

Transcript of ATA Third Quarter 2013 Earnings Call February 5, 2013/8:00 a.m. EST

Participants

Carolyne Yu – Senior Associate – The Equity Group

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Kevin Ma – Chairman and Chief Executive Officer – ATA

Presentation

Operator

Greetings and welcome to the ATA, Inc. Fiscal 2013 3rd Quarter Financial Results Conference Call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. As a reminder, this conference is being recorded. The webcast replay will be available within one hour of the end of this call. Please visit ir.ata.net.cn to access the replay.

It is now my pleasure to introduce your host, Carolyne Yu of The Equity Group.

Carolyne Yu – Senior Associate – The Equity Group

Thank you, operator, and good morning, everyone. Thank you for joining us. Copies of the press release announcing ATA's fiscal 2013 third quarter results are available at the IR section of the Company'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 certain 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 2 of the conference call presentation for further information.

All U.S. dollar amounts in this conference call relating to financial results for the Company's most recent quarter ended December 31, 2012 are converted from RMB using an exchange rate of 6.2301 RMB to US\$1. All historical conversions are accurate as of this time reported unless otherwise noted. The Company reports its financial results under U.S. GAAP and RMB and all percentages calculated in the presentation are based on RMB unless otherwise noted.

For those of you following along with the PowerPoint presentation there is an overview of the Company on Slide 3. The Company's CFO Mr. Benson Tsang will provide an overview of the quarter's operational and financial highlights beginning with Slide 4. 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 CFO Mr. Benson Tsang. Please go ahead, Benson.

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Thank you, Carolyne, and good morning, everyone. Today we will provide an overview of our highlights for the quarter, address our challenges, and then discuss our vision for the coming quarters.

On Slide 5 we have listed some of the quarter's operating highlights. Due to the timing of certain exams and campus recruitment projects the third fiscal quarter is typically our strongest. During 3rd Quarter 2013 we were pleased to have successfully delivered 4.2 million billable exams, approximately about a 34% increase over the prior year period. This increase was largely due to our successful delivery of 1.4 million exams across China, Hong Kong, and Macau Special Administrative Regions for the new computer based CPA exam in October. We also completed campus recruitment projects for various operations both domestic firms and multinationals.

On the right hand side of the presentation is a map of our extensive nationwide network of approximately 2,800 test centers, which enables ATA to deliver large scale exams simultaneously and cost effectively for our clients. We believe we are the only provider of this kind of large-scale testing solution in China.

During the period we also continued to push toward our goal of diversifying our sources of revenue by increasing the awareness of our service platform to the private sector, which we believe to be in the best interest of ATA and the shareholders.

While we believe that China's continued economic development will lead to larger growth opportunities, we also realize the importance of reducing our dependence on government-based exams

therefore providing greater visibility into our operations. We are monitoring and making administrative and personnel changes in the Company to make better use of our resources as we have not achieved the results we anticipated from our sales and marketing efforts for TOEIC and HR Select in recent quarters.

In the meantime, we also continue to explore opportunities to expand our product and service offerings including adding new industry test titles, converting paper-based exams to our computer-based platform, and increase engagement with our growing database of test takers to market our exams and services to students, job seekers, and potential employees.

Now moving to our financial highlights for the quarter on Slide 6, we achieved about 25% year-over-year growth on the topline during 3rd Quarter 2013 due to the growth in number of billable exams for the period. However, our gross margin continued to be impacted by a year-over-year decrease in Financial Securities SAC exam volumes, which resulted in lower contributions as a percentage of revenue, and implementation expenses to ensure client satisfaction and smooth delivery of the new China CPA exam. In addition, ATA incurred costs to deliver several exams in 3rd quarter 2013 for which the corresponding revenue will be recognized in 4th quarter 2013.

As a result of these challenges, we are revising our net revenue and non-GAAP net income guidance for the fiscal year, which I will expand upon shortly.

On Slide 7 we show our 3rd quarter 2013 results compared with our analysts' estimates. In the next slide we break out these revenues for 3rd quarter 2013 and the first nine months of fiscal 2013 by our businesses, which can be broken down broadly into two areas, testing services and test preparation and training solutions. At 94% our core segment of testing services was a significant percentage of our total revenue in the 2013 3rd quarter. Testing services include exams ranging from professional certification exams in various industries such as Securities and Futures to exams resulting from our private sector business, which includes TOEIC and HR Select exams.

During 3rd Quarter 2013 the new CPA exam contributed to the growth as we saw in our testing services segment. We expect this core segment to continue growing as a percentage of ATA's total revenue.

