

ATA TRANSCRIPT

ATA Inc.

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Q2 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 of The Equity Group

Participants – Conference Call Q&A

Ella Ji

Oppenheimer

Mark Marostica

Piper Jaffray

Operator:

Hello. Welcome, everyone, to 2QFY12 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 broadcast 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 now Carolyn Yu, Account Executive of the Equity Group. Ms. Yu, you may begin.

Carolyn Yu:

Thank you, operator, and good morning, everyone. Thank you for joining us. Copies of the press release announcing the fiscal 2Q12 and 1H 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 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 two of the conference call presentation for further information.

All USD amounts in this conference call, relating to the Company's most recent and six-month period ended September 30th, 2011 are converted from RMB using an exchange rate of RMB6.378/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 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 Wang:

Thank you, Carolyne, and good morning, evening, everyone. ATA continued to make progress in its operations throughout the quarter with significant year-over-year growth in revenues, gross profit, and net income. As Chairman Ma will discuss later, we are in a very strong financial position and are raising our net income guidance for the 2012 fiscal year.

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, and you can subscribe to them via RSS feed as well.

During the quarter, we delivered 1.8 million billable tests, an increase of approximately 62.5% from the prior-year period. The growth in the number of tests delivered is largely due to increased demand for ATA's securities and futures exams, HR Select, and TOEIC, along with significant growth in our test preparation and training solutions segment.

Revenues from TOEIC during the quarter increased by approximately 74% from the prior-year period, largely due to volume increases compared to the prior year. ATA is the exclusive distributor in China of TOEIC, an exam owned by ETS, a global leader in educational test solutions.

We continue to see an accelerating growth trend in ATA's HR Select business in this quarter, with year-over-year revenues increasing by 121%. We have worked diligently at both attracting new corporate clients and expanding our program offering to existing customers like the Bank of China.

We were also very pleased to report the Company's first revenues from the National Security Guard Qualification tests in Shanghai. While the volume was still a relatively small portion of our revenue, we are very excited to have taken our first steps into this market.

In September, ATA successfully administered a trial test to 120 security guards from several security service agencies in Changsha, Hu'nan Province. And in early October, ATA signed an official contract of the Security Guard exam in Changsha, Hu'nan Province, to provide testing services for qualifying their security guards.

You can see on the right-hand side a map of our extensive nationwide network of over 2,000 test centers, which enables ATA to deliver large-scale exams simultaneously and cost-effectively for our clients.

Next slide, accelerating test delivery. Let me conclude my portion of our presentation with a brief overview of ATA's growth within the computer-testing industry.

As the world's most populous nation, ATA has one of the world's largest testing markets. As competition in the job market increases, individuals are seeking to differentiate themselves from other job seekers, to appear more attractive to potential employers. This has led to a natural growing demand for certification exams.

Throughout our Company's history, we have worked to be in a position to take advantage of this opportunity. The chart on slide five illustrates the rapid growth in the number of billable exams that ATA has delivered since fiscal 2006. Overall, our operations continue to expand, and we delivered approximately 3.6 million billable exams in the 1H12, which is ahead of last year's pace.

We continue to focus on increasing our industry coverage, which will enable ATA to add new test titles to better serve candidates. Our growing database of test takers is also a resource from which ATA can draw for future growth. We expect to continue our proactive sales and marketing efforts, via campus visits and also marketing to specific sectors of candidates.

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

Benson Tsang:

Thank you, Walter. We are happy with our operating results for the quarter, where we improved all of our bottom line metrics, both in terms of margin percentage and incomes, and remained focused on strong and sustainable growth.

On slide seven, we show in USD that ATA has exceeded the market consensus estimates, which it has done for the past six quarters, in terms of net revenues, gross profit, net income, and diluted earnings per ADS.

We continue to budget carefully, and as our results for 1H12 have been better than we initially anticipated, we are raising our net income guidance for the 2012 fiscal year, which Kevin will discuss in more detail shortly.

In the next slide, we break out revenues for the 2Q12 and 1H12 by our business segments. Our business can be broken down broadly into two areas, testing services and test preparation & training solutions.

At about 73.3%, our core segment of testing services was once again a high percentage of our total revenue in the 2Q12. This includes specific types of exams ranging from professional certification exams in various industries, such as securities and futures, to our HR Select service, where we assist with tests for hiring and internal assessment at different companies, and TOEIC exams.

ATA is also involved in online test preparation and training for professional development and for English language education. This is where we package our testing services together with comprehensive training content and an online delivery platform. We charge these testing-related services generally on a per-unit-delivered basis.

Slide nine provides a more detailed breakdown of our revenues within each business segment. Our HR Select revenue increased over 100% in both the fiscal 2Q and the 1H12 as compared to the same period last year. TOEIC revenue increased over 60% in the fiscal 2Q and also in the 1H12 on a year-on-year basis. We expect both HR Select and TOEIC services shall continue the growth momentum in the 2H12.

On slide ten you will see a breakdown of the Company's financials for the quarter. Gross profit for the 2Q12 increased 163% to RMB40.1 million, from RMB15.2 million in the same period last year. Gross margin increased to 56.9% in the 2Q12 from 45.7% in the prior-year period, primarily due to increased revenues and volume of tests delivered.

