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TEDU - Q4 2016 Tarena International Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Tarena International Inc Fourth Quarter and Fiscal Year 2016 Earnings Conference Call.

(Operator Instructions)

Today's conference is being recorded. If you have any objections you may disconnect at any time.

I would now like to turn the call over to your host for today's conference, Miss Helen Song, Tarena's Investor Relations Director.

Helen Song - Tarena International Inc - Director, IR

Welcome to Tarena's fourth quarter and fiscal year 2016 earnings conference call. The Company's earnings results were released earlier today and are available on our IR Web Site, ir.tedu.cn, as well as our newswire services.

Today you will hear opening remarks from Tarena's founder, chairman and CEO, Mr. Shaoyun Han, followed by our Chief Financial Officer, Yuduo Yang, who will take you through the Company's operational and the financial results for the fourth quarter and the fiscal year 2016 and give guidance for the first quarter and the full year of 2017.

After the prepared remarks Mr. Han and Mr. Yang will be available to answer your questions.

Before we continue, please note that the discussion today will contain certain forward-looking statements made under the Safe Harbor provisions of the US Private Security Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations. Tarena does not assume any obligation to update any forward-looking statements except as required under applicable law.

Also, please note that some of the information to be discussed includes non-GAAP financial measures as defined in Regulation G. The US GAAP financial measures and the information reconciling these non-GAAP financial measures to Tarena's financial results prepared in accordance with US GAAP are included in Tarena's earnings release, which has been posted on the Company's IR Web Site at ir.tedu.cn.



Finally, as a reminder, this conference is being recorded. In addition, a webcast of this conference call is available on Tarena's investor relations Web Site.

I will now turn the call over to Mr. Shaoyun Han, Tarena's founder, chairman and CEO. Mr. Han will speak in Mandarin and then Mr. Yang will translate.

Shaoyun Han - *Tarena International Inc - CEO*

Welcome, everyone, to our fourth quarter and fiscal year 2016 earnings conference call.

We are delighted to report that we finished 2016 on a strong note.

Our net revenues in full year 2016 rose by 34% year over year to RMB1,580 million while net revenue for fourth quarter grew by 22% year over year to RMB464 million, which is in line with our previously issued guidance. In addition, non-GAAP net income increased by 52.4% year over year to RMB323 million.

In the fourth quarter, our course enrollments totaled 27,897; an increase of 19% year over year. This is primarily factor contributing to our revenue growth in the quarter.

Our student enrollment number is more of a lead operational indicator and defined as the number of new students recruited and registered in the quarter continued its healthy growth. Because of the early timing Chinese New Year, our new student enrollment, were light in the month of December. Although we experienced a [uncertain impact], total student enrollment this quarter increased by 18% year over year to reach 26,898.

Employment amount for certain IT-related positions experienced some fluctuations in 2016. Building all the success of upgrading curriculum portfolio and implementing differentiated advanced courses teaching model, we fully accomplished the target plans set at the beginning of the year.

The student enrollment in the full year 2016 totaled 107,493; increasing by 28% year over year.

Besides the professional education business, our business initiatives in K-12 at occasion and in name of Tongchuang and Tongmei have showed solid progress towards our target. At the end of fourth quarter, Tongchuang and Tongmei courses have been rolled out in 15 cities; accumulatively enrolled 2,354 students, 883 of which were enrolled in the fourth quarter.

In the past several quarters, we've stayed committed to continuously optimize our cost counting operational model and organizational structure for K to 12 business to better serve market demand. These strategic adjustment has started to bear fruit and brought us in the quarterly report high student enrollment figure in first quarter; which laid solid foundation for even faster growth in the long run.

Opening new learning centers and expanding these areas of current learning centers are critical ways that we increase our classroom areas so as to accommodate growing demand and business development. By the end of this quarter, our total seat capacity increased to 51,127, up by 21% from the same period last year and approximately 2% from the end of previous quarter.

In mean time, we focused on balancing utilization of facility resources and promoting centers' efficiency. Our seat utilization rate this quarter has reached 71.7%, reflecting that our original efficiency effectively maintained at a relatively high level as we continue business expansion.

In terms of new learning centers, we opened seven this quarter. As a result, our total number of learning centers capped at 145. Specifically this quarter, we opened one learning center in each of the [foreign] cities, which are Guangzhou, [Shijiazhuang], [Zhengzhou], [Wuhan], Qinhuangdao, Zibo and Nanyang. Among which, Shijiazhuang, Zibo and Nanyang are cities who are newly entered.

