農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Aug 23, 2021

CHINA EDUCATION SECTOR

Mixed policy environment; downgrade to NEUTRAL

Contents

China Education Sector

Mixed policy environment; downgrade to NEUTRAL

- New policy announcements complicate the policy environment for the education industry; the "Opinion on Reducing In-school and After-school Education Burdens for Students in Compulsory Education" (《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》) places more restrictions on after-school education institutions, while the "Revised Implementation Measures for the Law on the Promotion of Private Schools" (《中华人民共和国民办教育促进法实施条例》) reaffirms the government's support for the higher education and vocational education segments
- Potential demographic shift creates long-term challenges for the industry
- Downgrade sector rating to **NEUTRAL**; we prefer higher education segment for the supportive policy environment

Sector Report

Aug 23, 2021

NEUTRAL

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New policy to target after-school education institutions. The recently announced "Opinion on Reducing In-school and After-school Education Burdens for Students in Compulsory Education" 《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》("Opinion") mainly covers measures regulating formal schools and after-school education institutions for students in G1-9 (compulsory education). We believe the "Opinion" would impose more regulatory restrictions on after-school education institutions (especially those offering academic subject tutoring); players in the segment may suffer from slower growth, thus necessitating the need for new growth drivers.

Supportive stance for higher education. We believe the policy environment currently favors the higher education players. "Revised Implementation Measures for the Law on the Promotion of Private Schools" (《中华人民共和国民办教育促进法实施条例》) ("Revised Measures") announced recently covers the regulations for formal private education and entails numerous supportive policies for the development of higher education and vocational education.

Long-term challenges posed by potential demographic change. The number of newborns decreased to 12mn in 2020, marking China's fourth consecutive year of decline. If the downtrend continues, student enrollment will fall in the long term, and the sector's growth will be affected.

Sector recommendations. We believe the higher education segment will outperform on favorable policies. We advise investors to remain cautious over the after-school education as the new policy imposes more restrictions on operations, complicating the growth outlook. Due to the mixed policy environment, we downgrade our sector rating to **NEUTRAL**. Our top picks are **CEG (839 HK)** and **Edvantage (382 HK)**.

Risk factors: 1) Regulatory/Policy risk; 2) Prolonged pandemic risk; 3) Macroeconomic risk; 4) Demographic risk; 5) Education quality risk; 6) Operational risk; 7) Non-GAAP financial metrics; 8) Lack of dividend payout; 9) EPS dilution risk; 10) Leverage risk.

Key Data

Avg.21E P/E (x)	8.01
Avg.21E P/B (x)	1.35
Avg.21E Dividend Yield (%)	4.73

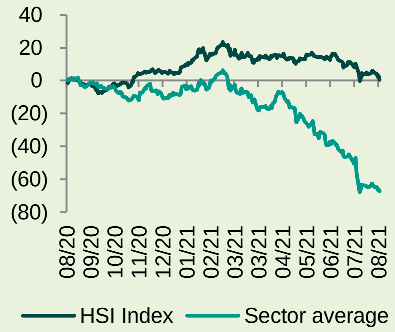
Source(s): Bloomberg, ABCI Securities

Sector Performance (%)

	Absolute	Relative*
1-mth	(38.75)	(29.15)
3-mth	(58.97)	(47.51)
6-mth	(64.74)	(50.83)

*Relative to HSI
Source(s): Bloomberg, ABCI Securities

1-year sector performance



Source(s): Bloomberg, ABCI Securities

Sector Valuation Summary

Company	Ticker	Rating	TP	Price	Upside (%)	P/E(x) 21E	P/E(x) 22E	P/B (x) 21E	P/B (x) 22E	Yield (%) 21E	Yield (%) 22E	ROAE (%) 21E	ROAE (%) 22E
CEG	839 HK	BUY	HK$ 22.6	HK$ 13.46	67.90	22.09	16.69	2.15	2.04	2.0	2.6	11.3	12.7
Edvantage	382 HK	BUY	HK$ 13.1	HK$ 5.27	148.84	10.99	7.48	1.82	1.46	3.3	4.8	19.4	21.6
New Oriental	EDU US	HOLD	US$1.97	US$1.81	8.97	6.65	7.04	0.61	0.56	0.0	0.0	11.9	8.3
	9901 HK		HK$ 15.4	HK$ 13.94	10.22	6.58	6.96	0.61	0.56	0.0	0.0		
TAL	TAL US	HOLD	US$5.25	US$5.07	3.64	N/A	N/A	0.60	0.60	0.0	0.0	(0.4)	(0.1)

Note: Data as of Aug 19, 2021; 2) New Oriental FY ends at May 30; 3) TAL FY ends at last day of Feb; 4) CEG and Edvantage FY end at Aug 31; 4) TAL's valuation multiples are for FY22E and FY23E
Source(s): Bloomberg, ABCI Securities estimates

A changing policy environment

After-school education segment to face more regulatory oversights

"Opinion on Reducing In-school and After-school Education Burdens for Students in Compulsory Education" 《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》

On Jul 24, 2021, the General Office of the Central Committee of the Communist Party of China and State Council jointly announced the "Opinion on Reducing In-school and After-school Education Burdens for Students in Compulsory Education" (《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》) ("Opinion"). The "Opinion" establishes comprehensive rules covering mainly the formal schools and after-school education institutions for students in compulsory education (G1-9). According to the "Opinion", the in-school and after-school education burdens for students should be effectively reduced in a year, and the reduction should achieve more significant results in three years.

We believe the "Opinion" has the following noteworthy aspects: 1) the goal to reduce education burden imposed by the after-school education institutions and help students achieve balanced development is emphasized more heavily in the current set of policies; 2) the current policies aim to serve higher policy objectives of boosting the affordability of child care, increasing the willingness to bear children, and reversing the declining number of newborns and aging population; 3) MOE announced the establishment of an independent office to oversee the after-school education institutions on Jun 15, 2021; and 4) the "Opinion" proposes compartmentalized management of academic/non-academic tutoring, compulsory/non-compulsory education tutoring, and offline/online tutoring, which signals that the new policies would be implemented based on more stringent standards and in a more systematic manner.

