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TEDU - Q1 2014 Tarena International Inc Earnings Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Tarena International Inc. first quarter 2014 earnings conference call. At this time, all participants are in a listen-only mode. After management's prepared remarks, there will be a question-and-answer session. 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, Ms. Christina Zhu, Tarena's investor relations manager.

Christina Zhu - *Tarena International Inc. - IR Manager*

Thank you, Operator.

Hello, everyone, and welcome to Tarena's first quarter 2014 earning conference call. The company's earnings results were released earlier today and are visible on our IR website, ir.tarena.com.cn, as well as on news wire services.

Today you will hear opening remarks from Tarena's founder, chairman, and CEO, Mr. Shaoyun Han, followed by our chief financial officer, Suhai Ji, who will take you through the company's operational and financial results for the first quarter of 2014, and give guidance for the second quarter of 2014.

After their prepared remarks, Mr. Han and Mr. Ji 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 U.S. Private Securities 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 statement 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 U.S. GAAP financial measures and information reconciling these non-GAAP financial measures to Tarena's financial results prepared in accordance with U.S. GAAP are included in Tarena's earnings release, which has been posted on the company's IR website at ir.tarena.com.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 website.

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



Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(Spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

Thank you, Christina, and welcome, everyone, to our first earning conference call as a public company.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

I am very pleased that we delivered a solid first quarter in 2014, which involves record revenue and profit despite a first quarter being [seasonally] slow as quarter go in our business.

Our top line revenue grew by almost 61 percent, to reach 24.3 million, and our non-GAAP net income was 1.4 million, far exceeding the .2 million in the same period last year.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

Our student enrollment in the first quarter of 2014 totaled 10,985, a 30 percent increase year-over-year. This growth was impacted by the timing of the Chinese New Year holiday in 2014, which fell at the end of the month on January 31, when we typically commence new classes for our courses.

As a result, we only had new students starting classes at the end of February and March in the first quarter this year, instead of having new students at the end of each month in the first quarter of 2013, because the Chinese New Year fell on February 10 in 2013.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

(interpreted) Despite the [above] factor, we saw continued strong growth in student enrollments in both IT and non-IT courses. Our efforts to further diversify our course offerings and revenues by expanding into other high-growth disciplines are also starting to pay off.

The two newer non-IT courses, namely Digital Arts and Online Sales and Marketing, which were only launched in 2013, already together accounted for more than 25 percent of the total student enrollments in the first quarter.

Our Digital Arts course, which was launched in the first quarter of 2013, has grown tremendously, to become our number-two course in terms of student enrollments in the first quarter of 2014, only behind our flagship Java course.

We also expect to see increased enrollments for the Java course in 2014. It accounted for less than 42 percent of total student enrollments in the first quarter, compared with more than 60 percent in the same period in 2013.

The job placement rating for our graduates also continued to be excellent, resulting from the strong employer demands for qualified skilled professionals.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

In addition, our student enrollment from the retail channel increased to 87 percent of the total student enrollments, compared with 80 percent in the same period in 2013, which resulted in higher average revenue per student.

Combined with a tuition fee increase in 2013, this contributed to the revenue growth exceeding our strong student enrollment growth. As our brand reach continues to grow, we expect to see our retail channel percentage further increase.

Although there will be seasonal fluctuations in the channel mix due to the timing of the university graduates. For example, we usually see higher percentage of student enrollments from the university channel in the second quarter of the year.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

In terms of course offerings, we had 11 courses in total in the first quarter of 2014, up from 9 in the same period a year ago, and unchanged from the previous quarter. As we outlined at the time of our IPO, our key growth area is to launch more courses in existing cities by opening new learning centers, or adding the courses (technical difficulty) launch three new courses in 2013, two of which launched towards the end of the year, and plan to launch one additional course in accounting by the end of 2014.

As we achieve more success in the non-IT courses, our targeted demographic and geographic regions will become even broader, and our market growth potential will be further increased.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

In terms of new learning centers, we opened five in the first quarter of 2014, one each in Shanghai, Nanjing, [Chongqing], [Tian], and Taiyuan. We are on track to open about 20 more by the end of 2014. By comparison, in 2013 we expanded more significantly by opening 35 new learning centers to accommodate the growing demand for our courses.



While maintaining our strong top line growth, we set a key objective and priority for 2014 in improving our center efficiency and utilization, especially for newly opened centers. We expect to see higher efficiency and utilization rate in 2014, and we already saw encouraging and tangible results in our first quarter of 2014 financial numbers, in terms of significant growth margin and operating margin growth.

