

ATA TRANSCRIPT

ATA Inc.
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Q3 Fiscal Year 2012 ATA Inc. Earnings Conference Call

PARTICIPANTS – CORPORATE

Kevin Ma

Chairman & Chief Executive Officer

Walter Wang

President

Benson Tsang

Chief Financial Officer and Chief Accounting Officer

Carolyn Yu

Account Executive at The Equity Group

Participants – Conference Call Q&A

Ella Ji

Oppenheimer

Mark Marostica

Piper Jaffray

Operator:

Welcome everyone to the 3QFY12 ATA Inc. earnings conference call. All lines have been placed on mute to prevent background noises. After the presentation, there will be a question and answer session. Please, follow the instructions given at that time, if you would like to ask a question. For your information, this conference call is now being broadcasted live over the Internet.

Webcast replay will be available within an hour after the conference is finished; please visit ir.ata.net.cn.

I would like to introduce Carlyne Yu, Account Executive of the Equity Group. Ms. Yu, you may now begin.

Carlyne Yu:

Thank you, operator, and good morning everyone. Thank you for joining us. Copies of the press release announcing the fiscal 3Q12 and nine months results are available at the IR Section of ATA's website, at www.ata.net.cn.

As part of this conference call, the Company has an accompanying slide presentation available on the Company's website. You are also welcome to contact our office, at (212) 836-9600, and we would be happy to send you a copy. In addition, a replay of this broadcast will be made available at ATA'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 forward-looking statements within the meaning of the Safe Harbor Provision of the Private Securities Litigation Reform Act of 1995.

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 ATA 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 two of the conference call presentation for further information.

All US\$ amounts in this conference call, relating to the Company's most recent and nine-month period ended December 31st, 2011 financial results are converted from RMB using an exchange rate of RMB6.2939 to US\$1. 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 three.

The Company's President, Mr. Walter Wang, will open with an operational overview, beginning with slide four. The Company's CFO, Mr. Benson Tsang, will discuss the financials, and the Company's Chairman and CEO, Mr. Kevin Ma, will then provide closing remarks.

With that, I will turn the call over to ATA's President, Mr. Walter Wang. Please go ahead, Mr. Wang.

Walter Lin Wang:

Thank you, Carolyne, and good morning, everyone. During the 3Q, ATA saw year-over-year growth in revenues, gross profit, and net income. On slide four, we list a few of the quarter's operating highlights. For those of you who are interested, we provide regular updates on our website.

During the quarter, we delivered 3.1 million billable tests, an increase of approximately 4.9% from the prior-year period. The growth in the number of tests delivered is largely due to increased demand for TOEIC and continued growth in HR Select.

Despite certain timing issues related to projects such as the Security Guard exams, we continued to turn this strong growth in billable tests into revenues. ATA's net revenues increased over 14% in the 9M12. This acceleration is actually greater when you consider that we are gradually exiting the test-based educational services business consisting of university courses offered in conjunction with Microsoft. If you back this out of our current and prior quarters, our net revenues actually improved over 19% on a pro forma basis.

One of the primary reasons for this increase is the continued growth in our HR Select business. Year-over-year revenues from HR Select increased 46% during the 3Q. We continue working to attract new corporate clients and expanding our program offering to existing customers, like the Agricultural Bank of China for whom we conducted internal assessment exams and campus recruitment during the quarter.

We are also making progress with the Security Guard exam, but as Kevin will note later, prolonged negotiations translated into lower-than-expected revenue contributions from this exam during the 3Q. However, we continue engaging in regular discussions with provincial governments on contract negotiations and are confident that we will be able to realize the benefits of these efforts in early fiscal 2013.

In late October, ATA successfully held the Security Guard National Qualification trial test to more than 1,000 security guards in five different cities in Henan province: Zhengzhou, Luoyang, Xinxiang, Xinyang, and Nanyang. The Public Security Bureau of Henan province was very pleased with the trials, and we continue to work with the bureau to secure an official contract that will make ATA the provider of test services for qualifying their security guards.