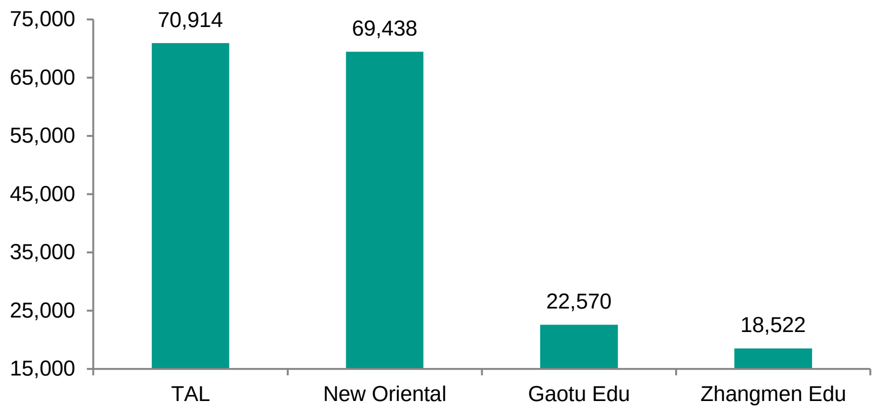
Based on the "Opinion", after-school education institutions would have to embrace numerous changes. Enrollment and course hours of the after-school education players would be significantly reduced since academic-subject tutoring for G1-9 students during weekends, public holidays, and summer/winter vacations will be prohibited. Compliance costs would also increase since the regulatory bodies will conduct inspections on industry players offering online tutoring services, which are required to reapply for their operating licenses; approval would only be granted for those passing the assessment. Promotional activities conducted by the after-school education institutions would also have to face new limitations in terms of how and where they are conducted.

The "Opinion" lays out additional regulatory requirements for academic subject tutoring institutions. All academic subject tutoring institutions are required to register as not-for-profit entities, which would affect various aspects of their operations. For the differences between for-profit and not-for-profit entities, please see Exhibit 3. The "Opinion" also prohibits capital market activities by academic subject tutoring institutions. The measures include: 1) prohibiting IPOs by such institutions; 2) listed institutions are prohibited from using funds from new share issuance or cash reserves to acquire other academic subject tutoring institutions; 3) foreign investors are banned from investing in academic subject tutoring institutions via M&A, management contracts, franchise agreement, or VIE structure.

Local authorities also have swiftly launched new policies for the education industry after announcement of the “Opinion”. The Department of Education of Guangdong Province recently released “Notice on On-campus Post-school Activities in Compulsory Education Schools” (《广东省教育厅关于进一步做好义务教育校内课后服务工作的通知》). The “Guangdong Notice” aims to provide implementation guidelines for the execution of on-campus post-school activities for G1-9 students; it further states that schools and afterschool education institutions cannot cooperate to provide paid academic subject tutoring courses as part of the on-campus post-school activities. Beijing Municipal Committee of the Communist Party of China and the Beijing Municipality Government jointly issued "Beijing Municipality's Measures to Further Reduce In-school and After-school Education Burdens for Students in Compulsory Education in Beijing" (“Beijing Measures”) (《北京市关于进一步减轻义务教育阶段学生作业负担和校外培训负担的措施》). The “Beijing Measures” provides rules for after-school education institutions similar to those in the “Opinion”. Moreover, the head of Department of Education of Guangdong Province has posted an article recently stating that the oversight of after-school education institutions would be part of the crackdown of crime syndicates (“扫黑除恶”); the Hubei Province’s office for “Combating Pornography and Illegal Publications” (“扫黄打非”) announced its branch office in various cities in Hubei Province also took up the task of overseeing and inspecting after-school education institutions. We believe the local policies announced so far show the importance of reducing academic burdens and we expect more local policies and regulatory actions to be launched.

We believe the market players would have to diversify away from the K-12-centric course offerings and cultivate new growth drivers in areas including vocational training, language training, professional education, or interest-based non-academic courses. Such transitions would create uncertainty in enrollment and ASP growth, and it is reasonable to expect that some players would fail. The transition would increase R&D expenses and sales & marketing expenses, which would make margins more volatile. In addition, amid such drastic industry change, we believe cost-cutting measures would be necessary, and the industry players are likely to reduce headcounts in academic subject tutoring programs and downsize their school network.

Exhibit 1: Latest full-time employee figures of major after-school education players



Note: Figures for TAL, New Oriental, Gaotu Edu, and Zhangmen Edu are disclosed in FY21 report, FY20 report, FY20 report, and prospectus respectively

Source(s): Companies, ABCI Securities

Exhibit 2: Policy highlights – "Opinion on Reducing In-school and After-school Education Burdens for Students in Compulsory Education" (《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》)

Policy objective

To effectively reduce in-school and after-school education burdens for students in compulsory education (G1-9) and the corresponding monetary and energy spent by parents on education in one year and achieve significant results in three years.