As a key indicator that shows our education quality and outcome, job placement records is an important metric that we always focus on. The six months post graduation job placement rates in the quarter was about 95%. This outstanding result would further support our leading brand and overall competitive position in the industry.

We're also encouraged to see relatively strong operating margins in the fourth quarter and the full year 2016. Our non-GAAP operating margins in the first quarter increased by 0.4 percentage point year-over-year to 25.9%. Non-GAAP operating margins in 2016 increased by 2.6 percentage points year-over-year to 18.8%, which is the highest level in the Tarena's entire history as a public Company.

The expansion of our operating margin was primarily driven by greater business skill; optimized sales and marketing work flow to drive better operational efficiency, as well as effective control in bad debt. Our CFO, Dennis, will elaborate on this further in his later remarks.

To sum up, with constant effort in the expanding business field for professional allocation services, launching new disciplines, exploring more opportunities in the K to 12 business; Tarena achieves actual end performance in both top line and bottom line in fiscal year of 2016 and has been well positioned to drive future growth in the next year.

With that, I will now turn the call over to our CFO, Dennis Yang to discuss in the fourth quarter financial results and outlook for the first quarter and full year 2017.

Yuduo Yang - Tarena International Inc - CFO

Thank you Shaoyan and hello everyone on the call. We're pleased with the strong financial results for the fourth quarter and fiscal year 2016. Since you already have all the detail numbers in the press release, I will review the financial results for the fourth quarter and the fiscal year briefly and only focus on a couple of more important areas.

So now, let's start with net revenues. For the first quarter, 2016, our net revenue increased by 22% year-over-year to RNB464 million. For fiscal year 2016, we grew our net revenues by 34.1% year-over-year to RNB1,580 million.

As has been mention, student enrollment is a leading indicator of our business growth and course enrollment is a primary driver of our revenue growth, total student enrollment in the quarter, increased by 18.1%, year over year, to 26,898. Total course enrollment increase by 18.9% , year over year, to 27,897.

For fiscal year 2016, student enrollments and course enrollments increased by 27.9% and 29.9% respectively, as compared with those of fiscal year of 2015. AFP increase is another driver for revenue growth. Average revenue per course enrollment in the fourth quarter had defined by net revenue divided by course enrollment was RMB16,634, which increased by 2.6% as compared to RMB16,208 in the same quarter last year.

For the fiscal year 2016, average revenue per course enrollment increased by 3.2% to RMB15,441. Such an increase of average revenue per course enrollment were mainly attributable to the increase of the standard tuition by RMB1,000 to 2,000 for selective courses in 2016.

Now, let's move on to cost and revenue and gross profits. Key utilization rate is one of the key matrix measuring our operational efficiency of facility resources, this utilization rate for this quarter was 71.7%, which almost flat-ish as compared to the same period last year. For fiscal year 2016, utilization rate decreased by 30 basis points from 73.5% in the fiscal year 2015 to 73.2% in fiscal year of 2016. Because the properties that had been purchased in 2016 has not yet reached to the optimal utilization level.

In the fourth quarter, gross margin decreased by 1.45% points to 73.4% as compared to the same quarter a year ago. Such a decrease in the gross margin was mainly attributable to currently lower K to 12 business gross margin than our professional education business in fiscal year 2016. As a K to 12 business that's still in its ramp up period and utilization of our K to 12 teaching resources has not yet reached at the ideal level.

For the fiscal year of 2016, gross margin was 1.6% which was stable as compared to 71.7% of fiscal year 2015. As for operating expenditures, since 2015 we have been focusing on operation efficiency improvements and implementation of adequate controls over account receivables. Our strategy started to bear fruit in 2016. I would like to highlight the following key points.

Firstly, student acquisition cost is one of our largest operating expenditures. In this quarter we continued to optimize student acquisition channel mix and improved our sales lead conversion. We're pleased to see that average advertising spending per student's enrollment decreased by 2.5% percent from RMB2,069 in the previous quarter, to RMB2,017 in this quarter. This represents that our student acquisition improvement strategy is successful.

