

ATA TRANSCRIPT

ATA Inc.
November 6th, 2012
Q2 Fiscal Year 2013 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 2Q13 ATA Inc. earnings conference call.

All lines have been placed on mute to prevent background noise. 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 Carolyn Yu, Account Executive at The Equity Group. Ms. Yu, you may begin.

Carolyn Yu:

Thanks, operator, and good morning, everyone. Thank you for joining us.

Copies of the press release announcing ATA's fiscal 2013 second 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 September 30, 2012, are converted from RMB using an exchange rate of 6.2848 RMB:1 USD. 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.

The Company's President Mr. Walter Wang will open with an operational overview, beginning with slide 4. 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'll turn the call over to ATA's President, Mr. Walter Wang. Please go ahead, Mr. Wang.

Walter Wang:

Thank you, Carolyne, and good morning, everyone.

On slide 5, we have listed some of the quarter's operating highlights.

We continued to explore new exam titles in different markets despite weaker economic conditions, which we believe led to an overall slowdown in certain public-sector examinations, such as the SAC exam. During the quarter, we delivered 1.4 million billable tests, compared to 1.8 million in the prior-year period.

In September, near the end of the quarter, ATA signed an official contract with the Chinese Institute for Certified Public Accountants to be the service provider for China's first ever computer-based national unified CPA exam in 2012. ATA successfully administered the CPA exam in October and expects to begin seeing contributions from this exam to its top line in Third Quarter 2013.

We also administered a large-scale internal assessment exam for the Bank of China in 74 cities across 31 provinces to help them determine which of their employees would be most suitable for overseas placement.

We also continue to explore ways of diversifying our sources of revenue from public sector exams: converting paper-based exams to computer-based exams, looking at potential new industry test titles to include potential test candidates we do not currently serve, while engaging with our growing database of test takers to market our exams and services to students, job seekers, and potential employers.

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

Benson Tsang:

Thank you, Walter.

We encountered a set of challenges during Second Quarter 2013 and came short of meeting our previously provided guidance for net revenues during the period. This was partially due to lower exam volumes for the SAC exam caused by a slowdown in the financial industry, as well as delayed delivery of services for contracted projects.

Our gross margin was affected by a year-over-year decrease in SAC exam volumes and contributions as a percentage of total revenues, and lower contributions from the test preparation and training solutions business. The Company also incurred expenses to ensure client satisfaction and smooth delivery of the new computer-based CPA exam, for which Walter just mentioned we expect to record revenues in fiscal 2013 Q3.

Due to the unexpected decrease in SAC exam volumes, which we anticipate will continue through the remainder of FY 2013, and other challenges, we are revising our net revenue and non-GAAP net income guidance for the fiscal year, which I will expand upon shortly. As Walter mentioned, we believe the decrease in the number of test takers for the financial securities exam is largely a result of macroeconomic conditions that are out of our control. However, we remain focused on what we can control, which is increasing our base of exams through new agreements to deliver large-scale exams like the CPA exam.

We have always strived to be transparent in explaining our results in comparison to what's expected by the market. On slide 8, we show in U.S. dollars ATA's Second Quarter 2013 results. As you can see here, we only met or exceeded market consensus estimates for non-GAAP net income and non-GAAP diluted earnings per ADS for the ninth consecutive quarter.

In the next slide, we break out revenues for Second Quarter 2013 and First Half 2013 by our businesses, which can be broken down broadly into two areas, testing services and test preparation & training solutions. At 87%, our core segment of testing services was a significant percentage of our total revenue in the 2013 second 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 include TOEIC and HR Select exams. During Second Quarter 2013, we continued our push in sales & marketing for TOEIC and HR Select in the private sector to drive future growth. We expect this core segment to continue growing as a percentage of ATA's total revenue.

Though revenue from our traditional testing services business during Second Quarter 2013 was down year over year, revenues from this segment for Six Months 2013 increased 7.4% when compared to the prior-year period.

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 Second Quarter 2013 was RMB21.6 million, or US\$3.4 million, compared to RMB40.1 million in the same period last year. Gross margin was 46.1% in Second Quarter 2013, compared to 56.9% in the prior-year period. As I mentioned earlier, gross margin was impacted by a year-over-year decrease in SAC exam volumes and contributions as a percentage of total revenues, and lower contributions from the test preparation and training solutions business. The Company also incurred expenses to ensure client satisfaction and smooth delivery of the new computer-based CPA exam, which had an impact of about 5% on our Q2 gross margin.