For after-school education institutions

➢ *Academic subject tutoring institutions targeting G1-9 students:*

1) Approval for new academic subject tutoring institutions targeting G1-9 students will be suspended; all the existing institutions should be registered as not-for-profit organizations;
2) Online academic subject tutoring institutions, which has record-filing with the government's education department or the government's human resources and social security department at the provincial level, should reapply for approval for new record-filing and operating licenses; approval should be based on findings in inspections conducted by relevant authorities; failure to obtain approval will result in record-filing and ICP license being rescinded;
3) Unlisted institutions are prohibited from listing, and all institutions are prohibited from conducting other capital market activities for financing; listed institutions are prohibited from using new funding obtained from the capital market or using shares/cash to acquire academic subject tutoring institutions; foreign investors are prohibited from investing in or obtaining control of academic subject tutoring institutions through M&A, entrusted operation, franchise agreement, or VIE structure; any violation should be rectified;
4) Academic subject tutoring activities are prohibited during weekends, public holidays, and summer/winter vacations;
5) Instructors in academic subject tutoring courses must obtain relevant teaching qualifications, which should be displayed prominently on websites and in the sites of teaching;
6) Academic subject tutoring institutions are prohibited from offering advanced content for students; non-academic subject tutoring institutions must not offer academic subject tutoring courses; foreign curriculum or teaching material are not allowed to be used.
7) Online tutoring course providers are prohibited from offering and promoting "snap & search" function for students to get answers, in order to foster independent learning ability and problem-solving skills;

➢ *Other general rules for after-school education institutions:*

1) Relevant authorities should assign/establish regulating bodies for non-academic subject tutoring institutions based on their area of education; after-school education institutions will be published if they fail to comply with operating standards outlined by regulators or operate in multiple sites without approval;
2) Guidelines for overseeing teaching material of after-school education institutions will be launched and overseas teaching materials cannot be used;
3) Monopolistic behaviors should be punished and rectified according to relevant regulations; after-school education institutions are prohibited from falsifying prices/discounts or exaggerating effectiveness of courses during marketing promotion to generate sales;
4) Each online tutoring course should be conducted within 30 minutes, and interval between online courses should be at least 10 minutes; online tutoring courses should end at no later than 9pm; online tutoring course providers should use AI and big data to monitor time spent online by students; after-school education institutions cannot hire overseas-based foreigners as instructors and hiring of domestic-based foreigners must follow relevant regulations;
4) Advertising by after-school education institutions are prohibited in mainstream media, new media, public venues, or residential area; after-school education institutions cannot conduct commercial activities on campus of kindergartens, primary schools and junior highs, or using teaching materials/school uniforms/stationary/school bus to promote courses; any promotional activity exaggerating the effectiveness of tutoring courses, misleading the public on education philosophy, or fanning anxiety among parents will be reprimanded.

➢ *After-school education institutions targeting children at the age of 3-6 and high school students:*

1) Institutions are prohibited from offering online tutoring to preschool students;
2) Institutions are prohibited from offering offline academic subject tutoring courses (including foreign language) disguised as preschool training, transition courses for incoming primary school students, or thought training to preschool students;
3) Approval for new after-school education institutions targeting preschool students and high school students will be suspended.

➢ *Pilot programs for implementation:*

1) Beijing, Shanghai, Shenyang, Guangzhou, Chengdu, Zhengzhou, Changzhi, Weihai, and Nantong, as well as at least one designated city in other provinces, will be selected to run pilot programs for the following measures;
2) All academic subject tutoring institutions must be inspected and resubmit the application for approval; the overall number of institutions should be reduced; those that are under-qualified, mismanaged, overcharging students, or colluding with formal education schools will be investigated thoroughly and severely punished;
3) Encourage G1-9 schools to offer interest-based extracurricular activities, which students should be able to participate in on a voluntary basis; relevant authorities will select qualified non-academic subject tutoring institutions to provide interest-based extracurricular activities for schools without such capability; participating non-academic subject tutoring institutions will be disqualified if they are unable to provide adequate service, try to enroll student on campus, or disrupt the normal enrollment procedure;
4) Relevant authorities will provide guidance on the pricing of G1-9 academic subject tutoring institutions; risk measures for funding management should be set up, which includes mandating third-party custodial management of prepaid tuitions and risk reserves, to lower the hurdle for seeking refunds and prevent misappropriation/mismanagement of funding.

(Cont') Exhibit 2: Policy highlights – "Opinion on reducing in-school and after-school education burdens for compulsory education students" (《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》)

For schools in compulsory education (G1-9 schools)

- Reduce the amount of homework assigned to students by school teachers: no homework should be assigned to G1-2 students; G3-6 students should be able to complete homework within 60 minutes while G7-9 students should be able to complete homework within 90mins; teachers, instead of students and parents, should grade the homework and adjust the teaching progress according to students' performance; teachers should guide students to finish their homework, and G1-6 students should be able to complete all homework at school while G7-9 students should be able to complete most of their homework at school; homework should be part of curriculum design and assigned to students based on their learning progress, and should not be repetitive and be used as punishment;
- Organize diverse post-school activities: schools should provide post-school study sessions and extracurricular activities to students after school hours and students should be able to participate in voluntarily; schools should organize in-school study sessions for students to complete homework under the supervision of teachers; additional interest-based activities in non-academic subjects, art, sports, cultural, and science should be provided for students; no new academic subject can be taught after school hours; post-school activities should provide a buffer for parents until they can pick up their children;
- MOE should organize the collective resources of schools to develop an online education platform, which will provide free education materials and tools to all students.

Source(s): MOE, ABCI Securities

Exhibit 3: Difference between for-profit and not-for-profit private schools

Operational aspects	For-profit private schools	Not-for-profit private schools
Receipt of operating profits	School sponsors are allowed to receive operating profits, and the surplus from operations shall be handled in accordance with the provisions of the PRC Company Law and other applicable laws and regulations.	Sponsors are not allowed to receive operating profits, and all surpluses from operations shall be used for the school's operation.
License & registration	Private school operating licenses and business licenses	Private school operating licenses and legal person certificate of private non-enterprise/the legal person certificate of the public institution
Fees to be charged	Determined based on school operating costs and market demands, and no prior regulatory approval is required	Determined pursuant to the fee charge regulations to be promulgated by the local governments
Tax treatment	Preferential tax treatment as stipulated by the state government	Same preferential tax treatment as public schools
Land	Acquired either through land allocation or land transfer	Acquired through land allocation
Public funding	Public funding in the form of purchase of services, student loans, scholarships, lease, or acquisition of unused state-owned assets	Public funding in the form of purchase of services, student loans, scholarships, lease or acquisition of unused state-owned assets, and government grants, incentive funds, and donations
Liquidation	Liquidated in accordance with the provisions of the PRC Company Law. Sponsors can obtain the school's remaining assets after the settlement of its indebtedness	schools established before the promulgation of the 2016 Decision(1), if there are still remaining school assets after the settlement of its indebtedness, such assets shall be used continuously for the operation of non-profit school. Sponsor can apply for compensation or rewards, which shall be decided based on a number of factors