On the next slide we are providing a breakdown of the Company's financial results for the quarter. I addressed gross margin earlier and despite these challenges we were pleased to report profitable operations with 3rd quarter 2013 net income of RMB33.2 million, compared to RMB38.1 million in the prior-year period. Diluted earnings per ADS was about US\$0.24 in 3rd quarter 2013.

You can see a summary of financial results for the first nine months of fiscal 2013 on Slide 10. Net income for nine months 2013 was RMB29.3 million for the period, and diluted earnings per ADS was approximately US\$0.20.

On Slide 11 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 3rd quarter 2013 was RMB35.8 million, compared to RMB40.8 million in the prior-year period. Diluted

earnings per ADS during 3rd quarter 2013 on a non-GAAP basis was about US\$0.26. Adjusted net income for nine months 2013 was RMB38.8 million, and diluted earnings per ADS on a non-GAAP basis was about US\$0.28.

We continue to be supported by free cash flow and a solid balance sheet, which we have highlighted on Slide 12. As of December 31, 2012, we had about US\$47 million in cash. We have no long-term debt or short-term borrowings, and continue to follow the strict cost structure that has served us well over the past several years.

On November 1, 2012, the Company's Board of Directors authorized the repurchase up to US\$5 million of its issued and outstanding ADSs from time to time in open market and privately negotiated transactions. By the end of 3rd quarter 2013 the Company had repurchased about 8,000 ADSs at an average stock price of US\$3.95. This share repurchase plan was originally set to expire on March 31, 2013, but the Board recently voted to extend the plan through May 31, 2013.

Finally, I would like to discuss our outlook for the remainder of fiscal year 2013. While we continue to work towards our goal of diversifying revenue streams away from the less flexible public sector, we have encountered a number of challenges during this fiscal year, which has hindered our progress. Though we have seen weaker volumes in the financial sector certification exams in the first nine months of fiscal year 2013, which we anticipate will also impact 4th quarter 2013, revenues from our traditional testing services business has, in fact, grown over 20% year-over-year during the period due to the strength in our public sector exams.

We continue to see many areas of opportunity for ATA to grow. The CPA exam is a good example of this kind of opportunity. With our excellent track record and long client relationships, we are confident in the continued growth of our core testing services business, which will ultimately be driven by our competencies in technology, operations, security, and quality service.

We are also working to streamline our operations through a corporate restructuring, which includes consolidating responsibilities among department heads and management, a new reporting structure for improved accountability, and select layoffs within the Company. Restructuring costs are estimated to be up to RMB8 million in 4th quarter 2013. We believe these changes will drive greater efficiencies throughout our organization and help us to achieve even greater results in the long term.

Because of the challenges I've just mentioned, we are revising our guidance for fiscal year 2013 to between RMB352 million to RMB362 million, from between 390 million to 410 million, and on a non-GAAP basis net income to be between RMB18 million to RMB23 million, from 40 million to 50 million. This is highlighted on Slide 13.

The new non-GAAP net income guidance includes the estimated restructuring costs of RMB8 million that I just referenced.

In addition, based on existing exam schedules we expect 4th quarter revenues will be in the range of RMB38 million to RMB48 million. Please keep in mind that this guidance is based on our own internal growth projections, and we will continue to evaluate our projections on an ongoing basis.

With that, I'd like to turn it over to our Chairman, Mr. Kevin Ma for concluding remarks.

Kevin Ma – Chairman and Chief Executive Officer – ATA

Thank you, Benson. Despite the challenges we just discussed all of our team at ATA remains confident in and optimistic about ATA's long-term future in providing advanced, large-scale testing solutions. I would like to tell each of you that we do not take changes within our organization lightly. Our entire management team made a number of difficult decisions after months of evaluating our results over the past year. We believe that this restructuring was ultimately necessary in setting ATA on the path for long-term, sustainable growth and is in the best interest of our company.

We intend to leverage the many strengths of ATA. We have the proven technology, a solid track record among clients, and an extensive nationwide network of test centers to support our strategies for growth for the remainder of fiscal year 2013, which we list on Slide 15.

In addition to increasing public awareness of the benefits of obtaining certification or official assessment of one's skills, we continue looking into new test titles in new industries and opportunities to transition large-scale, paper-based exams to our secure and more cost-effective computer-based platform.

We are very excited about the opportunities that lie ahead for our company. Our position within the growing testing market is unmatched within China. Our duty as management is to lead ATA on a path of healthy, organic growth, and we expect to do so.