You can see, on the right-hand side, a map of our extensive nationwide network of over 2,400 test centers, which enables ATA to deliver large-scale exams simultaneously and cost-effectively for our clients. We are not aware of any competitor in China that can provide this kind of large-scale testing solution.

I would like to conclude my portion of the presentation with an update on ATA's growth within the computer-testing industry.

We continue to work to increase awareness of the exams and services we provide, which we believe benefit two primary groups: those seeking employment and those looking for qualified individuals to fill positions in China, the world's most populous nation.

The chart on slide five illustrates the rapid growth in the number of billable exams ATA has delivered since fiscal 2006. On the right side of the chart, you will see that we delivered approximately 6.7 million billable exams in the 9M12, which is well ahead of last year's pace.

Our growth strategy continues to center around adding new test titles in new industries to include potential test candidates we do not currently serve. Using our growing database of test takers, we also expect to continue taking a proactive approach to marketing our exams and services to students, job seekers, and potential employers.

With that, I would like to turn it over to Benson for a review of the financials.

Benson Tsang:

Thank you, Walter. We are pleased with our operating results for the quarter, where we once again improved all of our bottom line metrics, including gross profit and net income.

On slide seven, we show in US\$ ATA's 3Q12 results, which met or exceeded market consensus estimates for net revenues, gross profit, net income, and diluted EPS per ADS for the seventh consecutive quarter. We continue to focus on growing and expanding our business, and are pleased that throughout this period of growth we have maintained a consistent record of performance for current and potential shareholders.

As a result of shifts in timing of certain exam negotiations and the rescheduling of a banking exam from the 4Q12 to the 1Q13, we are adjusting our net revenue guidance for the 2012 fiscal year. Kevin will talk about it more later in his presentation.

In the next slide, we break out revenues for the 3Q12 and 9M12 by our business segments, which can be broken down broadly into two areas: testing services and test preparation & training solutions.

At over 88%, our core segment of testing services was a significant percentage of our total revenue in the 3Q12. This segment includes exams ranging from professional certification exams in various industries, such as securities and futures, to exams resulting from our HR Select service, where we assist with tests for hiring and internal assessment at different companies, and TOEIC exams. We expect this core segment to continue growing as a percentage of ATA's total revenue.

Slide nine provides a more detailed breakdown of our revenues within each business segment. 3Q12 HR Select revenue increased 46% year over year, while TOEIC revenue increased about 30% during the period. For the 9M12, HR Select revenue increased 69%, and TOEIC revenue increased over 44% when compared to the prior-year period. We expect both HR Select and TOEIC to see year-over-year growth in the remainder of 2012.

On the next slide, we have provided a breakdown of the Company's financial results for the quarter. I will quickly outline the results below the top line. Gross profit for the 3Q12 increased 2.9% to approximately RMB75 million, or US\$12 million, from RMB73.3 million in the same period last year.

Gross margin was 52.5% in the 3Q12, compared to 53.9% in the prior-year period. The decline was primarily due to the fact that while the cost of delivering a test was incurred in the 3Q12, the corresponding revenue will not be recognized until the 4Q12, after the service fee had been confirmed in February 2012. If such revenue had been recognized in the 3Q12, our gross margin would have been 2.2% higher than 52.5%.

Net income increased 22% to RMB38.1 million, compared to RMB31.2 million in the prior-year period. Diluted earnings per ADS were RMB1.62, or US\$0.26 in the 3Q12, compared to RMB1.40 in the prior-year period.

You can see full results for the 9M12 on slide 11. We reported a 55% gross margin for the period, compared to 52.1% in the prior-year period, and continue to expect gross margin to improve in the last quarter of fiscal year 2012 when compared to that of the fiscal 4Q11 due to greater economies of scale with our testing center partners, new and expanded relationships with our customers, and more streamlined operations.

We reported net income of RMB52.5 million, or US\$8.3 million for the period, or diluted earnings per ADS of RMB2.22, or US\$0.36.