Our gross margin increased by 440 basis points year-over-year, 65 percent in the first quarter of 2014. And for the first time in our history, we delivered an operating profit in the first quarter. This type of positive momentum, and our focus on execution, gives us more conviction to deliver even stronger results in the quarters ahead for 2014. We are confident that we will continue to grow our student enrollments, and at the same time further increase our margins to drive both top line and bottom line growth.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

After almost 12 years in business, we believe Tarena has firmly established its leading position in a large and growing professional education services market in China. Our innovative and proven hybrid learning model presents us with huge growth potential over both near and long term.

Our high-quality education services and strong track record of graduate success provide a compelling value for position to students, employers, and universities in today's increasingly competitive job market in China. Our recent NASDAQ IPO has further enhanced our market visibility and brand and better positions us to forge more partnerships with the relevant players in our industry.

For example, we recently announced partnership agreements with Bank of China Consumer Finance Company and Red Hat China, which enable us to provide additional and better services to our students, and have also reinforced our credibility and brand in the industry.

In the coming quarters and years, we will continue to focus on upgrading our education platform, optimizing our operational and management systems, and enhancing students' learning experiences and outcomes. We are confident in our ability to further grow our business and deliver long-term shareholder value.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

With that, I will now turn the call over to our CFO, Suhai Ji, to discuss the first quarter financial results and outlook for the second quarter.

Suhai Ji - *Tarena International Inc. - CFO*

Thank you, Mr. Han. Thank you, Christina. Hello to everyone on the call. As Mr. Han mentioned, we are very pleased to have achieved record first quarter top and bottom line results. As a reminder, the first quarter is actually our seasonally slowest period due to the impact of Chinese New Year holiday. Historically we have experienced much bigger enrollments in the second to the fourth quarter of the year, and we expect the same seasonality pattern to repeat for 2014 with regard to the student enrollments and top line revenues.

Now let me quickly review our financial results for the first quarter of 2014. Please note that unless stated otherwise, all numbers I will discuss today are in U.S. dollars.

First, on the top line growth, our net revenues in the quarter increased by 61 percent year-over-year, to 24 million. The increase was primarily due to increased student enrollments and higher average revenue per student, as defined by net revenues divided by student enrollments.

Total student enrollments in the quarter increased by 30 percent year-over-year, to 10,985, which was driven by the number and the popularity of our course offerings. The number of our course offerings increased from 9 to 11 in the first quarter year-over-year, while the number of our learning centers increased from 76 to 97 in the same period year-over-year, to cater to the increased demand for our courses.

Average revenue per student in the quarter increased by 24 percent year-over-year, to \$2,216. The growth was mainly driven by the increase of standard tuition fees for our courses and a higher percentage of retail channel in our student enrollment channel mix.

Before moving on to the cost of revenues and operating expenses, I want to refer you to our disclosure under non-GAAP financial measures, which was included in our official press release. The only difference between our GAAP and non-GAAP numbers is share based compensation expenses, or SBC expenses.

SBC expenses are included across cost of revenues and operating expenses on a GAAP basis, but excluded to derive our non-GAAP numbers. We have included a reconciliation table in our earnings release showing the detailed calculation.

In the first quarter of 2014, total SBC expenses were .5 million, up from .2 million in the same period in 2013. More than 84 percent of the total SBC expenses this quarter fall in the general and administrative expense line, with the rest being relatively insignificant across the other expense lines.

Cost revenues in the first quarter increased by 43 percent year-over-year, to 8.6 million. The increase was due to higher personnel costs and [welfare] expenses, resulting from an increased number of teaching and advisory staff at our learning centers and increased rental and the depreciation expenses for our learning centers.

GAAP gross profit increased by 73 percent year-over-year, to 15.8 million. GAAP gross margin increased by 440 basis points year-over-year, to 64.7 percent. The improvement in gross margin was mainly due to enhanced operational efficiency for our learning centers in terms of lower personnel costs and [welfare] expenses as a percentage of net revenues, and lower rental expenses as a percentage of net revenues.

Now moving on to operating expenses. Selling and marketing expenses increased by 60 percent year-over-year, to 8.8 million. The increase was due to increased personnel costs and [welfare] expenses related to the growth in our selling and marketing staff head counts, and expanded marketing efforts primarily as a result of increased spending on advertising as we expanded our network of learning centers.

Non-GAAP general administrative expenses increased by 72 percent year-over-year, to 5.3 million. The increase was mainly due to higher compensation costs for our increased number of general administrative personnel to support our growing operations, higher bad debt allowance, given the slower collection during the Chinese New Year period in the first quarter, and, to a lesser extent, higher professional expenses.