Note: 1) Refers to Decision of the Standing Committee of the NPC on Amending the Private Schools Promotion Law (全国人民代表大会常务委员会关于修改<中华人民共和国民办教育促进法>的决定), which was promulgated on November 7, 2016, and came into force on September 1, 2017

Source(s): Prospectus of South China Vocational Education Group, ABCI Securities

Exhibit 4: Definition of academic subjects and non-academic subjects for after-school education institutions

Academic subjects	Non-academic subjects
Morality & Rule of Law Chinese History Geography Math Foreign language (English, Japanese, & Russian) Physics Biology	PE (sports or health management) Arts (music or painting) Other activities (including information technology education, vocational education, and labor class education)

Source(s): MOE, ABCI Securities

Exhibit 5: Policy highlights – "Notice on On-campus Post-school Activities in Compulsory Education Schools" issued by Department of Education of Guangdong Province (《广东省教育厅关于进一步做好义务教育校内课后服务工作的通知》)

Goal

To reduce the excessive education burden (both in-school and after-school) for students and strengthen formal school's role in education; to ensure high-quality on-campus post-school activities to be launched

Measures

1) Starting from the fall semester in 2021, on-campus post-school activities should be provided in all G1-9 schools (compulsory education) and be accessible to all students in need;
2) County-level education authority should bear policy management responsibility and schools should bear program execution responsibility; each county should have one set of strategies designed based on local situation for reducing education burden for students, while the local G1-9 schools should have their own execution plan for carrying out on-campus post-school activities;
3) Promote the "5+2" model across schools: schools should organize on-campus post-school activities from Monday to Friday; post-school activities include sessions of breakfast, lunch, lunch break, and post-school activities in the afternoon, which should last no less than 2 hours and should last till at least half an hour past normal local office closing time;
4) Schools should extend the on-campus post-school activities for students with special needs; students should be able to participate in the on-campus post-school activities with flexibility and schools are prohibited from asking students to leave before the end of such activities against their will;
5) On-campus post-school activities for G1-9 student should be an extension of regular classes and should only provide either study sessions, in which students are able to study independently and finish homework with the supervision & guidance from teachers, or interest-based extracurricular activities, in areas such as art, sports, literature, or student clubs etc.; the study sessions should last no less than 1 hour;
6) Schools are prohibited from teaching academic subjects during on-campus post-school study session;
7) Teachers should be the primary organizer of the post-school activities, while volunteers and retired teachers can be hired to assist;
8) Schools can hire qualified third-party after-school education institutions to provide post-school activities;
9) Local authorities should strengthen the monitoring and management of such third-party service providers and create a mechanism for selection and disqualification;
10) On-campus post-school activities should not be organized solely by the third-party service providers and schools are prohibited from cooperating with after-school education institutions to provide paid tutoring courses (especially academic subject and test preparation courses);
11) Local authorities should release pricing guidelines according to the "Notice on Improving the Pricing Policy of G1-12 Schools in Guangdong" (《广东省发展改革委 广东省教育厅 广东省财政厅关于进一步完善我省中小学教育收费政策的通知》(粤发改规〔2018〕14 号)) for on-campus post-school activities, in order to strengthen the management of the pricing standards and prevent overpricing or mispricing;
12) Explore daycare programs during summer vacation: daycare programs in summer vacation should be an extension of on-campus post-school activities; schools with the capability are encouraged to set up such programs; organizations and individuals from various social backgrounds are encouraged to participate as well;
13) Daycare programs in summer vacation should provide classrooms, libraries, and sports venues for students to organize activities on their own; schools should only supervise such activities; schools can also arrange activities in areas including homework assistance, literature, sports & cultural activities, etc.;
14) Schools are prohibited from teaching academic subject courses during the daycare programs in summer vacation.

Source(s): Department of Education of Guangdong Province, ABCI Securities

Exhibit 6: Policy highlights – "Beijing Municipality's Measures to Further Reduce In-school and After-school Education Burden for Students in Compulsory Education in Beijing" (《北京市关于进一步减轻义务教育阶段学生作业负担和校外培训负担的措施》)

Goal

To greatly reduce the academic burdens of students in compulsory education (G1-9) by end of 2021 and to achieve further reduction in two years

Measures

1) Approval for new academic subject tutoring institutions targeting G1-9 students will be suspended; existing after-school education institutions covering academic subject tutoring for student in compulsory education will be reviewed and re-registered, and the remaining ones will be registered as not-for-profit institutions; online players offering academic subject tutoring for G1-9 student will also be subjected to review and re-registration, and registration and ICP license of unqualified players will be rescinded;
2) After-school education institutions are strictly prohibited from providing academic subject tutoring during weekends, public holidays, or summer/winter vacation; online academic subject tutoring courses should end before 9pm during weekdays;
3) Academic subject tutoring courses are prohibited from teaching advanced materials, material outside school curriculum, or material based on foreign curriculum; after school education institutions offering academic subject tutoring are prohibited from soliciting or recruiting teachers by offering excessive compensation or employing overseas foreigners as instructors; non-academic subject tutoring agencies cannot provide academic subject tutoring;
4) Prices of academic subject tutoring courses should follow the pricing guidelines provided by the authority to prevent "any excessive charging or profit-seeking activity";
5) After-school education institutions are prohibited from pursing listing or conducting other capital market activities for financing; listed players cannot invest in peers offering academic subject tutoring with funding obtained from capital market activities and cannot acquire assets of peers offering academic subject tutoring by paying cash or issuing securities; foreign investors are prohibited from controlling or investing in after-school education institutions offering academic subject tutoring courses through M&A, entrusted operations, franchise agreement, VIE structure, or other structures;
6) Oversight of after-school education institutions offering academic subject tutoring courses will be enhanced; more restrictions for advertisements will come.