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

Operator

Our first question comes from the line of Ella Ji with Oppenheimer.

<Q>: My first question is in regard to your 4Q guidance. Benson, could you break down for us within your total revenue guidance approximately how much would be from the private sector and how much would be from the public sector?

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Good morning, Ella. Thank you for your question. On a full-year basis we estimate probably around 80% will be from the public sector and about 20% will be from the private sector, ballpark figure.

<Q>: Then also regarding your margin trends I understand that in this physical 3Q you accrued some one-time items, so could you comment on the gross margins year-over-year trend on a normalized basis in future?

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Sure. Let me first talk on the margin in Q3. Q3 the margin was impacted by a few items. First of all is the volume on a year-on-year basis, the Financial Securities exams came down and the margin impact is approximately about 1%; and then on our investment on our TOEIC business the impact is about 1%; and then, if you look at our financials we do have the test prep and solution business. It came down because the continued education business from financial security was down. The impact was about 1.8% from that. Then for the costs we incurred in Q3 for those projects the revenue was recognized in Q4. The margin impact was about 2%.

That basically explains primarily the drop on the gross margin on a quarter year-over-year basis. The remaining of the margin impact is really because of the investment cost we put in the China CPA exam, and we achieved a margin for the first year. It's below the norm of our testing services. The norm of our testing services margin is 50%. On a full year basis we anticipate this year we probably will achieve gross margin for full year in the range of 46% to 48% depending on the final results in our Q4.

<Q>: Then could you also give us some details with regards to your next year's business plan? Could you comment around your pipeline in the public sector? Also, I understand that your private sector business is facing some challenges. What do you plan to do to overcome the challenges and make it a strong revenue contributor again? Any detailed comments or thoughts about your business plan would be very helpful.

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Okay. Regarding the trend of the business let me start off with the traditional business we normally call the public sector. In fact, for the public sector, as our chairman Mr. Kevin Ma mentioned, we're actually quite happy to see the growth in our public sector--government-controlled, government-regulated carrier. For our public sector, especially this year we clearly see because of our computer platform, our track record, and our operation experience and the testing network, we managed to win the contract from the Ministry of Finance for the China CPA exam. We clearly see, ATA we are on higher ground whenever we need to go out and bid for large-scale, computer-based examinations, and in that particular area in the past two years we really see encouraging results.

If you recall, 2012 we got China Customs and this year we got China CPA, and currently we are working on three potential projects. All of them are considering converting paper-based to computer-based testing. We feel quite comfortable or strongly that we will be able to crystalize one project in 2014, and we believe the traditional business will continue to be the bread and butter to provide the cash and fuel for us to make investment in new area.

Now I would like to move on to the private sector. Private sector 2013 at the beginning we decided to make an aggressive approach to invest in sales and marketing, and we are hoping we can educate the market so they can adopt a concept of campus recruitment and also adopting some of the test content we recommend to become better assessment tools. After nine months we realized there is a natural time requirement in order to educate the corporation and also the individual consumers to adopt something new. Going forward first we believe the amount of time and money invested by ATA in 2013

will continue to rely on the content that we make in this year and will try to follow up in 2014 financial year. We strongly believe given a little bit more time we should be able to crystalize more of these potential opportunities.

Then we're also exploring at the moment to create a new direction. We would like to go back to the relationship with different universities and educational schools. We would like to encourage these universities to adopt TOEIC maybe as a normal course program or maybe suggest that students take the TOEIC exam in order to increase the revenue to be generated from TOEIC. That is a new direction.

In summary, I think the company feels very comfortable with the traditional business, the government sector. We clearly see growth potential. In the private sector we believe the strategy we will make some changes and it will continue to bring better results, and we are hoping to see growth starting 2014.

Operator

Our next question comes from the line of Mark Marostica with Piper Jaffray.

<Q>: My first question is in regard to your public sector, and I was wondering if you could give us your thoughts regarding the outlook for your key exam titles, for example, the Securities exam that you've been having some difficulties with lately. How is that shaping up as we look to fiscal '14, and then the Banking Association exam and any others that you want to highlight? Thank you.

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Sure. Thank you, Mark for the questions. For the key title within our public sector, our Financial Securities, this year we did face some challenges due to the downturn in the financial sectors in China, but we started to see stable stage towards Q3 and Q4. In fiscal year 2013 we anticipate we can complete 1.8 million tests for Financial Securities, and for this particular title in recent weeks or in this particular month we started to see the trend that financial sector is getting better. It could be a result of the global markets appears to be little bit better, and also we work together with the Financial Security Association.