Research and development expenses increased by 83 percent year-over-year, to 1.1 million. The increase was mainly due to the higher personnel costs and [welfare] expenses of our instructors, allocated to their content development activities for our courses.

Our operating income increased to .1 million in the first quarter of 2014, from an operating loss of .2 million in the same period in 2013. Non-GAAP operating income increased to .6 million, from a non-GAAP operating loss of .1 million in the same period in 2013.

Due to the seasonality of our business, we typically see much higher operating margins from the second quarter onward than the first quarter. In the first quarter of 2014 we had a decrease in effective income tax rates to 7.1 percent, from 17.5 percent in the same period in 2013. The decrease was primarily due to a tax holiday of a two-year full exemption from 2014 to 2015, followed by a three-year 50 percent exemption from 2016 to 2018, entitled by one of our wholly owned subsidiaries, which is qualified as a newly established software enterprise under the PRC enterprise income tax law.



Our net income for the first quarter was about 1 million, compared with .05 million in the same period in 2013. Non-GAAP net income for the quarter, which excluded the share base compensation expenses, increased to 1.4 million from .2 million in the same period in 2013.

Given our total basic share count of 50.1 million ADS, and the fully diluted share count of 60.2 million ADS post IPO, our performer gap basic and diluted earnings per ADS for the first quarter of 2014 were \$.019 and \$.016 respectively. Non-GAAP basic and diluted earnings per ADS were \$.028 and \$.024 respectively. Because we did not complete our IPO until April 3, 2014, we did not have earnings per ADS information for the first quarter results.

Looking forward to the second quarter of 2014, we expect total net revenues to be in the range of 30.5 million and 31.5 million, representing an increase of 47 percent to 51 percent on a year-over-year basis. This guidance reflects the company's current expectation, which is subject to change.

So this concludes my remarks, and I will now hand the call over to the operator, and open the line for questions. Operator?

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, if you do wish to ask a question today, please press star followed by 1 on your telephone keypad and wait for your name to be announced. If you wish to cancel your request, please press the pound or hash key.

Your first question today (technical difficulty) from Goldman Sachs. Please go ahead.

Unidentified Audience Member

Hi, Han and Suhai, congratulations on a good set of results. Thanks for the opportunity. Your 1Q gross margin year-on-year expansion was obviously very impressive. I'm wondering if you could elaborate on the drivers a little bit more, whether that's at least partially due to the substantial 24 percent ASP increase, and going into the second quarter, I think last year you raised ASP in the second quarter, so the favorable [base in fact] is probably going away to a certain extent in the next quarter. How do you think about the gross margin outlook? Thanks.

Suhai Ji - Tarena International Inc. - CFO

Christina will translate the question for [Hanjon] and I will address your question in English.

So yes, we did have a very good improvement in gross margins in Q1 this year compared to the same period a year ago. And it was, you know, as I discussed earlier, it is actually due to the leverage we have in our, you know, center operation professionally in terms of personnel costs and [welfare] expenses as a percentage of net revenue, and also the rental expenses as a percentage of net revenue. Both have come down quite a bit from last year, and those are the key items in the cost of revenue.

Because we opened more centers in tier 2 and tier 3 cities in the same period over last year, those centers have generally lower average rental cost per square meter. That's why we're able to realize the lower rental expense as a percentage of net revenue. And also for the staff cost in the lower tier cities, they are also lower than the first tier cities, and that's a result.

And also on the ASP, or the average revenue per student basis, as you notice from our historical numbers, the enrollment growth generally contributes to a higher percentage in the second quarter to the fourth quarter, in those three quarters, than the enrollment gross for the first quarter, because the first quarter enrollment is typically the lowest among the four quarters in the year.



Unidentified Audience Member

Thanks a lot, that's very helpful. If I can have a follow-up question here. So your GNA and R&D expenses all [inaudible] gross profit growth. Can you talk a little bit about the results achieved here and what will be the outlook for these expenses in the coming quarters? Thank you.

Suhai Ji - Tarena International Inc. - CFO

Our GNA expenses went up a little bit more because in the first quarter we, you know, added additional personnel at the more senior level, especially regarding the finance department, and also raised the compensation for certain management staff, and that's the reason causing higher GNA expenses. And for research and development, as you know, we're in the process of hiring and building the team for the accounting course, and also our, you know, research and development staff, all the instructors are devoting more time into the R&D, and that's the reason for the R&D expenses increase outpacing the gross profit.