Source(s): Beijing Municipal Education Commission, ABCI Securities

Other complementary policies

In addition, a series of new policies has been released by the MOE prior to the "Opinion" with the same aim to lessen the burden of K12 students. According to "Notice on Homework Management for Compulsory Education Schools" (《教育部办公厅关于加强义务教育学校作业管理的通知》), after-school education institutions are prohibited from assigning homework to students to prevent reduction of in-school homework being offset by increase of after-school homework. According to "Opinion on Transition from Preschool Education to Primary School" (《教育部关于大力推进幼儿园与小学科学衔接的指导意见》), after-school education institutions cannot provide training for students in preschool education. Performance in after-school training or credentials earned in contests/competitions should not be used as the basis for primary school student enrollment. Institutions with violations will be blacklisted, and records of violation would be publicized on a national credit information sharing platform. According to the "Notice on Sleep Management of G1-12 Students" (《教育部办公厅关于进一步加强中小学生睡眠管理工作的通知》), students in primary schools, junior highs, and high schools ought to have at least 10 hours, 9 hours, and 8 hours of sleep every day; after-school education institutions should end all offline courses by 8:30pm and all online courses by 9pm. The "Regulation on Minor Protection at School" (《未成年人学校保护规定》) prohibits schools and after-school education institutions from cooperating to provide courses to students.

Exhibit 7: Other policies/regulations for the after-school education segment

Policy/Regulation	Highlights
"Regulation on Minor Protection at School" 《未成年人学校保护规定》	➢ Schools and after-school education institutions are not allowed to cooperate to provide courses to students.
"Notice on Homework Management for Compulsory Education Schools" 《教育部办公厅关于加强义务教育学校作业管理的通知》	➢ After-school education institutions are prohibited from assigning homework to students. To prevent excessive burden caused by homework from after-school courses, relevant authorities should prioritize the homework ban in regulatory oversight and enforcement measures for after-school education programs for primary and middle school students.
"Opinion on Transition from Preschool Education to Primary School" 《教育部关于大力推进幼儿园与小学科学衔接的指导意见》	➢ Relevant authorities should continue to ramp up regulatory oversight and enforcement measures on after-school education institutions, primary schools, and kindergartens. ➢ After-school education institutions should not provide training or tutorial courses to preschool students. ➢ Primary schools should implement admission by locality rather than examination; any form of results from exams, contest/competition, or training/tutorial courses cannot be used as basis of admission. Primary schools should strictly follow the teaching guideline provided by the MOE without skipping entry-level or transitional courses for G1 students. Primary schools should not offer prep-school education. ➢ Kindergartens should not teach courses designated for primary schools, assign homework that involves calculation, writing, or reading. Kindergartens should not provide prep-school education. Kindergartens should investigate and report to relevant authorities about dropout of senior students. ➢ After-school education institutions in violation of providing preschool students training or tutorial courses would be put on a blacklist, which would be posted on a national credit information sharing platform. Violations would be reprimanded accordingly.
"Notice on Sleep Management of G1-12 Students" 《教育部办公厅关于进一步加强中小学生睡眠管理工作的通知》	➢ Relevant authorities should supervise the online tutorial platforms, and all online training/tutorial activities must end by 9pm.

Source(s): MOE, ABCI Securities

New policy continues to benefit higher education segment

On May 14, 2021, the State Council announced "Revised Implementation Measures for the Law on the Promotion of Private Schools" (《中华人民共和国民办教育促进法实施条例》) ("Revised Measures") effective on Sep 1, 2021.

Highlights of the "Revised Measures" include 1) prohibiting foreign entities from participating in the compulsory education institutions (G1-9); 2) prohibiting connected-party transactions for compulsory education institutions; meanwhile, it allows such transactions for G10-12/vocational/higher education school, given that they are conducted in a transparent and fair manner based on a periodically audited disclosure system; 3) allows one company to operate multiple private schools, given such a company or its ultimate controller has adequate resources to do so; 4) prohibiting the control of private compulsory education institutions or not-for-profit private preschool education institutions through the means of M&A or contractual control; 5) giving private formal education institutions the same rights in student enrollment as the public counterparts; 6) providing preferential tax policies for private schools in line with national policies and allowing not-for-profit schools to enjoy the same tax treatment as the public counterparts.

Exhibit 8: Policy/Regulation highlights – "Revised Implementation Measures for the Law on the Promotion of Private Schools"(《中华人民共和国民办教育促进法实施条例》)

Policy/Regulation	Highlights
"Revised Implementation Measures for the Law on the Promotion of Private Education" 《中华人民共和国民办教育促进法实施条例》	➢ Foreign-invested enterprises in China or social organizations with a non-domestic ultimate controller cannot participate in the compulsory education (G1-9) institutions; ➢ Prohibits the control of private compulsory education institutions or not-for-profit private preschool education institutions through the means of M&A or contractual control; ➢ Allows one company operating multiple private schools, but the company or the ultimate controller of the company should have adequate funding, personnel, and organizational flexibility ➢ Prohibits connected-party transactions for compulsory education institutions; it allows such transactions for G10-12/vocational/higher education institutions to be conducted in a transparent and fair manner based on a periodically audited disclosure system; ➢ Private formal education institutions can enjoy the same rights in student enrollment as their public counterparts; ➢ Provides preferential tax policies for private schools in line with national policies, and not-for-profit schools can enjoy the same tax treatment as their public counterparts.

Source(s): MOE, ABCI Securities

The "Revised Measures" lays down a regulatory foundation for the future development of the private education industry in China; the policy will reduce policy uncertainties weighing on the sector before. Compared to the previous version, the "Revised Regulation" maintains a largely similar policy stance towards different segments of the private education industry – the K-9 (kindergarten to grade 9) education segment would be subject to more regulatory supervision and limitation than the high school/vocational/higher education segments.

