Conference Call
TRANSCRIPT**

August 12, 2021 at 9 p.m. ET

SPEAKERS

Carolyne Sohn – Vice President, The Equity Group

Kevin Ma – Chairman and Chief Executive Officer, ACG

Jun Zhang – President, ACG

Amy Tung – Chief Financial Officer, ACG

Q&A Participant

Lewis Fan, The Benchmark Company

Operator:

Greetings and welcome to ATA Creativity Global's Second Quarter 2021 Financial Results Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator instructions] As a reminder this conference is being recorded. It is now my pleasure to introduce your host, Carolyne Sohn. Thank you Carolyne, you may begin.

Ms. Carolyne Sohn:

Thank you, operator, and hello, everyone. Thank you for joining us.

The press release announcing ATA Creativity Global's, or ACG's, results for the second quarter ended June 30, 2021, is available at the IR Section of the Company's website at www.atai.net.cn.

As part of this conference call, the Company has an accompanying slide presentation available on its website. A replay of this broadcast will also be made available at ACG's website for the next 90 days.

Before we get started, I would like to remind everyone that this conference call and any accompanying information discussed herein contains certain forward-looking statements within the meaning of the safe harbor provision of the Private Securities Litigation Reform Act of 1995. These forward-looking statements can be identified by terms such as “anticipate”, “believe”, “expect”, “future”, “plan”, “outlook”, and “will” and include, among other things, statements regarding ACG’s future growth and results of operations; ACG’s plans for mergers and acquisitions generally; ACG’s growth strategy, anticipated growth prospects and subsequent business activities; market demand for ACG’s portfolio training programs and other education services; the impact of the COVID-19 pandemic and the Guidelines on ACG and its operations; and ACG’s plan and anticipated benefits of the measures implemented in response to the COVID-19 pandemic.

Although the Company believes that the expectations reflected in its forward-looking statements are reasonable as of today, those statements are subject to risks and uncertainties that could cause the actual results to differ dramatically from those projected. There can be no assurance that those expectations will prove to be correct. Information about the risks associated with investing in ACG is included in its filings with the Securities and Exchange Commission, which we encourage you to review before making an investment decision.

The Company does not assume any obligation to update any forward-looking statements as a result of new information, future events, changes in market conditions, or otherwise, except as required by law. Regarding the disclaimer language, I would also like to refer you to slide 2 of the conference call presentation for further information.

All U.S. dollar amounts in this conference call, relating to financial results for second quarter ended June 30, 2021, are converted from RMB using an exchange rate of 6.4566 RMB: 1.00 USD, the noon buying rate as of June 30, 2021. All historical conversions are accurate as of the time reported, unless otherwise noted. The Company reports its financial results under U.S. GAAP in RMB, and all percentages calculated in the presentation are based on RMB unless otherwise noted.

For those of you following along with the accompanying PowerPoint presentation, there is an overview of the Company on slide 3. In addition, we are more than happy to take investor questions during today’s Q&A session or via email to the Company.

On today’s call, the Company’s CFO Ms. Amy Tung will provide a brief overview of operating and financial highlights for the second quarter and first half of 2021. Chairman and CEO Mr. Kevin Ma and President Mr. Jun Zhang will follow with an update on the Company’s outlook and its long-term growth strategy before opening the floor for questions.

With that, I'll turn the call over to ACG's CFO, Ms. Amy Tung. Please go ahead, Amy.

Ms. Amy Tung:

Thank you, Carolyne, and welcome everyone. Good evening to those in America. We appreciate everyone's time.

We are pleased to have continued our growth into the year, reporting a 36.1% increase in total student enrollment to 1,051 students in the second quarter of the year. We believe the momentum we have seen in enrollment in the first half of the year bodes well for revenue growth in the second half.

During the second quarter, we saw significant year-over-year enrollment growth across our major programs—portfolio training, overseas study counselling, research-based learning and foreign language training.