Next year Financial Security Association will in total have ten times of examination instead of four, and the additional six times will be in select cities and to be organized by appointment basis. We strongly believe with the increase in the number of tests a student or job seeker can take that will help us to at least maintain about the same level this year in terms of the number of test takers.

And for the Banking Association, in fact, this year both the revenue and the number of tests we achieved over 50% growth. Within the Banking Association we strongly believe we will continue to see positive growth in the next couple years simply because we think the Banking Association there are still quite a few number of members. They have to pass the examination and get the certificates.

And then, other big examination is China CPA, and China CPA based on the feedback we got so far CPA Association they are happy with our services this year, and there's a very good chance we will be able to renew the contract this year.

I think those are the very key contracts under the public sector. In summary, I think we believe 2013 will be a challenging year for us in the public sector, but to be more specific we consider it's small, particularly in the financial sector, but not in other areas or in other government sectors.

<Q>: Benson, just to remind us those three exams do they contribute about half the revenue of the company? Is that about correct?

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Yes. I think CPA exam, Financial Security and Banking Association we anticipate on a full year basis a little bit over 50%.

<Q>: Then regarding the Security Guard exam we haven't heard an update on that recently. Can you give us an update on progress there?

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Sure, Mark. In last quarter earnings call I mentioned to the Street we don't feel we will be able to sign the provincial contract with Guangdong province, and as a result of that in last quarter we adjust the revenue forecast from RMB25 million to RMB5 million in total. In Q3 we managed to sign on another two cities so by now we have a total signed contract with eight cities versus at the end of last year we had three. In terms of number of tests, number of cities and revenue, we were basically double this year.

As far as the revenue is concerned last year was about RMB2 million and this year, as I communicated last time in last quarter, we anticipate we can achieve around RMB5 million. I think we are on track. We should be able to achieve that, and going forward for the Security Guard Program internally we anticipate an annual growth of 30%, and we think it's very doable and it's very conservative. If we manage to sign on one big city like Guangzhou or Chengdu in Sichuan province, we could easily double in one year, but as I said before, our government contract with a particular security guard the negotiation process may take some time.

<Q>: So taking a step back—and I know you're not providing detailed guidance for fiscal '14 at this moment but in trying to help us get an understanding of the longer term financial model that you're targeting in terms of revenue growth and margins, what generally can we expect to be considered reasonable for fiscal '14 from your current thinking.

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

In first quarter, the beginning of this year, ATA we make a decision we need to think three years and five years down the road what ATA will become. And as a result of that we started the strategy: we have the view on the bread and butter business providing the fuel and now we have to go in to the private sector.

When we started this financial year we knew there could be impact on our margin because of the investment for the future, and as a result we can see up to today it does affect our margin. But we do believe we have experienced and learned something this year, and we also have viewed some of the client content. We expect the margin will start to go north starting 2014. And the investment in the private sector will continue but we believe we will change from the aggressive mode in sales and marketing, particular door-to-door type of sales strategy, to a more moderate and normal strategy and we'll make some investment, as I mentioned earlier, in kind of the channel distribution concept--go to the universities. We anticipate with this change in the strategy we will continue to see improvement in the margin.

On the longer term, on a three, five year basis we would like to see the margin will be up to the range of about 52%.

<Q>: Then last question, Benson. You mentioned you will be spending about RMB8 million in the 4th quarter for the restructuring activities. What saving should we expect from that? If you could give us kind of an annual expense savings from the restructuring that would be helpful. Thanks.

Benson Tsang – Chief Financial Officer & Chief Accounting Officer – ATA

Sure. Right now we are in the process of reviewing the different departments. We are progressing. We have done some consolidation of management and consolidation of departments. We are yet to complete the restructuring, and that's why in my earlier communication we anticipate we may spend up to RMB8 million. At this moment we don't have a final figure going forward how much we can save, but in a ballpark figure we anticipate in the op ex area we can probably save a minimum of RMB5 million, at the minimum. That will include the labor costs and will also include some of the related overhead such as rental space and some equipment expenses.

Operator

Mr. Ma, there are no further questions at this time. I'd like to turn the floor back over to you for closing comments.

Kevin Ma – Chairman and Chief Executive Officer – ATA

Thank you, again, all of you for joining us. We look forward to speaking with you again after we report our 4th quarter and year-end financial results in May. As always, we welcome any visitors to our office in Beijing. Thank you.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.