The Company reported net income of RMB1.4 million, compared to net loss of RMB14.8 million in the prior-year period. Basic and diluted earnings per ADS were even in the 2Q12, compared to a loss of RMB0.66 in the prior-year period.

You can see the full 1H results on slide 11. We reported over 57.5% gross margin for the 1H12, which we feel is a testament to our highly scalable method of delivering computerized large-scale testing services.

We expect continued gross margin improvement in fiscal year 2012 as compared to last year due to improved economies-of-scale with our testing center partners, greater inroads with banking and financial institutions, and more streamlined operations.

We reported net income of RMB14.5 million, or US\$2.3 million, for the 1H12, diluted earnings per ADS of approximately US\$0.08.

We continue to be supported by free cash flow and a solid balance sheet, which we have highlighted on slide 12. As of September 30th, 2011, we had about US\$31.8 million in cash and no long-term debt. We also do not have any short-term borrowings.

We believe that we have sufficient funds to meet both our short-term and long-term liquidity needs and capital expenditure requirements to achieve our expansion plans, including internal growth initiatives.

Before I turn it over to Kevin for closing remarks and a revised outlook for the 2012 fiscal year, I would like to move to slide 13 and provide some projections for the 3Q12. Based on existing exam schedules, we expect 3Q revenues to be in the range of RMB136 million to RMB141 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.

Kevin Ma:

Thank you, Benson. We are very pleased with our strong performance in the 1H12. Because increased demand for our certification exams led to better-than-expected results from our testing services business, we are maintaining our net revenue guidance of between RMB395 million and RMB415 million and raising our annual net income guidance for the full fiscal 2012 year, shown on slide 15.

We now expect net income of between RMB55 million and RMB60 million for fiscal 2012, up from the previous range of RMB40 million to RMB45 million.

We are basing this guidance on our own internal growth projections. We continue to be optimistic about the future of the China computer-based testing market, which is being driven by growing demand, improving brand recognition, and increasing awareness among both our corporate and government clients, and our test takers.

We remain confident that ATA will continue to see accelerating growth from our testing services business, while achieving improved levels of profitability from HR Select and TOEIC.

Slide 16 lists our strategies for growth for this fiscal year. Over the last two years, we feel that we have successfully built a foundation for growth, one where our business is scalable. We feel that ATA has an advantage because we are so far ahead of any potential competitor in terms of history, capability, and perhaps most important, security.

We also continue to move forward with implementing new large-scale tests, such as the nationwide security guard certification exam. We are hopeful to receive approvals from larger provinces in China in the coming months as we further penetrate the market.

We are flexible and well capitalized but continue to be focused 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, and congratulations on the quarter. My first question is in regard to the Security Guard exam. As you mentioned, you signed a contract with Changsha and began generating revenue. I am curious with regard to your 2H guidance revenue of about RMB250 million to RMB270 million, could you give us a sense of the Security Guard's exams' contribution that is implied in that 2H guidance? That would be helpful.

Benson Tsang:

Sure, Mark. In terms of our 2H, the Security Guard exam, right now we are still waiting for a few of the contracts currently being approved. I am talking about mainly contracts with the larger provinces. So, we have a number of contracts under negotiation, but in terms of the visibility and the actual timing coming in, we are yet to be concluded.

And tie that back into the numbers, currently in our financial forecast for the 2H, we are being cautious, and in the guidance we provided we are including only RMB10 million to RMB15 million.

Mark Marostica:

OK. Thank you, Benson. That is helpful. And then, regarding the balance of the business, the traditional core business, can you give us a sense regarding your visibility on revenue in the 2H? What major tests are occurring and the timing would be helpful, and how confident you are in the revenue from those exams?

Benson Tsang:

For the core business at the beginning of the year, we anticipate we can achieve in the range of about 20% growth. But after the 1H12, we achieved pretty strong growth momentum. At the moment we anticipate for the organic growth we can probably achieve in the range of 25%. That will bring the Company from an organic growth perspective, can generate approximately RMB370 million to RMB380 million. Let me just try to clarify: this RMB370 million to RMB380 million is excluding the potential revenue generated from the Security Guard program.

Mark Marostica:

OK. Thank you for that. Just switching gears a little bit, your gross margins were up significantly in the quarter. You talked about economies of scale, Benson, is there anything specific that happened in the 2Q that drove the margins up so high?

Benson Tsang:

I think it is a mix. In terms of the growth margin, the few points that are worth mentioning is, first, as you know we have a very scalable business model. The first thing that drives the gross margin up is the volume, the number of tests we deliver.

And second, we actually achieved a price increase in the Security Association Exams, and we also have a better mix of revenue from the private sector business, meaning the HR Select and TOEIC.

As you can see in our financials or in the PPT, for HR Select we achieved over a 100% growth in the 2Q as compared to last year, and for TOEIC we also achieved 50% growth as compared to last year.

And finally due to the cautious approach the Company is adopting, trying to make sure we have an efficient cost structure and combining all these four points, that naturally helps you to drive the gross margin improvements.