Second Quarter 2013 net loss was RMB9.1 million, or US\$1.4 million, compared to net income of RMB1.4 million in the prior-year period. Diluted loss per ADS was RMB0.42, or US\$0.06, in Second Quarter 2013, compared to diluted earnings per ADS of RMB0.00 in the prior-year period.

You can see the full First Half results on slide 11. Gross margin for First Half 2012 was 50.6%, compared to 57.5% in the prior-year period, primarily due to the same challenges I just mentioned impacted Second Quarter 2013. We expect gross margin shall be in the 50% range for the remainder of FY 2013. We reported a net loss of RMB3.8 million, or US\$0.6 million, for the period, or diluted loss per ADS of RMB0.20, or US\$0.04.

On slide 12, we provide a chart of quarterly numbers adjusted for share-based compensation expense and foreign currency exchange gains/losses. Excluding these items, adjusted net loss for Second Quarter 2013 was RMB6.6 million, or US\$1.1 million, compared to adjusted net income of RMB4.6 million in the prior-year period. Diluted losses per ADS during Second Quarter 2013 on a non-GAAP basis was RMB0.30 (US\$0.04). Adjusted net income for Six Months 2013 was RMB3.0 million, compared to RMB17.7 million in the prior-year period, and diluted earnings per ADS on a non-GAAP basis was RMB0.14 (US\$0.02).

We continue to be supported by free cash flow and a solid balance sheet, which we've highlighted on slide 13. As of September 30, 2012, we had about US\$39.9 million in cash. We have no long-term debt or short-term borrowings. We continue to follow a strict cost structure, which we continue to believe is key to funding our long-term growth and allowing ATA some flexibility should any timing changes related to the delivery of exams arise.

In addition, on November 1, 2012, the Company's Board of Directors authorized the repurchase of up to US\$5.0 million of its issued and outstanding ADSs from time to time in open market or privately negotiated transactions. This share repurchase plan will be in effect through March 31, 2013. The timing and actual number of ADSs purchased will depend on a variety of factors such as price, corporate and regulatory requirements, and other prevailing market conditions. ATA's Board of Directors will periodically review the share repurchase plan and may authorize adjustments to the plan's terms and size. The Board may also suspend or discontinue the repurchase plan at any time. The Company intends to provide updates on the plan each quarter.

On slide 14, we provide some projections for the 2013 third quarter. Based on existing exam schedules, we expect third quarter net revenues will be in the range of RMB170.0 million to RMB200.0 million, which compares to actual net revenues of RMB143.6 million in the prior-year period.

Finally, I'd like to provide a bit more background on ATA's outlook for the remainder of FY 2013. ATA continues to believe it is crucial to the Company's future that we diversify our revenue streams away from the public sector due to its generally less flexible nature. We saw weaker volumes in certain public sector exams during First Half 2013 and anticipate this trend will continue for the remainder of this fiscal year. For these reasons, we believe it is important for us to continue moving forward with our push to grow ATA's private business with TOEIC and HR Select. We have also taken steps to streamline our operations and continue to monitor our progress closely.

Third Quarter 2013 is typically our strongest quarter due to the timing of campus recruitment projects, and ATA expects to begin realizing a return on these new business efforts in the private sector in the coming quarters.

However, because of certain challenges—weaker volumes of some of our larger public sector exams, a longer-than-expected ramp-up of our private sector business, and the need to sign security guard contracts with individual provinces and cities, we are revising our guidance for Fiscal Year 2013 to between RMB390.0 million and RMB410.0 million, from between RMB420.0 and RMB440.0 million, and non-GAAP net income to be between RMB40.0 million and RMB50.0 million, from between RMB70.0 million and RMB80.0 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. We are confident that as ATA works to execute its FY 2013 growth initiatives, we will continue achieving strong organic growth.

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

Kevin Ma:

Thank you, Benson.

Despite some unforeseen challenges in First Half 2013, ATA remains confident in its ability to capitalize on the various opportunities before us. We have our solid track record among clients and nationwide network to support our strategies for growth over the next two quarters, which we list on slide 17.

As Benson just mentioned, it is more important than ever for ATA to grow its private sector business, as a measure of diversifying our revenue sources away from the public sector and setting a firm foundation for future growth. We believe we will begin to realize the benefits of our sales and marketing campaign for TOEIC and HR Select in Third Quarter 2013, which has typically been our strongest quarter of the fiscal year.

We continue working to attract a larger audience of test takers for our existing test titles as we look into new test titles and new industries we currently do not serve.

