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TEDU - Q1 2016 Tarena International Inc Earnings Call

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## CORPORATE PARTICIPANTS

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## CONFERENCE CALL PARTICIPANTS

**Zoe Zhao** *Credit Suisse - Analyst*

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**Tony Yang** *Industrial Securities - Analyst*

## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by and welcome to the Tarena International, Incorporated first Quarter of Fiscal Year 2016 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 conference over to your host for today's conference, Ms. Helen Song, Tarena's Investor Relations Manager. Please go ahead.

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### Helen Song - Tarena International, Inc. - IR Manager

Thank you, Operator. Hello, everyone, and welcome to Tarena's first quarter 2016 earnings conference call. The Company's earnings results were released earlier today and are available on our IR website, [ir.tedu.cn](http://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, Dennis Yang, who will take you through the Company's operational and financial results for the first quarter 2016 and give guidance for the second quarter and full-year of 2016.

After their 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 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 the 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 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 website at [ir.tedu.cn](http://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 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 Mr. Yang will translate.

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

(Interpreted) Thank you, Helen. And welcome, everyone, to our first quarter 2016 earnings conference call.

2016 marks our third fiscal year as a public company, and I am very pleased as we delivered solid first quarter 2016. Our net revenues increased by 47%, to which \$41.28 million exceeding the high-end of our previously issued guidance, which is \$39.5 million in net revenues and 40% year-over-year growth rates.

The strong top-line revenue growth in the first quarter was mostly due to the strong student enrollment growth recorded in the first quarter last year and it is reflected in the course enrollment number from first quarter. As we explained in the previous earnings call, course enrollment for the period is cumulative total number of courses enrolled in by our students during such period, and better [work rights] was the revenue recognized in the quarter. In the first quarter, our course enrollments totaled 21,121; an increase of 48% year-over-year, and this is the primary factor contributing our revenue growth in the quarter.

Our student enrollment number, which is more of a leading indicator as defined as number of new students recruited and registered in the quarter, also grew strongly at 52% year-over-year to reach 23,030, which is the number two highest quarterly enrollment figure in Tarena's entire operating history, only behind the third quarter last year, supported by the strengthened brand recognition, expanded course offerings, as well as good track record in education quality.

Tarena has been able to attract more and more students for training. Moreover, the earlier timing of Chinese New Year this year, which happened on the second week of February, is also good for our student recruitment and revenue recognition. Specifically, 79% of our first quarter total student enrollment was 19,158 student enrollments occurred after Chinese New Year in February and March. Know this enrollment has limited impact on this quarter; it is expected to contribute more to our net revenues in the second quarter.

In the first quarter 2016, both IT and non-IT courses capped sustainable growth momentum. However, we have seen strong market demand in the IT courses with the strategic efforts in large recruitment of high-growth IT subjects to total student enrollment for the 11 IT courses increased by 85.4% year-over-year. IT courses together accounted for 68% of total student enrollment as compared to 58% in the same period a year ago.

This quarter we have four courses with enrollment over 1,000 and we will continue to execute on our strategy to diversify our course offerings and expand into high-growth disciplines as we did in the past few years, which bring us unique leading position in professional education market.

Besides professional education courses, we launched kids training programs under the name Tongcheng and Tongmei at the end of 2015 to target younger audience from primary to high school. This new initiative had made progress towards our target and entered into five new cities outside Beijing with 2,046 student enrollment by the end of this quarter.

In the first quarter, our student enrollment from retail and university channels was 93% and 7% of the total student enrollment compared with 89% and 11% in the same period in 2015, respectively. Given Chinese New Year, this quarter [has] generally been the smallest quarter for university channel enrollment as we expect a higher percentage of student enrollment from the university channel in the second quarter.

As we further penetrate into university channel and drive enrollment growth, more and more students recruited through such channel are now in their final year of college and may postpone their training until summer vacation.

In terms of course offerings, we started to implement our Teaching at a Corporate Level strategy and launched advanced-level courses in Java, iOS, Android, web [form] and development, and Digital art, which we believe we can have our students equipped with even better skills and make them more competitive in job market.



After the [power] trial in several large cities since March this year, we successfully attracted more students. Therefore, we will continue to focus on delivering this differentiated education services to our students, which is not only diversifying our existing course offering, but also further consolidating the competitiveness by designing more appropriate course content to different students.

In terms of new learning centers, we opened four in the first quarter 2016, same as in first quarter of 2015. Specifically, in the first quarter we opened one learning center in each of the following four cities, which are Beijing, Changsha, Chengdu, and Chongqing. We also merged three learning centers into existing centers due to relocation of lease property and changes in course offerings and general management.