In addition to the "Revised Measures", it is worth noting that the support for vocational education development and the conversion of independent colleges in the higher education segment has stayed intact.

The government's supportive stance for vocational education development would provide more opportunities for the higher education players. The development of the vocational education system was emphasized in the Central Economic Work

Conference in Dec 2020; the Government Work Report released in early 2021 also stated the targeted increase of 1mn in higher and vocational education enrollment. The target proposed by the Government Work Report released in early 2020 was 2mn addition in higher and vocational education enrollment in 2020-2021.

The conversion of independent colleges also has been proceeding steadily. CEG (839 HK) and Edvantage (328 HK) are among the earliest to obtain relevant approvals for independent colleges in their portfolio schools. After completion of the conversion, the independent colleges would be able to eliminate sponsor fees (as a certain percentage of tuition income) paid to their sponsor schools, which would help improve the margins of their parent companies.

Exhibit 9: Independent colleges that have been publicly notified to enter the conversion process

Independent college	Conversion Status	Current owner
四川外国语大学重庆南方翻译学院 Chongqing Nanfang Translators College (CNTC) of SISU	Obtained approval	CEG (839 HK)
广州大学松田学院 Guangzhou University Sontan College	Obtained approval	
济南大学泉城学院 Shandong Quancheng University	Obtained approval	
四川大学锦城学院 （新并购学校） Sichuan University Jincheng College (newly acquired school)	Obtained approval	
广东财经大学华商学院 Huashang College Guangdong University of Finance and Economics	Obtained approval	Edvantage (382 HK)
广东工业大学华立学院 Huali College Guangdong University of Technology	Obtained approval	Huali University (1756 HK)

Source(s): MOE, Companies, ABCI Securities

As the general policy stance remains supportive for the higher education segment, we believe the players in the segment would outperform. We favor companies with a leading market position and school network covering regions with strong economic fundamentals or a strong record of school acquisitions.

Long-term challenges posed by demographic change

Declining newborns may change the industry landscape

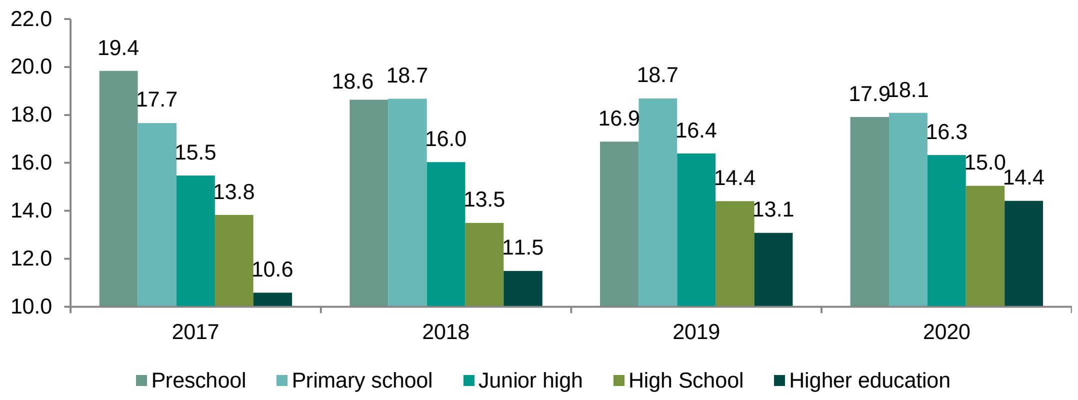
According to the NBS, the number of newborns decreased to 12mn in 2020, down 18.1% YoY, marking the fourth consecutive year of decline. If willingness to bear children and the number of newborns remain low, the education industry will face a declining student pool in the long term. In the short or medium term, declining newborns would mean lower enrollment, and sustaining growth would become more difficult for certain players. Facing such a challenge, we expect education players to focus more on developing schools in higher-tier cities or relatively populous regions to maintain enrollment and tuition growth.

The decline in new student intake may reflect early impacts of declining birth rate

Enrollment figures in 2020 continue to increase. According to MOE, in 2020, enrollment of preschools, primary schools, junior highs, high schools, and higher education institutions grew by 2.2% YoY, 1.6% YoY, 1.8% YoY, 3.3% YoY, and 4.5% YoY, respectively.

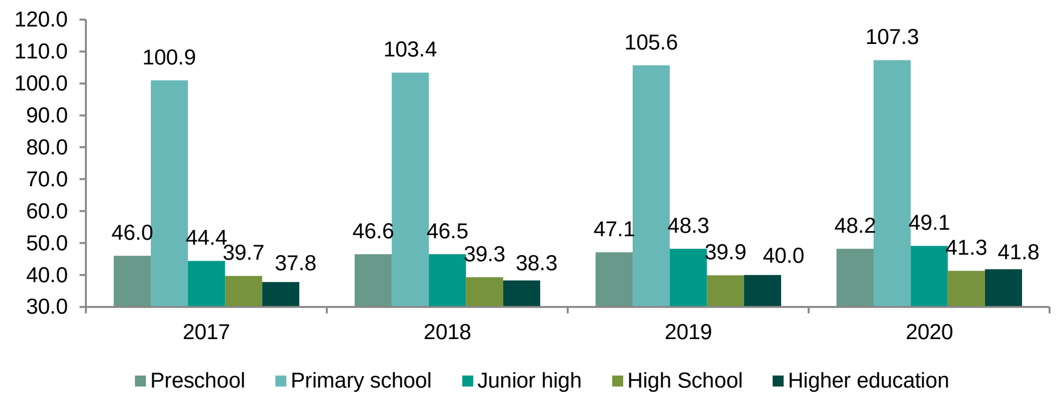
New student enrollment, however, shows a different picture. The number of new students in primary school and junior high decreased by 0.6mn and 0.1mn in 2020. The number is insignificant compared to the overall student enrollment, but it may reflect the early impact of declining newborns in recent years.