For fiscal year 2016, average advertising spending per student enrollment increased by 6% from RMB1,890 in fiscal year 2015, to RMB2,004 in 2016. This increase was resulted from higher unit cost for student acquired from switch engine channel in 2016, especially after [Vaizhou] revised its advertising policy in May 2016 and partially offset by the optimization of channel mix and improvement of our facility conversion.

Second, we reported data allowances for [downed] account receivables from 2014. As communicated previously, our data expenses resulted from the latency issue of installment payment plans extended by joining to our students. After having part of what third party financing provide us and implemented extensive internal controls over credit granting and cash collections, we're well manage this latency issue and in fourth quarter data expenses decreased by 65% from the same period last year to RMB8.2 million.

For fiscal year 2016, we recorded data expenses of RMB33.6 million, which was 47% lower than the amount of fiscal year 2015. We're pleased to see that we finally turned the corner of this latency issue and data expenses started to decrease after reaching the peak in 2015. In addition, in 2016, we also attempted to improve the employee productivity through work flow standardization and improvement of our internal systems and providing adequate trainings to our employees.

The overall employee productivity ratio, which is defined as total student enrollment divided by the average number of employees for the period, improved by 5% from 16.7% in fiscal year 2015 to 17.5% in fiscal year 2016. As a result from our business scalability, improvement of operational efficiency and the reduced data expenses our non-GAAP operating income for this quarter increased by 23.7% as compared to the same period in 2015, while non-GAAP operating income for FY16 increased by 56.2% as compared to FY15.

The non-GAAP operating margin also expanded accordingly. Non-GAAP operating margin expanded by 36 basis points to 29% in the first quarter 2016 from 25.5% in same quarter in 2015. For FY16 non-GAAP operating margin expansion was even stronger, extended by 266 basis points from 16.2% in 2015 to 18.8% in 2016. Our nonproft was RMB242 million for FY16 which increased by 35% from RMB179 million last year.

Non-GAAP net income also increased by 52% to RMB323 million for FY16 from the non-GAAP nonproft of RMB212 million in 2015. Non-GAAP nonproft margin also expanded by 245 basis points from 18% in 2015 to 20.4% in 2016. We generated RMB534 million in properties operating cash flow in FY16 which was 52% higher than the amount of FY15. In 2016 we spend capital expenditures of RMB282 million to purchase for properties, many for teaching purposes. Looking forward to first quarter in 2017, total net revenues for the quarter are expected to between RMB322.5 million and RMB329.5 million representing an increase of 19.7% to 22.3% on a year over year basis. We also expect the revenue for the full year of 2017 to be between RMB1,990 million and RMB2,070 million, representing increase of 26% to 31% on a year over year basis. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Zoe from Credit Suisse.



Zoe Zhao - *Credit Suisse - Analyst*

I actually have three questions here.

First question is that Mr. Han mentioned that we've seen some fluctuations in ITB from certain sectors. Can we please elaborate on this? What is the outlook over the overall job market? The second question is, just wanted to get some update on the core and cores enrollment growth after Chinese New Year and the question is on the 2017 operating margin outlook especially around our sales and marketing strategy, where should we expect more additional premium leverage?

(Spoken in foreign language).

Shaoyun Han - *Tarena International Inc - CEO*

(Spoken in foreign language)

Yuduo Yang - *Tarena International Inc - CFO*

Okay, let me translate.

Mr. Han said to Zoe's question, the first question Zoe asked about the fluctuation of IQ related courses employee market in 2016. All we know that 2015, now in China there are over heated in all four markets. And then, turn to 2015, the all to all markets went down and this have adversely impact on the students job placement for iOS and Android.

So in 2016, we encourage the students initially want to take iOS and Android to take other courses, for example, Java and Web front. And for Java and Web front, we observed a very strong year over year growth in student enrollment. For example Java, the year over year enrollment growth of close to 60%, this is what we mention in our speech on the IT employment market fluctuation.

Zoe's second question is about the student enrollment after Chinese New Year, from the very beginning of February, just after the Chinese New Year we started our marketing and student enrollment. The student enrollment right now is very strong and we believe the total enrollment would be around 25% year over year growth as compared to last Q1 2016.

As all we know, the Q1 2015, that quarter had very strong growth as compared in the previous year, it was 51.8% year over year growth. With that, very strong high base, we are expect to further grow our student enrollment by around 25% in this quarter, first quarter 2017.