In total, we added a net of one learning center in the first quarter, bringing the total number of learning centers from 134 in the previous quarter to 135. We expect to open another 15 to 20 new learning centers for the remaining three quarters in 2016.

In addition to opening new learning centers, we also expanded lease areas in a number of existing learning centers so that our total seat capacity increased to more than 44,000; up by 4% from the end of previous quarter and by 26% from the same period last year.

In first quarter, we focused on optimizing facility resources and achieved center utilization rate of 71%, higher than the 69% figure in the first quarter of 2015. This slightly increased operating efficiency.

As a key indicator that shows our education quality and outcome, job placements occurred is an operating matrix that we are always proud of, and this quarter is no exception. We're pleased to report that in the first quarter of 2016, we continued to deliver outstanding employment results for our students. Although the employment demand for certain positions and disciplines became moderate since the end of 2015, our six months post-graduation job placement rate in the first quarter was above 90%. This best-in-class result would further support our market-leading brand and overall competitive position in the industry.

In first quarter, we are also pleased to see the significant year-over-year improvement in profitability for our business. Our gross margin in the first quarter increased by 3.3 percentage points year-over-year to 64.4% from 61.1% in the same period last year. And non-GAAP operating margin improved by 11.4 percentage points year-over-year from minus-12.8% to minus-1.4%, mainly due to the increased business scale as well as improvement in sales and marketing efficiency and better control on [bad expenses].

Given the seasonality of our business, the profitability level in this quarter is within normal range. Historically, our operating scale is significantly higher in the second half of the year, which typically generates around 60% of full-year revenues and even greater percentage of profit in the second half of the year.

Our CFO, Dennis, will elaborate on this further in his later remarks.

In a recently issued press release, we announced the purchase of a property worth the consideration of RMB114 million. The property is located in Beijing Economic Technological Development Area, Yizhuang area. This building is mainly for teaching purpose and will be constructed as a multi-functional learning center for those students who come to Beijing for training. We plan to open classrooms with an aggregate of approximately 2,000 seats in this office building, and such seat capacity would fulfill new student enrollment of up to 6,000 annually.

Given total consideration of this processing, depreciation cost per seat is lower than the rental cost per seat in similar leased premises. As the rental expenses in Beijing continue to grow dramatically in recent years, we believe this property investment will further improve our operational efficiency while reducing our overall cost in longer term.

Now a quick update on the progress of our online learning platform, tmooc.cn, which was launched in March 2015. The number of registered TMOOC users has reached more 173,000 today, and our proprietary content library currently offers nearly 14,500 hours of video content. Through TMOOC, we also generated 16,300 VIP users up to date, who have become our paying customers to take our standard courses.

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

**Dennis Yang** - *Tarena International, Inc. - CFO*

Thank you, Han Yun, and hello, everyone, on the call. Since you already have all detail numbers in the press release, I will review financial results from the first quarter of 2016 briefly and focus on a couple of more important areas.

Since first quarter of 2015, we grew our net revenues by 47% year-over-year to \$41 million. As Han Yun explained earlier, student enrollment is a primary driver for the revenue growth; the total student enrollment in the quarter increased by 52% year-over-year to 23,030. Total course enrollments increased by 48% year-over-year to 21,121.

Average revenue per course enrollment this quarter, as defined by net revenues divided by course enrollment, was \$1,954 compared to \$1,978 in the same period a year ago. The 1.2% decrease was mainly due to the RMB depreciation against US dollars since August 2015. If we exclude the impact of RMB depreciation, average revenue per course enrollment this quarter in RMB increased by 5% year-over-year, which resulted from increase of our standard tuition fee by RMB1,000 starting from second quarter of 2016.

Now let's move to the cost of revenues and operating expenses. Cost of revenues in first quarter increased by 34% year-over-year to \$15 million, mainly due to higher personnel costs resulting from increased number of our productive staff, higher rental cost and higher depreciation expenses resulting from our increased seat capacity. Gross profit increased by 54% year-over-year to \$27 million given the higher level of center utilization rate of 71%. Gross profit also increased to 64% in the first quarter from 61% in the same period last year.

Selling and marketing expenses increased by 43% year-over-year to \$17 million, mainly due to higher personnel cost and higher advertising expenses as we expanded our network of learning centers and grew student enrollment. However, we can see our sales and marketing efficiency improved through a decrease of average advertising spending per student enrollment to \$301 in the first quarter of this year from \$340 in the same quarter a year ago.

As previously communicated with investors, in the third quarter of 2015 we have realized the benefits of Baidu account migration, and then further enhanced our sales and marketing efficiency by restructuring our sales and marketing functions and streamlining and workflows.