We recently completed the successful administration of the first ever computer-based CPA exam in China, which had more than 1.3 million test takers spanning 221 cities throughout the country. With the majority of large-scale exams still being conducted under a traditional pen-and-paper method, we will continue to explore opportunities where ATA can convert these exams to the more cost-efficient computer-based platform.

ATA continues to focus on generating free cash flow that will enable the Company to fund and nurture healthy, organic growth.

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

Operator:

We will now begin our question and answer session. If you have a question for any of today's speakers, please press 01 on your telephone keypad and you will enter a queue. After you are announced, please ask your question. If you find that your question has been answered before it is your turn to speak, please press 02 to cancel the question.

The first question is from Ella Ji from Oppenheimer. Please go ahead; your line is open.

Ella Ji, Oppenheimer:

Hi, good evening. My first question is regarding the SAC exam. I understand the test takers fell short of your original expectation, so I am wondering if you think this decline is just temporary, maybe cyclical along with China's economy or if you think this can be structural in the long term.

Benson Tsang:

Ella, I will try to answer your question. Based on what we saw in 2Q, we think that the shortfall in the number of test takers is a direct result from the economy in the financial securities area. One thing we noted is, due to slowdown, financial security companies are not hiring new graduates, they are taking new workers from other work areas.

So, we believe in the near term the number of test takers will really depend on the financial sector, particularly the security market, whether there will be a rebound. To some extent, we think the National Congress--the result may have some impact on the overall financial security market.

Ella Ji:

OK. Within the private sector, I do not know if I missed it, how much revenue did this sector contribute for this current quarter?

Benson Tsang:

This quarter the private sector was about RMB13 million.

Ella Ji:

OK. And do you expect the sector will be able to grow around 40% for the full year?

Benson Tsang:

I think right now, what we anticipate, we will see the private sector will continue to grow, it is really depending on the timing of the contracts. As I mentioned maybe in previous quarters, the challenge to us in the private sector is a bit different from the public sector.

The private sector, at the very last minute, corporations or our clients, they can make a decision to delay or change the time, depending on their own time schedule. So, based on what we see in the 2Q, we actually encounter one particularly client that did really make a last call to change the examination to another quarter. So, with this taken into consideration, we anticipate this year we will continue to grow the private sector, but we believe the range could be between 20% and 40%.

Ella Ji:

OK, but in a potential decline of revenue growth would be a delay to the next year? Is that correct?

Benson Tsang:

Correct.

Ella Ji:

OK, great. All right, and then my third question is regarding your standing operating expenses. As you mentioned, you are going to continue working hard on pushing the private sector; so can you just get it down to the operating expenses and give us an outlook of where do you plan to spend the money, which areas? What will be your focus? Thanks.

Benson Tsang:

The total OPEX for the first two quarters was about RMB73 million, and the majority of the cash spending was really on the sales and marketing area, although if you look at the G&A area, we have a pretty thick dollar value there, but the majority of those actually could be like depreciation and some non-cash items and also including share comp charges.

Going forward for 3Q or the 2H13, we anticipate we will spend probably a total OPEX in the range of RMB80 million to RMB85 million, and the majority of the actual cash spending will be in the sales and marketing area, which we anticipate probably in the range of RMB40 million in total.

Ella Ji:

OK, great. Thank you for taking my questions.

Operator:

The next question is from the line of Mark Marostica from Piper Jaffray. Please go ahead, sir.

Mark Marostica, Piper Jaffray:

Good evening, gentlemen. My first question is in regards to the visibility in the 2H of the fiscal year, given some of the challenges you have endured. Basically, can you give us your sense as to how much revenue you have in backlog that just needs to be recognized more or less, like your guidance for the 2H?

Benson Tsang:

Sure. Good morning to you, Mark, or maybe good evening; you could be in Hong Kong. So, for the 2H, I think for the moment of the 3Q, the guidance we provided is RMB170 million to RMB200 million. The backlog we have, meaning we have the contracts on hand, we are just waiting to deliver the services, is about RMB145 million.

We have a number of contracts, meaning in the private sector, we are actually in the final process to conclude the contract with the clients. So, that is the reason why if you look at the guidance for 3Q we did provide a pretty wide range, a RMB30 million spread.

We really depend on the timing when we can conclude the contracts, but we believe for those contracts we will either deliver them in December this calendar year, or January 2013.

Going into 4Q, at the moment we do have some signed contracts, but those are like government related, and in particular will be like the security association contract, SAC exam. We have not started the actual registration, but based on what we saw in 1Q and 2Q, we anticipate the number of test takers will probably be around 400,000 people.

So, in terms of visibility, I think with reasonable comfort that is probably what I can share with you at the moment.