Walter briefly mentioned earlier ATA's strategic decision to exit the test-based educational services, which consists of university courses offered in conjunction with Microsoft. On slide 12, we provide the calculations for adjusted net revenues that exclude revenues from the test-based educational services business.

With this adjustment, ATA's net revenues for the 9M12 increased 19.5% to RMB282.7 million from RMB236.5 million in the prior-year period.

Please turn to slide 13. We provide a chart of quarterly numbers adjusted for share-based compensation expense and foreign currency exchange gains and losses. Excluding these items, adjusted net income for the 3Q12 increased 26.9% to RMB40.8 million, or approximately US\$6.5 million, compared to RMB32.2 million in the prior-year period. Diluted earnings per ADS during the period on a non-GAAP basis were RMB1.74 or approximately US\$0.28.

Adjusted net income for the 9M12 increased 101% to RMB58.5 million, compared to RMB29 million in the prior-year period, and diluted earnings per ADS on a non-GAAP basis was approximately US\$0.40.

We continue to be supported by free cash flow and a solid balance sheet, which we have highlighted on slide 14. As of December 31st, 2011, we had about US\$40 million in cash and no long-term debt. We also do not have any short-term borrowings. This has not only helped to fund our growth, but has also provided ATA with the flexibility to work with our clients on any timing considerations related to the delivery of exams while pursuing other potential opportunities as they arise.

Finally, I would like to move to slide 15, where we provide some projections for the 4Q12. Based on existing exam schedules, which take into account the rescheduling of a banking exam from the 4Q to early FY2013, we expect 4Q net revenues will be in the range of RMB54 million to RMB59 million. We also expect continued net margin expansion.

With that, I would like to turn it over to our Chairman, Mr. Kevin Ma for concluding remarks and a revised outlook for the 2012 fiscal year.

Kevin Ma:

Thank you, Benson. We are very pleased with the healthy growth we have seen thus far in fiscal 2012. We have worked diligently to expand our HR Select and TOEIC businesses, while also working with our government and corporate clients to provide exam services.

Due to an extended timeline for negotiations relating to the Security Guard exams and the rescheduling of a banking exam from the 4Q12 to the 1Q13, we are revising our net revenue guidance for FY2012. While negotiating contracts for the Security Guard exams is taking longer than initially anticipated, we continue to be in regular discussions with provincial governments and believe the additional time will allow us to attain reasonable terms for both parties. We remain confident that we will be able to sign contracts with a number of provincial locations in China and hope to realize the benefits of these efforts in early fiscal 2013.

We are adjusting our net revenue guidance for full FY2012 to between RMB345 million and RMB350 million, from between RMB395 million to RMB415 million, as shown on slide 17. However, we continue to benefit from our current economies of scale, and are reiterating our net income guidance of between RMB55 million and RMB60 million for fiscal 2012.

This guidance is based on our own internal growth projections, and we will continue to evaluate our projections on an ongoing basis. We are confident that as ATA works to improve its brand recognition and awareness among consumers and corporate and government clients, the computer-based testing market that we serve will continue its strong organic growth.

Slide 18 lists our strategies for growth for the remainder of fiscal year 2012 and going into fiscal 2013. Having built a solid foundation for long-term organic growth, ATA is well positioned to capitalize on a variety of opportunities. With its scalable business model, strong track record of administering secure exams, and geographic coverage, ATA plans to continue looking into new test titles and new industries, and is also planning to devote more resources to marketing TOEIC in the coming year by expanding its sales team in various cities.

We also continue to move forward with implementing new large-scale tests, such as the nationwide security guard certification exam. We continue to work with various provinces in China in negotiations for contracts and conducting trial exams.

Finally, we continue to focus on generating free cash flow and strengthening our financial position to fund the Company's healthy organic growth.

With that, operator, let us open it up for any questions.

Mark Marostica, Piper Jaffray:

Thank you. I wanted to start off with a question about the Security Guard exam and the ongoing contract negotiations. Could you help us understand how these negotiations with respect to the Security Guard exam are different with the test that some of us remember few years ago with the Ministry of Culture and the Internet Café exam, which underwent a number of delays. Could you compare and contrast the two tests? You seem to have much more confidence with the Security Guard exam that it will in fact generate the revenue that you expected it will. It is just delayed for maybe a quarter or so. So, any enlightenment there would be helpful.