For the third quarter, the third question about the operational expansion, expanded structure. Mr. Han mentioned about the student acquisition cost. In 2015, we optimized the channel mix to acquire students as the search engine has most extensive channel we're acquiring new students. So in 2015, we started to try to optimize the overall channel mix and reduce the contribution from the search engine contribution light by through searches.

We continue to do optimizing the channel mix in 2017 and we tried further reduce the contribution from search engine for our total student enrollment. We tried to increase the student referrals and the streaming media in 2017. And for those two, we believe we are backing the channel with the lower cost, so with this, overall the student acquisition cost for students became the relatively stable level as compared to 2016.

In terms of whole year 2017 margin, I would say the overall financial was about the flattish in the non-GAAP operating margins, which included two parts. The first we see through the business scalability and further control our Fed expenses in 2017. We may see there's certain level of expansion in non-GAAP operating margin in profession education business.



But K to 12 still in 2017 is a ramp-up period and the operating margin from K to 12 would be very low, or even inactive in short term. So with this and the pressure from K to 12 in the overall margin, so with our expectation for the whole year non-GAAP operating margin would be flat in 2017 as compared to 2016.

Operator

Phan Liu from Goldman Sachs.

Phan Liu - Goldman Sachs - Analyst

I have two quick questions.

First question is about may I know, what's your current utilization level of K to 12 segments? And then what kind of operating margins level you are looking at for this segment on a normalized level? And the second question is regarding to your advertising expenses. Apologies if I may, may I know how much student enrollment are contributed by Vaizhou and the referral effective rate in this quarter? Thank you.

Yuduo Yang - Tarena International Inc - CFO

Phan, in the first quarter 2015, we enrolled 800, fairly close to 900 K to 12 students. Some of them, the K to 12 students, they take classes in our profession education learning centers. So right now, we have limited number of K to 12 centers, specialized center for K to 12, very limited. So it's hard to say, the utilization purely for K to 12 distance right now. This is my answer to your first question.

Your second question is the contribution from search engine and student referral in the first quarter; let me check the number, 43% is contribution from search engine and student referral took about 20%.

Phan Liu - Goldman Sachs - Analyst

May I know what kind of operating margin level you are looking at for K to 12 segment on a normalized level, maybe even longer term?

Yuduo Yang - Tarena International Inc - CFO

Okay, good question. Yes, for 2017, you know we target to grow our K to 12 business dramatically. In 2016, the total student enrollment for K to 12 is 2,354 and we target to even more than double the total student enrollment in 2017. For this, you might realize that the K to 12 revenue would be recognized in the longer term.

Our professional education will be down to four months full time but the K to 12 business will be run throughout the year. So the revenue recognized and as well as in the marketing stance was kind of a mismatch.

And in a short term, there will be a pressure in the margin. In the long run, we believe there has been a normalizing level in the K 12 business can generate non GAAP, opening the margin higher than 30%. Incremental --

Yuduo Yang - Tarena International Inc - CFO

Sorry, let me clarify. The incremental non GAAP opening margin for K to 12 business will be higher than 30% in the long run, that will be normalized.



Operator

Ivy Laos from Macquarie.

Ivy Laos - *Macquarie Financial - Analyst*

Thank you for taking my question. I have two quick questions.

The first one is just to follow up on the channel mix of our student acquisition. So you mentioned that 33% from the search engine and 20% from student referral. I'm wondering what's the percentage that we got from those job posting Web Sites such as WeHaveJobs and [Oopa]? And also what's the percentage that's from the other corporation with college and university?

And my second question is our [fancy payoff]. So currently, what's the percentage of students enrollments, now on the fancy payout and what's the revenue contribution? Thank you.

Yuduo Yang - *Tarena International Inc - CFO*

Let me check the number. First off, I'd like to highlight the search engine took about 43%. Student referral took 20 and job posting Web Site takes about 18. 18% in the first quarter, which included classified Web Site and job recruiting Web Sites and university contributed 19% of the total student enrollment in the first quarter, 2016.

So this is the overall channel mix of our student enrollment in the quarter. So your second question about the proportion of advanced courses, the total student taking advanced courses as 14% of student take advanced courses in the first quarter, 2015.

Operator

(Operator Instructions).

Sean Zhang from 86 Research.