Mark Marostica:

On that point, Benson, how should we think about your operating expenses from a standpoint of fixed versus variable? What proportion do you consider fixed going forward?

Benson Tsang:

In the OPEX category, meaning including three categories, the R&D, the sales and marketing, and the general & administrative, the fixed component within OPEX is roughly about 65% to 70%, and the remaining percentage will be variable. The variable portion is normally related to sales and marketing activities, the commission for our salesmen.

And for the full year, internally we always have a formula. We consider the OPEX, the growth percentage should be normally 50% of our net revenue growth. So, let me clarify by an example. If we anticipate a net revenue growth of 30%, we would normally have an internal formula to cap the OPEX to grow about 15%.

Mark Marostica:

Got it. And then last question and I will turn it over. We have been talking a lot about the Security Guard exam. I am curious, in addition to the Security Guard exam, are there any other new tests on the horizon that you are currently cultivating that perhaps have not yet generated any revenue but that you are confident may in fact be revenue-generating either late this year or fiscal 2013? Thank you.

Benson Tsang:

Yes. In fact, in the 3Q we managed to obtain a few new test titles. One of the test title is actually from Government. It is relating to the import and export coordinator. We just finished the examination.

And for the other private sector area, in particular HR Select and TOEIC, we also managed to expand into deeper pockets of our milestone customers, and for TOEIC we also managed to expand to reach out more private corporations.

I will give you a sense of our pipeline. For our 3Q guidance of RMB136 million to RMB141 million, we already have in our pocket RMB110 million. That is in our backlog.

Mark Marostica:

Great. Thank you very much. Again, congratulations on the fine quarter.

Benson Tsang:

Thank you, Mark.

Ella Ji, Oppenheimer:

Thank you and congratulations. Good evening. I have a couple of follow-up questions. First, regarding your National Security Guard Test, could you elaborate on the sales efforts that you are going to do in the next few quarters to help promote the business and sign more contracts with more provinces? And I am wondering if you have a target for the number of provinces to be signed either by this fiscal year-end or by next fiscal year-end.

Benson Tsang:

Sure. Let me take this question. For sales and marketing, in fact the effort that we put in started at the beginning of this fiscal year. As I shared in the past, the strategy we are adopting is start approaching basically every single province and city, and then we will try to classify them into different buckets.

And based on whether we will have a much better chance to get a client, our second batch is provinces with large number of security guards, and then the third bucket is probably those provinces that want to take a wait and see position. I will give you one example, Shanghai will be the bucket that we really want to engage them as our first batch of clients, and we did. We got the Shanghai contract in the end of the 2Q.

Going forward, the sales strategy is: we have a sales team, basically have different allocation of provinces or cities and they will go keep on demonstrating our ability, repeating, introducing to them how we do the examinations and the experience we have with other province and cities we already started the examination.

In fact we find it is not that difficult to approach them and to introduce the examination. As you recall, this is not an examination that they do have a choice. It is an examination enforced by a law, passed by the Central Government. So, right now we just need to try to approach them, continue to convince them that we can actually do the examination for them with the top level of services.

And in terms of the pipeline, currently we already signed three contracts. We signed contracts with three provinces and cities, including Shanghai, Guizhou, and Changsha, and we do have a few other small provinces and cities under negotiation. In fact we are already in final stage with four larger provinces or cities, and they are Guangdong, Sichuan, Hunan, and Hubei. And we are hoping, as Kevin mentioned earlier, we are hopeful we can get those contracts with larger provinces in by the end of this quarter or by the end of this year.

Ella Ji:

Great. Thanks for the color. And my second question is regarding your gross margin. You already achieved very nice growth margin improvements in the 1H of the year and you still expect to achieve more. My question is: how much is the potential there that your business nature allows for your gross margin?

Benson Tsang:

In terms of the limit of the improvement on the gross margin and from the Company perspective, we are trying to find the cap as well. But honestly, from what we see right now, because the nature of the business is very scalable, as long as we can continue to improve the number of tests we deliver to our clients or the test takers, we do not really see the limit of the improvement on the gross margin.

That said, what we predict will happen is, maybe this year we can obtain a gross margin improvement, maybe 2 to 3 percentage points. Next year we may continue to do so, but as time goes by and the base of our revenue getting bigger and bigger, we will predict the magnitude of the improvement will be getting smaller and smaller. But in the foreseeable future we feel quite comfortable we can continue to improve the gross margin. And most of the improvement on the gross margin we will probably be able to throw down to the net margin.

Ella Ji:

Nice. And lastly, regarding your organic growth estimates, you increased it to 25%, up from 20%. Within that 25%, could you further break down between how much is from volume and how much is from price increase?

Benson Tsang:

Our estimate will be roughly 60% from volume and then about 40% from the price increase.

Ella Ji:

OK, great. Those are all my questions. Thank you, and congrats again.

Kevin Ma:

Thank you. Thanks again to all of you for joining us. We are looking forward to speaking with you again after we report our 3Q financial results in February. As always, we welcome any visitors to our office in Beijing. Thank you.

Operator:

This now concludes our call. Thank you very much for attending. You may now disconnect your lines.

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