Our primary offering, the portfolio training program, enrolled 561 students during the period, up 26% from 444 in the same period last year. We delivered 28,445 credit hours for portfolio training programs, which is a slight increase from Q2 2020. As we have made a conscious effort in recent years to shift our portfolio training mix toward project-based programs versus time-based programs, project-based program credit hours increased over 20% year over year during the second quarter although total credit hours delivered stayed relatively flat.

With our conscious shift toward project-based programs, we have also restructured our full-time instructor's compensation to be more focused on the number of projects completed, instead of the credit hours delivered. This grants instructors greater autonomy and flexibility in completing projects and has consequently resulted in improved operating and cost efficiencies while maintaining the same level of quality education and support for our students. This shift has not only contributed to our top line growth but also our bottom line improvement.

We do anticipate credit hours delivered for the portfolio training programs to gradually increase along with enrollments as the increased shift to project-based programs eventually stabilizes over time, with project-based programs credit hours comprising the majority of overall portfolio training credit hours.

At this time, we are working closely with overseas partner institutions in delivering our summer programs. We were pleased to offer themed domestic tours similar to those we held last summer,

internships, academic projects as well as various online bootcamps, and on-site workshop programs in partnership with our overseas partners.

With that, let's move to financials for the second quarter and first half of the year.

Total net revenues for the second quarter of 2021 increased 39.4% to RMB36.8 million, from RMB26.4 million in the second quarter of 2020. This was primarily driven by increased contributions from portfolio training and other educational services for which we delivered more services when compared with the prior-year period when more restrictions on service delivery were in place due to the COVID-19 pandemic.

Gross margin improved to 43.4% during the 2021 second quarter, up from 25.1% in the prior-year period. The improvement was contributed by the increasing shift toward project-based programs in portfolio training, which has led to improved operating efficiencies and cost optimization in service delivery.

Net income attributable to ACG was RMB14.1 million, which compares to a net loss attributable to ACG of RMB32.1 million in the prior-year period. This was primarily a result of the increase in net revenues and decreased operating expenses related to the deferral of the final RMB10 million that will be used to fund our research project with the Research Institute of Future Education and Assessment of Tsinghua Project, as well as decreased professional fees, which was partially offset by increased selling expenses related to sales performance bonuses.

Turning to the first half of 2021, net revenue was RMB74.4 million, up 25.9% from RMB59.1 million in the same period of 2020.

Gross margin improved to 41.5%, from 31.1% in the prior-year period.

Net loss attributable to ACG improved to RMB4.9 million, compared to RMB52.5 million.

Moving to the balance sheet, we continue to be in a solid financial position with US\$14.2 million in cash and cash equivalents.

Working capital deficit was US\$28.4 million, and total shareholders' equity was US\$34.1 million at June 30, 2021, compared to working capital deficit of US\$23.6 million and shareholders' equity of US\$30.5 million, respectively, at December 31, 2020.

With that, I'd now like to turn it over to Kevin who will expand upon our outlook and growth strategy. Kevin?

Mr. Kevin Ma:

Thank you, Amy.

We are pleased to see the positive trends surrounding enrollments continue into the second quarter of 2021. We achieved over 36% year over year growth in total enrollments as a result of increases across all our lines of business, which bodes well for the remainder of the year. The public health situation in China remained stable during the second quarter, and we were able to see the tangible results yielded by our new sales management platform across several of our business lines during this period.

However, the delta variant has introduced some uncertainty as we have seen certain outbreaks in China in late July and early August, which coincides with our usual peak season for research-based learning services. We are monitoring the situation very carefully and are mindful of putting our students and employees' safety first.

As with last summer, we did not offer international study abroad programs this summer given the lingering impact of the pandemic. However, we are very pleased with the demand and positive reception of the alternative programs we have developed, many in cooperation with our international partner institutions. We successfully launched several themed domestic travel programs with one of our longstanding international school partners in July. One of these tours was a visit to Pingyao City in Shanxi Province, one of the most ancient cities in Chinese history. Students had the opportunity to conduct their own research and study the design of ancient buildings in old China. We have also developed various on-site workshop programs on topics such as the future of design, cultural relic restoration and others.