Sean Zhang - *86 Research - Analyst*

Just want to understand your growth strategy of your professional education in 2017. Can you break out just in terms of penetration to new cities, designing of new court, which will be the major driver going forward, just give us some color on that.

Also, very interesting, your key education. I think this is very topical at the moment. I think there will be a shift from the current focus of Mathematics, English to the future, maybe to IT skills. Just want to understand. What's your strategy to grow your key education business by over 100%?

So you talk about you want to double your key enrollment this year. Just want to learn a little bit more about your strategy of key education this year and maybe just any updates from regional government policy change. Is there any talk among the regulatory bodies regarding this new area of education for K-12 students? Thank you.

Shaoyun Han - *Tarena International Inc - CEO*

In 2017, we target to launch at least one new course for our professional education sector. In terms of the cities we entered in 2017, we have a list of the cities in our short list which include [Chening], [Tianjian], [Chengdu], [Hangzhou] and [Woho]. We target to penetrate our business into third tier cities and in the meantime, we also focus on to grow our business in our current cities, especially in the first tier and second tier cities.

With our business and deductment plan, in the future, to extend our business into third tier cities. In third tier cities, there was lower personal cost as well as the rental cost in those areas. So with balancing the cost and the tuition in the third tier cities with other cities, we believe the higher contribution margin will be generated from the third tier cities. And with that, there will be have the potential to further expanding our overall margins in our financial report in the long run.

Okay, our core strategy for K to 12 is to focus on expanding impact with leveraging our existing resources in professional education learning centers. We try to use most of our professional education teaching resources was supplemented by the K to 12 flagship centers in the cities we launched in the K to 12 [districts].

Those flagship center for K to 12 will be more focused on sales marketing as well as [lesson planning] and [travel] provided to the student and their parents. In terms of the regulatory, we believe the K to 12 and technology courses will be follow the similar rules and regulations as other K to 12 business like math, like English, Chinese.

For professional, right now K to 12 we focus on the technology computer-related courses. Most of our companies have the license in the core computer training.

We believe there won't be any problem for us to run K to 12 business.

Operator

(Operator Instructions)

Eric Giu from CCBI.

Eric Giu - CCBI - Analyst

My question is regarding to the business growth. You said because some reasons for you sense less demand for some IT course or the Spring festivals reasons then you see some slowing down of business. I was just wondering if it's temporary or the business grows will come into a new stable level, I mean, at around 20% year over year growth for the next few quarters.

Because I see the trend that quarter two revenue growth decreasing for several quarters already in the last four, five quarters. Thank you.

Yuduo Yang - Tarena International Inc - CFO

Let me answer your questions. First of all, I would like to say that only one or two IT disciplines have certain level of fluctuation in 2016. The main driver for business growth was not from each of specific discipline. I'm sorry, our key driver of business growth is the huge demand in the market from the graduates and the young people.

Those young people are not equipped with necessary skills to find ideal job opportunities in the IT related industry. Overall in China, we believe with the transition to new economy there's no doubt that more and more people will shift to the IT world technology-related positions. With this we believe in the long run IT related, technology-related professional trainings will have a huge market potential.

Just what Mr. Han discussed, in 2016 our student enrollment growth very close to 28% year over year. With those students coming to our learning centers, initially some students may want to take iOS and Android, but we found out at that time the iOS and Android wasn't a very good employment market, so we encouraged those students to take the back end development like Java, PHP, or other front end development like Web front.

With this, we believe those three disciplines with very good job markets were much easier to find job opportunities when the students finish their study. We don't have any doubt for the long-term growth for IT-related professional education market. The only frustration came from one or two

specific disciplines with certain level of market trends in particular point of time like iOS an Android because in the overheated market in 2015 and some kind of correction in 2016.

We don't believe this kind of correction will be last long time and maybe in 2017, maybe in last time next year, the employment market will become better.

Operator

Thank you. Now I'll revert the call to Miss Helen Song, Tarena's Investor Relations Director.

Helen Song - *Tarena International Inc - Director, IR*

Thank you, operator.

If there are no further questions at present, we'd like to conclude by thanking everyone for joining us on the call. We will continue to reach out to us directly by e-mailing IR@tdu.cn should you have any questions or requests for additional information and encourage you to visit our investor relations site at ir.tdu.cn.

This concludes Tarena's earnings conference call. Thank you.

Operator

That does conclude our conference for today. Thank you for participating. You may now disconnect.

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