Exhibit 10: New student intake in China (mn ppl)



Source(s): MOE, ABCI Securities

Exhibit 11: Total student enrollment in China(mn ppl)



Source(s): MOE, ABCI Securities

Regional resurgence of pandemic adds to uncertainty

New COVID-19 cases have emerged across the country and measures to contain the new outbreaks are employed. The effectiveness of containment efforts remains uncertain since the new wave was caused by the Delta variant with higher transmissibility. If not contained, the new outbreak will disrupt the fall semester schedule for schools in formal education. Online teaching is likely to resume with students staying home, meaning that schools can only rely on the tuition income. In addition, continued deployment of social-distancing measures will dent earnings of the after-school education institutions, which were unable to conduct offline teaching during the outbreak in 2020. In certain regions, they were allowed to resume offline teaching only after all the formal education schools resumed offline teaching at the end of 2020 outbreak.

Sector recommendation

In conclusion, the policy environment supports higher education players; in contrast, after-school education players will be subject to more restrictions. We favor the leading higher education players, and our top picks are **CEG (839 HK)** and **Edvantage (382 HK)**. We downgrade **New Oriental (EDU US/9001 HK)** and **TAL (TAL US)** to **HOLD** due to the stringent policies posing threats on growth outlook.

Exhibit 12: Valuation comparison of the sector

Ticker	Name	Rating	TP	Price	Upside (%)	P/E(x)		P/B (x)		Yield (%)		ROAA (%)		ROAE (%)	
						21E	22E	21E	22E	21E	22E	21E	22E	21E	22E
839 HK	CEG	BUY	HK$ 22.6	HK$ 13.46	67.90	22.09	16.69	2.15	2.04	2.0	2.6	5.2	6.5	11.3	12.7
382 HK	Edvantage	BUY	HK$ 13.1	HK$ 5.27	148.84	10.99	7.48	1.82	1.46	3.3	4.8	9.6	10.7	19.4	21.6
EDU US	New Oriental	HOLD	US$1.97	US$1.81	8.97	6.65	7.04	0.61	0.56	0.0	0.0	4.5	4.1	11.9	8.3
9901 HK			HK$ 15.4	HK$ 13.94	10.22	6.58	6.96	0.61	0.56	0.0	0.0				
TAL US	TAL	HOLD	US$5.25	US$5.07	3.64	N/A	N/A	0.60	0.60	0.0	0.0	(0.2)	(0.1)	(0.4)	(0.1)
Average						*11.58*	*9.54*	*1.16*	*1.04*	*1.0*	*1.5*	*4.8*	*5.3*	*10.5*	*10.6*

Note: 1) Data as of Aug 19, 2021; 2) New Oriental FY ends at May 30; 3) TAL FY ends at Feb 28/29; 4) CEG and Edvantage FY ends at Aug 31; 4) TAL's valuation multiples are for FY22E and FY23E

Source(s): Bloomberg, ABCI Securities estimates

Risk factors

Regulatory/policy risk

New policies for the education industry indicate more regulatory oversight for the after-school education segment while support for higher education segment stays intact. After-school education players would have to embrace changes in their operating segments and develop new revenue growth drivers.

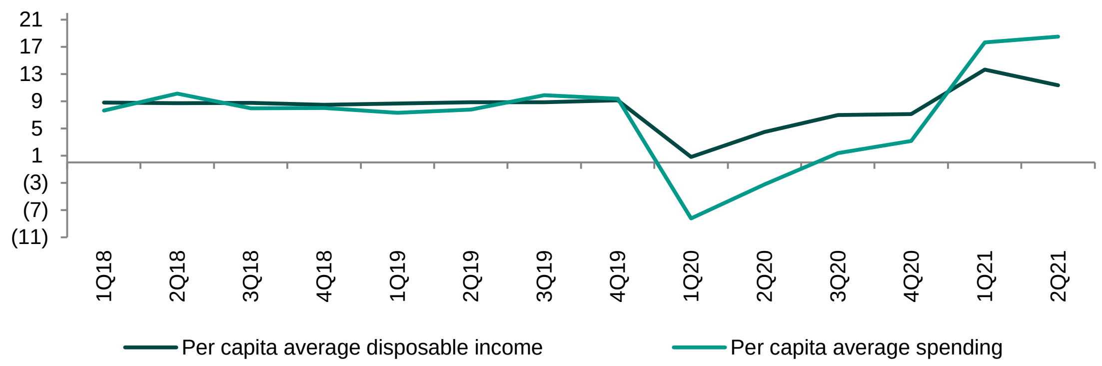
Prolonged pandemic risk

Recent COVID-19 cases in various regions in China show the potential of another major outbreak with the emergence of new variants. Disruption of offline teaching for the formal education and after-school education players would slash revenue growth.

Macroeconomic risk

Recovery of the per capita average disposable income/spending has been uneven, with spending growth exceeding the income growth in the first two quarters in 2021. If the trend continues, the sustainability of recovery will be in question. In addition, the spending on "Education, cultural, & entertainment services" was 9.76% of overall spending in 1H21 vs. 10.0% in 1H19, showing that spending on education after the pandemic may have not been fully resumed.

Exhibit 13: Growth of per capita average disposable income/spending (YoY %)



Source(s): NBS, ABCI Securities

Exhibit 14: Per capita average spending on "Education, cultural, & entertainment services" (RMB, YTD)

	1Q19	1H19	9M19	2019	1Q20	1H20	9M20	2021	1Q21	1H21
Average spending	5,538	10,330	15,464	21,559	5,082	9,718	14,923	21,210	5,978	11,471
Average spending on "Education, cultural, & entertainment services"	548	1,033	1,766	2,513	350	664	1,276	2,032	545	1,119

Source(s): NBS, ABCI Securities

Demographic risk

The number of newborns in China was 12mn in 2020, marking the fourth year of decline. The government has announced the three-child policy that allows couples to have three children. However, if the willingness to bear children remains lows, the potential demographic shift would imply long-term decline in student enrollment.