I'd now like to take a moment to address the significant events that have impacted the education industry in China over the past few weeks. The guidelines jointly issued on July 24th by the General Office of the Communist Party of China Central Committee and the General Office of the State Council were primarily focused on companies providing after-school academic tutoring services for grade-school students. As we shared a week ago, ACG believes that there will be no materially adverse impact on our business given our focus on creative arts education and experiential learning. We continue to monitor the situation closely and are committed to remaining in compliance with all applicable rules and regulations in providing educational services in China and countries where ACG's partner institutions are located.

I'd now like to hand the floor over to Jun Zhang, ACG's president, to provide an update on our current growth initiatives. Jun will make his remarks in Mandarin, which will be followed by an English translation.

Jun, please go ahead.

Mr. Jun Zhang:

Thank you, Kevin.

今年夏天，我们继续与国内外知名院校合作，提供一系列高质量的可选择的课程，并很高兴已收到了来自参与学生的积极反馈。

在第二季度，ACG 战略性决定出售留存的 K-12 教育评测服务业务。这让我们能够专注于我们的核心创意教育和体验式学习业务。我们相信自己提供的各种课程和项目是区别于许多同行的，且虽然那些关于阅读、写作、数学、科学、历史等典型学术科目对一个人的教育发展至关重要，但艺术和课堂外的学习对学生的全面发展也被证明是同样重要的。

我们关注到相比去年同期，在 COVID-19 疫情逐渐恢复以后，我们的产品需求持续增长，结合我们集中销售管理平台的开发以及促销和营销活动的增加，我们看到入学人数正呈积极增长态势。

我们会持续拓展自己的课程设置，关注（于）学生们感兴趣并且能够帮助他们实现海外留学目标中受益的方面。尽管德尔塔病毒带来了一些不确定性，我们仍然对全球经济复苏持乐观态度。我们将在优先考虑学生和员工的安全和健康基础上，继续与全球各地的合作伙伴保持密切合作。同时鉴于政府最新发布的《双减》政策，我们对课（海）外学科培训行业的不确定性影响也将持续关注。

接下来交回给 Kevin。

Ms. Carolyne Sohn [translation]:

Thank you, Kevin.

We have continued to offer quality alternative programs this summer, partnering with reputable domestic and overseas institutions, and are pleased to have received positive feedback from our students.

During the second quarter, ACG made the strategic decision to sell one of its legacy businesses in K-12 education assessment services. This will enable us to focus on our core creative education and experiential learning business. We believe the curriculum and various programs we offer differentiate us from many of our peers and, while typical academic subjects of reading, writing, math, science, history, etc. are critical to one's education, the arts and learning outside of the classroom have been demonstrated to be just as important to a student's overall development.

We are seeing increased demand for our offerings during the gradual post-pandemic recovery compared with the prior-year period and, combined with the development of our centralized sales platform and increased promotional and marketing activities, we are seeing a positive impact on our enrollment numbers.

We continue working to expand our course offerings, looking to our students to see what interests them and would be most beneficial to them as they work toward their goal of pursuing studies at overseas institutions. We remain optimistic about the global recovery despite some uncertainties introduced by the delta variant. We will continue to work closely with our partners around the globe while prioritizing the safety and well-being of our students and staff. We are also remaining watchful as uncertainties impact the after-school academic tutoring industry given the recent guidelines released by the government.

With that, I'll turn it back over to Kevin.

Mr. Kevin Ma:

Thanks, Jun and Carolyne.

In closing, ACG believes we remain well positioned to execute on our growth initiatives, particularly as the effects of the pandemic continue to diminish over time. We are pleased to continue to be an organization that students trust and recognize for its quality education and excellent support both during the worst of the pandemic and as the world recovers. Our students continue to inspire us with their determination and perseverance through these challenges, and we look forward to serving a growing population of students looking to enrich themselves with creative art and experiential learning opportunities.