But going forward, as our revenue experiences stronger growth in the following quarters, you know, we expect that percentage, you know, either remain stable or actually potentially come down further in the next three quarters.

Unidentified Audience Member

That's great. Congratulations again.

Operator

Your next question today comes from the line of Clara Fan from Jefferies. Clara, please go ahead.

Clara Fan - Jefferies - Analyst

Hello, thank you for taking my question. Firstly, would you mind sharing the utilization rate of the centers in first quarter 2014 compared to, on a year-on-year basis, and were there any targets in terms of utilization improvement this year? Also, my other question is, how many centers do you plan to open in second quarter? And I would like to [inaudible] Mr. Han mentioned 20 more centers in the coming three quarters, so the full year will be 25 centers, and which cities are we planning to open the centers. And lastly, just wondering whether we have full year guidance on top line and margins. Thank you.

Suhai Ji - Tarena International Inc. - CFO

Sorry, what's your last question?

Clara Fan - Jefferies - Analyst

Full year guidance on top line and margins.

Suhai Ji - Tarena International Inc. - CFO

OK. Maybe I will take the first question, and Mr. Han will address the second question. The first and the last.

So the first, on the center utilization rate, for the first quarter it's comparable to the same period last year. Usually in the first quarter we have the lowest utilization rate; it's because the impact of Chinese New Year holidays, because we would have the classroom empty for at least for that week of holiday. And this year it had a greater impact because we did not commence new classes, you know, at the end of January.

So our utilization rate is above 60 percent in the first quarter, but we definitely see the continuous improvement in utilization rate to tick up in the following quarters. Just like last year, you know, the overall utilization rate was 67 percent, and in the first quarter last year it was around 60 percent. And this year we definitely expect our utilization rate to go above 70 percent or more, so we expect a higher, you know, utilization rate in the second quarter and also third and fourth quarter.

Your last question, regarding the full year guidance, as I stated earlier, you know, we are projecting 30.5 million to 31.5 million in top line growth. We do not provide official guidance for the margins, but we expect them, you know, definitely to be higher than, you know, the first quarter margins that we delivered, just because of the seasonality nature of our business.

OK, I will turn it to [Hanjon] your second question, and he will address it in Chinese and Christina will translate in English.

Shaoyun Han - Tarena International Inc. - CEO, Founder, & Chairman

(spoken in Mandarin)

Christina Zhu - Tarena International Inc. - IR Manager

We plan to open new learning centers in Beijing, [Chengdong], HaRMBin, Shanghai, Kunming, and Shenzhen.

(multiple speakers)

Suhai Ji - Tarena International Inc. - CFO

On the full year, what we meant by 20 centers in total, 20 additional centers in total for 2014, and we opened five of them in the first quarter, so that for the remainder of the three quarters, we plan to open 15, but there could be potentially more. But 20 was the initial target number for the total additional learning centers in 2014.

Clara Fan - Jefferies - Analyst

Thank you. I just want to clarify on my third question, is there full year guidance on top line growth?

Suhai Ji - Tarena International Inc. - CFO

Yeah, we had, we gave 30.5 to 31.5 million on the top line, you know, net revenues.

Clara Fan - Jefferies - Analyst

Yes, that's second quarter. I mean full year, fiscal year -

Suhai Ji - Tarena International Inc. - CFO

Sorry, sorry. For the full year, yeah. No, sorry, my apology, I misunderstood. Yeah, we gave the second quarter. For the full year, no, we do not provide official guidance for the full year for 2014.



Clara Fan - Jefferies - Analyst

OK, thank you.

Operator

Your next question today comes from the line of Ella Ji of Oppenheimer. Ella, please go ahead.

Ella Ji - Oppenheimer - Analyst

Good morning, [Hanjon], Suhai, and Christina. First question, do you also plan to raise price in the second quarter of this fiscal year? You mentioned you did last year. And if so, is it also going to be around RMB 1,000? And relating to that, can you help us break down your 2Q guidance between enrollment and ASP? That's my first two questions. Thank you.

Suhai Ji - Tarena International Inc. - CFO

Ella, yeah. Actually, we already increased the price this year, and that's effective at the end of March, but it will not have an impact on our Q1 results. But we did increase, you know, by 1,000 RMB most of our courses beginning, you know, in the second quarter. So you will see that impact from the second quarter financial numbers.

And your second question is on the 2Q ASP and enrollment, right? Typically if you see the historical numbers by quarters, in Q2 and Q3 and Q4 the enrollment growth will contribute to a higher percentage of the total revenue growth than the ASP, purely because the number of student enrollments will, you know, grow much stronger in Q2 and Q4, and that's also a seasonality pattern that we see in the past two years, the past eight quarters.