General and administrative expenses increased by 21% year-over-year to \$10 million, mainly due to higher compensation costs and higher share-based compensation expenses from our increased number of general and administrative personnel to support our growing operation.

Research and development expenses increased by 49% year-over-year to \$2.4 million, mainly due to higher personnel costs as we expanded our course offerings and operations. As a result, operating loss was \$3 million for the first quarter of 2016 as compared to the operating loss of \$4.7 million in the same period last year. Our non-GAAP operating loss on the first quarter was \$0.6 million as compared to non-GAAP operating loss of \$3.6 million in the same period a year ago.

Our net loss was \$3.8 million in the first quarter 2016 compared to \$2.5 million in the same period in 2015. Non-GAAP net income was \$1.7 million compared to a net loss of \$1.4 million in the same period in 2015. GAAP basic and diluted net loss for ADS was \$0.07 in first quarter 2016. Non-GAAP basic and non-GAAP diluted net income for ADS was \$0.03 in the first quarter of 2016.

We generated \$9.4 million in positive operating cash flow in the first quarter as compared to \$3.1 million operating cash flow generated in the same period last year. In addition, we incurred \$2.7 million in capital expenditures, mostly in opening new learning centers and upgrade and maintenance of IT infrastructure.

Looking forward into second quarter of 2016 is taking into consideration of significant change in RMB exchange rate against US dollar, total net revenues for the second quarter of 2016 are expected to be between \$51.5 million and \$52.5 million; representing an increase of 25% to 27% on a year-over-year basis. This is not including the impact from the depreciation of RMB against the US dollar, the projected revenue growth rate is expected to be in a range of 33% and 35% on a year-on-year basis for the second quarter of 2016.

We reaffirm our 2016 full-year net revenues guidance between \$230 million and \$236 million, representing an increase of 22% to 25% on a year-over-year basis.

This concludes my remarks and I would now hand over the phone over to the operator and open the line for questions. Operator?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Fan Liu of Goldman Sachs.

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### Unidentified Participant

This is Jason on behalf of Fan Liu. Could management share with us what can we expect on the utilization rate for second quarter? And also in the long run, do we have an optimal target?

And secondly, what can we expect on the ASP increases going forward, taking into account one is the pure price increases and then the course mix changes?

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### Dennis Yang - Tarena International, Inc. - CFO

In terms of utilization rate in Q2, we'll expect higher utilization rate as compared in the first quarter in 2016. As you can see, our student enrollment is quite strong in Q1. In the long run, we believe there will be our optimal utilization rate for our learning centers. The maximum would be, like, the record high utilization rate in Tarena's history is last Q3 of 2015, where we achieved at 80% of utilization. We believe 80% or 85% is our optimal level of utilization in the long run.

In terms of your second question of ASP, we communicated with investors before that we adopt different pricing strategy from 2016. We increased standard tuition for selective courses by RMB1,000. This pricing strategy we implemented from Q2 of this year have been already implemented. So based on our estimation, the overall blended ASP increase in 2016 will be between 3.5% to 4.5% as compared with last year.

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### Operator

Zoe Zhao of Credit Suisse.

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### Zoe Zhao - Credit Suisse - Analyst

I have two questions. One is could you elaborate update on your second quarter revenue guidance, given that we've seen very strong enrollment this quarter and the deferred revenue has also expanded? Can you explain why the guidance seems a bbit soft compared with the metrics?

And the second question is, can you give us an update on the operating margin outlook for the full-year? Maybe just a small follow-up on the answer you provided just now, like, the ASP you mentioned - is that in terms of RMB or in terms of US dollar?

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### Dennis Yang - Tarena International, Inc. - CFO

Let me give you quick update in the ASP. You last the mentioned the ASP; my understanding, our estimation, is based on RMB. So the 3.5%, 4.5% will be in RMB. This will be impacted by the RMB depreciation in the later period of this year.



Your first question, the Q2 revenue guidance; we provided our guidance between \$51.5 million to \$52.5 million. We give this guidance based on some consultative manner, because we foresee or we experienced some kind of uncertainties around a couple of factors. The first factor would be the tax reform in place in China. In China, business tax has been phased out and we replaced with the value-added tax.

Before the VAT reform, we paid 3% to 5% business tax. After that, we will pay 6% of VAT, value-added tax. So in terms of tax burden, we will foresee some kind of increase from May, so two months of Q2 will be higher taxes. From this regard, I will see about 2% impact to - around 2% impact on top-line. This is the first factor.