Everyone, please stay safe and healthy.

With that, operator, let's open it up for questions.

Question-and-Answer Session

Operator:

Thank you, we will now be conducting a question-and-answer session. [Operator instructions] Thank you, our first question comes from Lewis Fan with the Benchmark Company. Please proceed with your question.

Lewis Fan:

Hi, thanks for taking my call. First of all congratulations on a solid quarter. My first question is with regard to your operation numbers. I have noticed that you have achieved a positive net income for the quarter as opposed to a net loss over a year ago. So in this context could you please provide some estimate or color if this positive net income is going to become a trend going forward or if we will have more volatility in the upcoming quarters?

Amy Tung:

Thank you, Lewis, for the question. Well the positive net income realized in Q2 2021 was actually mainly contributed by the RMB33.5 million investment income recognized upon the deconsolidation of our legacy K-12 education assessment services. Our core business was still at a net loss status but has shown improvement compared with the prior-year period. Given the uncertainty caused by the global pandemic and delta variant resurgence in China in summer, it would not be prudent for us to make predictions about when we might achieve profitability at this stage, but we do believe we will see marked improvements over the course of the year.

Lewis Fan:

Great, that is fair enough, thank you, thank you. My second question is more about the macro environment. Over the past month or so we all saw they have some new Guidelines issued by the Chinese government with regard to the after-school education industry, so I know the management has already had some comments on this. But could you please provide some additional color on your view of this new Guidelines overall impact on the Chinese after-school education industry and, more specifically, what it might mean for ACG?

Amy Tung:

Certainly. Thank you, Lewis, for your question again. The Guidelines actually are focused on school homework and after-school tutoring for academic courses, and ACG's primary business focus is on creative education and experimental training. We do not expect our operations to be materially affected by the Guidelines in this regard. We will continue to monitor and comply with all applicable rules and regulations in China and all other jurisdictions where we conduct businesses while remaining committed to providing quality education and support services to our students.

We anticipate companies most directly affected by the Guidelines will look for ways to adjust their businesses, including seeking non-academic content for service delivery to avoid needing to issue refunds. We see these changes as an opportunity for ACG to explore new partnerships and potential avenues for growth. So we will remain tuned for what's coming on in the future period.

Lewis Fan:

Okay. Alright. Thank you. Thank you. Yes. Just one more question. So could you tell us a bit more about the industry landscape? More specifically, who are your major competitors? And how does ACG differentiate itself from its competition? And that's all my questions. Thank you.

Amy Tung:

Thank you again, Lewis, for your questions. Well, there are a few competitors of ACG in the arts training market in China, such as SIA, Sphinx and PSONE. Together with ACG, the four companies accounted for around 50% to 60% of the market share in China. SIA has been expanding very aggressively in recent years by selling courses at a big discount and providing classroom with luxury decoration. Sphinx is a subsidiary being acquired by the New Oriental Group in 2016. PSONE is a young company with about less than 10 years' experience but growing rapidly in the market.

Compared with these three competitors, ACG has the longest history in China for international education since commencing businesses in the international art education in 2006. It has the most number of training centers in China and is renowned for cultivating students to unleash their potential in art even with zero-base background. So I think I answered your questions, Lewis?

Lewis Fan:

Yes, that's very helpful. Thank you very much.

Amy Tung:

Thank you for your questions.

Operator:

Thank you. There are no further questions at this time. I'd like to turn the floor back over to management for any closing comments.

Kevin:

Thanks again to all of you for joining us. If anyone has questions for us, please feel free to reach out directly to us or our investor relations firm The Equity Group. We are always available to speak to investors and look forward to speaking with you all during our next quarterly call. Thank you.

Operator:

This concludes today's teleconference. You may now disconnect your lines at this time. Thank you for your participation and have a wonderful evening.