Benson Tsang:

Thank you for the question, Mark. First of all, the contract negotiations for these two different titles are very different. First of all, the Ministry of Culture project, the Internet Café, that contract first of all is not a requirement by the Central Government. It is really a self-initiated arrangement trying to regulate the Internal Café. The number of candidates or test takers involved in that particular program is very limited as well. So, it is basically only up to one ministry and very limited, a small department to make the decision.

And in the past, the reason for the complication of Ministry of Culture was first started by a different director in office and then there is people change and then make the contract negotiation very complicated. And then back to the Security Guard program we are currently working on. It is a whole countrywide program endorsed by the Central Government; there is a law passed to require all security guards to take the test.

And then another difference is we have to execute this contract through individual discussion with every single individual province. And that is a big difference from the Ministry or the Internet Café contract. We have to go to different provinces and major cities and talk to the people, basically every single province and major city becomes an individual customer. And in terms of the receivables and the credit risk assessment

and everything will be like a brand new customer. And that is why it will take a bit longer and even for our marketing and sales team to try to find a right person and understand the whole approval process within each province and major city.

Mark Marostica:

Thank you, Benson, for the color on that. Regarding the go-forward model, as we look into fiscal 2012, could you give us a little bit more insight as to whether you still believe you will be on a track of expanding margins? Given commentary on the call, I thought I heard that there were plans to invest in selling and marketing for TOEIC, for example. Just trying to get a sense of the potential for margin expansion in fiscal 2012, and also talk to us about the spend on the selling and marketing line too. Thank you.

Benson Tsang:

Sure, Mark. So the final quarter, fiscal 4Q12, we expect the net revenue as we mentioned earlier is about RMB54 million to RMB59 million. And for the gross margin, we expect it will be much better than what we achieved last year, which was 45% in the 4Q. We strongly believe our gross margin for 4Q will be no less than 52%.

And as for the OPEX, as you can see traditionally the 4Q is not a big quarter for us spend on R&D and sales & marketing. And we expect R&D and sales and marketing expenses will come down as compared to the 3Q.

And for the G&A, we do expect we will be relatively stable as most of the costs are fixed in nature, and we anticipate similar level as the 3Q. And overall we believe the OPEX will be in the range of RMB27 million to about RMB30 million.

And when it all comes down to all this, we strongly believe that net income for the 4Q will be in a much better position than last year. And on a full-year basis, the net margin we are hopeful to achieve at least 100% increase from 2011.

Mark Marostica:

And then, Benson, just a follow-on to that and I will turn it over. As you enter fiscal 2013, can you give us some color as to how you think margins will progress? And then also back to the question on selling and marketing, I am very curious on that line item, if you think you will continue to see leverage or if that will be an area where you will spend to drive revenue growth?

Benson Tsang:

Sure, Mark. For 2012, as you may recall, we started to do a cost rationalization program or cost restructure program in the 4Q11. And fiscal 2012 is a year we actually try to put all our infrastructure in place in a very efficient manner.

And as of today I am happy to tell you ATA achieved a very efficient structure. And going forward to 2013, we fully intend to expand our sales and marketing efforts. We believe we have now the right infrastructure to propel the business or to support the business. Now we need to build or continue to build the sales and marketing force and then we can drive the top line.

And then for some color on 2013, we still remain very positive. We anticipate the Security Guard program will provide significant contributions in 2013. And we also expect there are expanded or deeper operations with our existing customers, both in the public and private sectors.

And in the private sector, the existing two tools, HR Select and TOEIC, in 2012 fiscal year we achieved very decent growth. We anticipate on a full-year basis we can achieve a minimum of 50% growth. And we anticipate this growth momentum will continue.

And we are very glad to also see in 2012, we see the paper-based examinations started to do conversion to computer-based exam. One example that happened in the 3Q is the examination highlighted in our presentation PPT, is an examination done for China National Customs Declaration Examination.