Mark Marostica:

And then, Benson, help us understand, for 4Q then what would be the contracted backlog for that quarter? You mentioned RMB145 million, I think that is for the 3Q, do you have a similar number in mind that you have contracted backlog for the 4Q?

Benson Tsang:

So, the dimension of the 4Q backlog, according to our own definition, we consider the SAC exam is confirmed, because we actually have a contract on hand. And if you talk about other potential contracts we are actually working on, we do have a number of potential contracts.

In the private sector, we have started to contact some of the potential clients, and in the public sector we do have a few potential contracts we are working on. In fact, one of them is actually in the final stage, but, as usual, we have not yet signed the contract, we will not be able to disclose it.

As far as the comfort level, the Company feels quite comfortable we will have a fair number of contracts for 4Q at the moment.

Mark Marostica:

OK, thank you for the color on that. On the SAC exam, can you also give us your original target for the year in terms of revenue? Just what you expected to generate from the SAC exam in fiscal 2013, and what you think you will deliver? And then just to add to that, what revenues you delivered from SAC in fiscal 2012 for context? Thanks.

Benson Tsang:

Sure. SAC, at the beginning of this year, we anticipated we can probably maintain the same level of number of test takers, which was about 2.8 million test takers for SAC exams. For 2.8 million test takers, it translates into approximately RMB110 million.

Right now in terms of our 2013 rolling forecast we only put into anticipate about only 1.8 million test takers for 2013 financial year.

Mark Marostica:

OK, that is helpful. Regarding the CPA exam, can you give us a sense as to feedback you received from the CPA exam authorities regarding the success of the exam and just overall how they felt at the end?

Benson Tsang:

Sure. First of all, the CPA exam indeed was the challenge for ATA. It was the biggest exam we ever conducted. And it also demonstrated that ATA, we do have the ability to actually handle the exam for CPA as well, CPA association well. In fact, we believe we were the only ones really qualified doing the CPA election process.

In this examination we actually have over 700 test centers, and in these 700 test centers, we have 200+ totally new test centers. Within a very short time, basically within two months we managed to help CPA association to identify these centers and set it up and get them ready for examination.

According to the feedback we got right after the examination, the CPA association, they are very happy, so we do feel we will have a very good chance to continue the relationship. Right after the examination we see very happy faces, very relaxed faces from the association representatives.

Mark Marostica:

Congratulations on that. And the natural question would be, given what was said earlier on the call by Mr. Ma, concerning the need in China for ongoing conversion from paper to electronic testing, what does your pipeline look in terms of potential conversions much like on the scale of the CPA exam?

Benson Tsang:

Last year we managed to get China customs. At the beginning of this year, fiscal year 2013, our internal target is to get one additional conversion done.

We are very happy to see this actually achieved. But I have to be honest, at the beginning of this year we did not expect to get this one. We expected to get a smaller one, so it is a very good surprise for ATA. And going forward, so far we got very good feedback from both China customs and CPA association. We believe our reputation will continue to pass along within the Government sector.

Right now we do have other departments with the Government, we are under discussion. We feel comfortable and strongly we will be able to continue to see conversion in 2014 financial year. Our target is also our focus. We want to see more conversion, and on a relative basis conversion is a bit easier to get than completely new contracts from the Government sector.

Mark Marostica:

Last question, looking out a little bit further, I was curious as to how you grew your longer-term operating model, and I am thinking in terms of fiscal 2014, as we try to model that. What do you think in terms of a longer-term revenue growth target margin such for fiscal 2014 at this point? I do know it is early, but I am just trying to get a sense of your view on it.

Benson Tsang:

Internally, we do actually have some internal models regarding the next three years. And based on what we see in the 1H, we do expect that we will slow down in the financial security areas, probably continue for another year or two. So, what we budget or model is, we anticipate our revenue growth in the range of 15% to 20% in 2014. So, the margin, this year we invested quite a bit in building up the CPA exam, and there are some impacts on our margin this year. So, our overall margin for fiscal year 2013, as I mentioned earlier, we anticipate will be in the range of 50%. We anticipate that efficiency will start coming through in 2014. So, we do anticipate our gross margin will start to improve. Likewise, we will also see our non-GAAP net income will start improving as well.

Mark Marostica:

Very good. Thank you, I'll turn it over.

Operator:

As a reminder, please press 01 if you would like to ask a question.

As there are no further questions at this time, I will pass back to Kevin Ma for closing remarks.

Kevin Ma:

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

Operator:

Thank you for your participation in ATA's 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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