Ella Ji - Oppenheimer - Analyst

OK, thank you. And then my second question, you mentioned you incurred a higher bad debt expenses in the quarter. Can you help us quantify that [inaudible] how much bad debt reserve have you provided? And also, have you seen a pickup in your accounts receivable collections since the Chinese New Year?

Suhai Ji - Tarena International Inc. - CFO

Yes, definitely we have seen a pickup in the AR collection in April, and also, you know, to a certain extent in March as well. But because of the impact of the Chinese New Year, so we had a slower collection, and in total our bad debt allowance that hit our expense line in the GNA expense line is less than 1 million USD, and we expect that to be relatively stable in the next few quarters. And as we increase our collection effort and, you know, receive those cash from students who are installment payment options, we will continue to see the decline of AR.

There is a slight increase in AR balance in Q1. It's because for some students who are paying through the third-party financing providers, if those loans have not been approved yet, so we would record accounts receivable there as well. But that's, you know, the impact is relatively minor.

Ella Ji - Oppenheimer - Analyst

Got it. And then my last question, relating to your cooperation with Red Hat, I just want to clarify, are you going to introduce new courses separately, or is it going to be included in the existing Linux course?

Suhai Ji - *Tarena International Inc. - CFO*

I will have [Hanjon] address this question.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

Our cooperation with Red Hat China is more like a value add, an additional service in addition to our current content [inaudible] Linux and internet course.

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)

Christina Zhu - *Tarena International Inc. - IR Manager*

So the [inaudible] value add is around 4,000 RMB per student regarding the Red Hat license and training.

Ella Ji - *Oppenheimer - Analyst*

Got it. Thank you very much.

Operator

Your next question today comes from the line of [Dick Whey] from Credit Suisse. Dick, please go ahead.

Unidentified Participant

Hi, thank you for taking my questions. I have two questions. The first question is [inaudible] a bit of the macro slowdown in China. I wonder if the company is seeing any impact on the recruiting front and recruiting effectiveness as the rate that students sign up for the classes. So that's the first question.

And second question is that regarding the price increase in March, so for the early part of Q2 did the company see any kind of pushback by the students, or like any slowdown in signing up new students? Thank you.

Suhai Ji - *Tarena International Inc. - CFO*

Thanks, Dick. Christina will translate the questions for [Hanjon].

Shaoyun Han - *Tarena International Inc. - CEO, Founder, & Chairman*

(spoken in Mandarin)



Christina Zhu - Tarena International Inc. - IR Manager

So far we haven't felt any impact from the macro slowdown in China. On the contrary, we are actually seeing stronger demand from IT companies based on our regular search on [inaudible].com.

Shaoyun Han - Tarena International Inc. - CEO, Founder, & Chairman

(spoken in Mandarin)

Christina Zhu - Tarena International Inc. - IR Manager

And regarding to your second question, we raised our tuition price in February and in March, and the majority of our Q1 student enrollments came from February and March, so we really haven't felt any impact from the price increase.

Ella Ji - Oppenheimer - Analyst

OK, I understand. So maybe the last one, is that becoming the [inaudible] channel mix, do you expect the social channels are still going to increase contribution down the road? Thank you.

Shaoyun Han - Tarena International Inc. - CEO, Founder, & Chairman

(spoken in Mandarin)

Christina Zhu - Tarena International Inc. - IR Manager

Yeah, Dick, I guess when you say social channel, you mean retail channel, and yes, we expect retail channel contribution to our revenue will increase. However, there will be seasonality and seasonal fluctuations between the breakdown between retail and university channel, given the timing of Chinese college graduates.

Ella Ji - Oppenheimer - Analyst

Great. Thank you very much.

Operator

Once again, ladies and gentlemen, if you do wish to ask a question today, please press star 1 on your telephone. There are no further questions on the line today. I would like to now hand the conference back to Ms Zhu for closing remarks.

Christina Zhu - Tarena International Inc. - IR Manager

Thank you, operator. If there are no further questions at present, we would like to conclude by thanking everyone for joining us on the call. We welcome you to reach out to us directly by e-mailing ir@tarena.com.cn, should you have any questions or requests for additional information, and encourage you to visit our investor relations site at ir.tarena.com.cn. This concludes Tarena's earnings conference call. Thank you.



Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may now disconnect.

Editor: Portions of this transcript that are marked (interpreted) were spoken by an interpreter present on the live call. The interpreter was provided by the Company sponsoring this Event.

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