This conversion from paper-based to computer-based exams bring into ATA about RMB10 million. We are very encouraged to see that, and we are already in discussion with some other organizations to convert paper-based to computer-based exams. And also for the sales and marketing, as I mentioned, we do expect to spend a bit more in order to grow in particular in the private sector.

So, in terms of except margin expansion or the net income, we are currently working on our budgets, and in the upcoming 4Q earning release, we will be in a much better position to share a lot more with you.

Mark Marostica:

Thanks for the color, Benson. I will turn it over.

Ella Ji, Oppenheimer:

Thank you for taking my questions. First, I have a few follow-ups. Benson, when you mentioned that you expect the momentum of HR Select and TOEIC to continue in the next fiscal year, are you talking about the 50% growth rate? Do you expect that to continue in the next year? Can you just elaborate a little bit more on that?

Benson Tsang:

Sure. Currently the momentum we achieved so far is in fact a way past 50%. Based on what we can see now, we see the market is there. We fully intend to continue to achieve 50% growth for 2012.

Ella Ji:

Great. So, how many company customers do you have for HR Select, and also the number of test takers for TOEIC for this quarter?

Benson Tsang:

For TOEIC, the number of test takers for this quarter is about 220,000 test takers just for the 3Q this year. And for last year it was 175,000. And then for HR Select, the number of customers, currently active customers, we have about in the range of about 120.

Ella Ji:

OK. And then for your Security Guard exam, could you also talk about your pipeline? We know there are four provinces that you are negotiating with, and you are trying to lock the agreement in the next quarter or the 1Q13. In addition to those, are there any other provinces that are in the pipeline that you started negotiation?

Benson Tsang:

Sure, Ella. Let me start it off to remind you. Currently, we have three signed contracts, and we are currently delivering examination services to those cities. And we have four contracts currently out with four provinces and city for signing, going through the internal approval procedures. We also have five cities, we are currently in discussion with them about the commercial terms.

And we also recently conducted a trial test in five different cities. So, the pipeline we fully intend towards the end of the 4Q or early 1Q FY2013 we will expect to see more contracts coming in, and we'll also start delivering services for all these new contracts in the 1Q FY2013.

Ella Ji:

Great. And when you mentioned that new test - China customs preparation test, you mentioned your potential RMB10 million, is that the revenue that you expect to realize for next fiscal year? I am little confused there.

Benson Tsang:

I am very sorry about the confusion. In fact, the customs examination, we already provided the examination in the 3Q FY2012. And in that service, we recognized approximately RMB10 million in our 3Q traditional revenue.

Ella Ji:

I see. And you expect this to continue driving your revenue for the next fiscal year?

Benson Tsang:

At the moment, we fully intend it will be recurring revenue, starting 2013.

Ella Ji:

OK, great. And lastly, also talking about your spending in sales and marketing for next year, should we expect these sales and marketing expenses as a percentage of revenue also to go up next year, or are you just talking about absolute US\$ amount?

Benson Tsang:

I think in absolute US\$ that will definitely go up. And then in terms of as a percentage to revenue, at the moment, as I mentioned, we are currently doing the budget. So, it is a bit early for me to comment on that. But allow me to remind the kind of formula we always try to achieve.

Whenever we have a revenue increase, whatever the percentage, we always want to try to achieve, to cap the percentage increase in the overall OPEX to a certain percentage of the revenue increase. So, this direction will continue to be our main formula going forward.

Ella Ji:

OK, great. Thank you. Thanks for the color. Those are all my questions.

Operator:

We have no further questions at this moment. I hand back to Mr. Kevin Ma.

Kevin Ma:

Thanks again to all of you for joining us. We look forward to speaking with you again after we report our 4Q financial results in June. As always, we welcome any visitors to our office in Beijing. Thank you.

Operator:

Thank you for your participation in the ATA conference. There will be a webcast replay within an hour. Please visit ir.ata.net.cn. You may now disconnect. Goodbye.

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