The second factor; we experienced some kind of issue or situation that the student from university channels recruited in the first-half of 2015 suspended their courses, suspended their trainings until summer vacation. So the revenue will be recognized from August through November will be shown up in the second half of the year. So we will do some kind of consolidative view on this kind of suspension of the training for the student from university channels. So based on these two factors, we give this current Q2 guidance.

Back to your second question, the operating margin guidance, we will keep our full-year guidance as we communicated with Q1 guidance release. So we will see more quarters to evaluate whether we would change the full-year guidance.

But for this quarter, we will keep our full-year guidance remained.

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**Zoe Zhao** - *Credit Suisse - Analyst*

What about the operating margin outlook for the full-year?

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**Dennis Yang** - *Tarena International, Inc. - CFO*

[As we bring] more target to get back our operating margin to in the level of 2014, you can see the operating margin, non-GAAP operating margin for 2014 is 17%. So this is our target for the full-year 2016.

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**Operator**

(Operator Instructions) Anne Shih of Brean Capital.

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**Anne Shih** - *Brean Capital - Analyst*

Just, I guess, could you discuss any updates on the bad debt controls implemented more recently and expense expectations for the year?

And then secondly, just on the Tongcheng and Tongmei, could you just let us know in terms of operational kind of updates, if there are any, what the expectations are for revenue contribution this year and next?

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**Dennis Yang** - *Tarena International, Inc. - CFO*

Your first question about bad debt provision, where bad debt better control, let me give you some updates. The first thing I would like to highlight is, we made bad debt provision of \$10 million in 2015. Most of the bad debt provision made in 2015 is due to the lack in fee issue of installment payment plan extended by Tarena to our students before 2014.

From 2015 - late 2014-2015, we have partnered with a third party financing providers, such as Bank of China, Bank of Beijing and CreditEase, to greatly reduce the percentage of students on the installment payment plan we extended to our student. So the risk is significantly reducing.



Moreover, we implemented strengthened control over the credit lending and cash collections to reduce in risk our accounts receivable. We made a clear cash collection plan and we fulfill those plans to date. So for the Q1 of 2016, we made additional \$700,000 provision. The overall provision coverage for an AR overdue more than seven months is higher than 80% as of March 31. So we believe that right now we are in the right track on the account receivable control. Hopefully we can turn the corner of this issue and bad debt provision expenses will start going down in 2016.

And the second question about the K12 program, Mr. Han will give his feedback to you.

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

(Interpreted) So in terms of student enrollment for K12 programs, based on our current expectation, the total enrollment under K12 courses will take about 3% to 4% of total student enrollment in 2016. The total enrollment for the K12 program enrollment will increase - were up to 6% to 8% of total student enrollment in 2017.

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**Operator**

(Operator Instructions) Tony Yang of Industrial Securities.

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**Tony Yang** - *Industrial Securities - Analyst*

I have a question about the K12 program. As we know, the K12 program is using the existing learning centers. So I'm wondering, as the K12 program rollout, is that going to increase the utilization rate for the centers? And how are you going to calculate the utilization rate right now? Are you counting on the K12 program?

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**Dennis Yang** - *Tarena International, Inc. - CFO*

Well, you're asking about whether the K12 program will have impact on our seat utilization. Let me give you some hints about our current calculations of our utilization rate.

Our utilization rate right now is we're using the students [at school] divided by our seat capacity at the end of every month. So for K12 - right now you know, as of now, the K12 enrollment is quite - is a little bit low. Right now it's only about 246 enrollments. This may not have impact on our utilization rate from Q1.

On the long run, we'll assess or evaluate our method right now we're using to calculate the utilization. We'll do this evaluation and on the later quarter we will communicate it with the market whether we will change our utilization rate calculation now.

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**Tony Yang** - *Industrial Securities - Analyst*

I have a follow-up question also about the K12 program. If we just - ignoring the rental cost for the learning center, what's the margin for the K12 program right now?

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**Dennis Yang** - *Tarena International, Inc. - CFO*

The margin for the K12, to be honest, is much higher than our professional educational courses. For K12, we don't need to pay any additional rental. The only thing we need to spend on K12 program is the faculty cost, the cost of revenue, as well as the advertising revenue.



The advertising revenue - the advertising cost we will see on the similar level as our professional education courses. So the overall K12 margin is very high.

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**Operator**

(Operator Instructions) As there are no further questions in the queue at this time, I will now revert the call back to Ms. Helen Song, Tarena's Investor Relations Manager.

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**Helen Song - Tarena International, Inc. - IR Manager**

Thank you, Operator. If there are no further questions at present, I will 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@tedu.cn](mailto:ir@tedu.cn), should you have any questions or requests for additional information and encourage you to visit our Investor Relations site at [ir.tedu.cn](http://ir.tedu.cn).

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

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**Operator**

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

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