Education quality risk

Education quality is crucial for student retention and new student recruitment. If education players fail to maintain the education quality of the courses offered, students may switch to competitors – this is especially true for the after-school education providers.

Operational risk

The daily operations of education institutions involve unpredictable incidents, which include, but not limited to, accidents on campus and teacher/student's academic/personal misconducts, which may tarnish reputation.

Non-GAAP financial metrics

Some education players also disclose non-GAAP financial metrics, which exclude the impact of share-based compensation expenses on operating costs and expenses. Investors should be cautious on the discrepancies between the reported figures and the non-GAAP figures when interpreting the financial metrics.

Lack of dividend payout

Some education players lack a consistent track record of dividend payout. Since dividend payout would affect the total return to investors, companies not distributing dividends are generally considered to be less appealing.

EPS dilution risk

Some players in the industry recently conducted secondary listing or issuance of new shares; the increase in the number of shares would lead to EPS dilution.

Leverage risk

Certain players have increased their leverage, which would increase the finance costs and pressure margins.

CEG (839 HK)

New acquisition expands scale

- Acquisition of Sichuan University Jincheng College enhances scale; the Group will pay RMB 2,446mn (both cash & shares) for 51% of the equity and issue new shares at HK$ 15.688 for the transaction
- Policy environment turns favorable to higher education segment
- Expect revenue FY20-23E CAGR to reach 25.7%
- Maintain **BUY**; current TP represents 37.08x/28.02x 21E/22E P/E or 3.62x/3.42x FY21E/22E P/B

Company Report

Aug 23, 2021
Rating: BUY
TP: HK$ 22.6

Analyst: Paul Pan
Tel: (852) 2147 8829
Email: paulpan@abci.com.hk

Acquisition of Sichuan University Jincheng College to expand student enrollment and growth. According to the Group, Jincheng College has a strong qualification among peers: 1) ranked third among all independent colleges and first among all private independent colleges in terms of student enrollment in school year of 2020/21; 2) its sponsor school, Sichuan University, is a member of the national Project 985, Project 211, and the Double-Fist-Class University Plan; CEG is the first listed higher education company that acquires an independent college sponsored by such a high-caliber university; 3) its student enrollment was ~ 26k for 2020/21 school year, which represents 12.7% of the Group's student enrollment as of Feb 2021 (205.3k); 4) it runs programs in the first-tier admission and its admission score for Gaokao is the highest among private higher education institutions in Sichuan; 5) it has obtained approval for conversion and completed the conversion process, meaning that no more sponsor fees or break-up fees are required in the future and the Group can commence projects immediately after the acquisition. The Group will pay a total consideration of RMB 2,446mn for 51% of the equity - 68.5% (RMB 1,675.8mn) would be settled in cash while the rest (RMB 770mn) would be settled by the Group's share. The implied EV/EBITDA is 12.7x. The Group has planned to issue 58,996,455 new shares at HK$ 15.688 for the acquisition. It expects the acquisition would be completed in a month. With the acquisition of Jincheng College to be completed in a month, we expect full consolidation would start in FY22E. Based on our estimates, the Group's revenue in FY21E and FY22E would grow by 42.2% YoY and 28.6%; revenue CAGR in FY20E-23E would be 25.7%, supported by revenue per student and enrollment CAGRs at 19.6% and 5.1%. Moreover, we expect margins to benefit from conversion of portfolio independent colleges and higher operating efficiency; GPM and NPM (to shareholders of the Company) would improve to 63.2% and 34.2% in FY23E.

Reduced policy risk facilitates growth. MOE's announcement of the "Revised Implementation Measures for the Law on the Promotion of Private Education" has provided the legal framework for the operation of higher education players. For details of the policy, please see industry discussion in the previous session. As the policy uncertainty for higher education industry has receded, we believe the Group would implement more growth strategies, including M&A.

Maintain BUY; TP at HK$ 22.6. The Group once again demonstrated its execution capability in acquisitions, which would further strengthen its leading position among the higher education players. Maintain **BUY**. Our DCF-derived TP represents 37.08x/28.02x 21E/22E P/E or 3.62x/3.42x 21E/22E P/B.

Risk factors: 1) Growth risk; 2) Acquisition risk; 3) Cost risk; 5) Education quality and student dropout risk; 6) Expansion risk; 7) Regulatory risk; 8) Liquidity risk; 9) Prolonged pandemic risk.

Results and Valuation

FY ended Aug 31	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	1,955	2,678	3,809	4,897	5,314
Chg (YoY %)	51.1	37.0	42.2	28.6	8.5
Total Net Profit – to shareholders of the Company (RMB mn)	593	633	1,155	1,569	1,819
Chg (%,YoY)	18.6	6.8	82.5	35.8	16.0
Basic EPS (RMB cents)	29.33	31.28	50.83	67.27	78.00
Change (YoY %)	18.6	6.6	62.5	32.3	16.0
P/E (x)	38.27	35.89	22.09	16.69	14.39
BVPS (RMB cents)	326.43	398.72	521.19	551.08	601.02
P/B (x)	3.44	2.82	2.15	2.04	1.87
Dividend (HK cents)	12.50	27.30	21.92	29.01	33.63
Dividend yield	1.1	2.4	2.0	2.6	3.0
ROAA (%)	5.7	4.3	5.2	6.5	6.8
ROAE (%)	9.3	8.3	11.3	12.7	13.5

Source(s): The Group, ABCI Securities estimates

Share price (HK$)	13.46
52WK H/L (HK$)	20.8/11.3
Est. share price return	67.90%
Est. dividend yield	1.95%
Est. total returns	69.86%
Previous rating&TP	BUY/HK$ 20.0
Previous report date	Jan 29, 2021

Source(s): Bloomberg, ABCI Securities estimates

Key data

Issued shares (mn)	2,272.95
Mkt cap (HK$ mn)	30,593.93
3-mth avg ADT (HK$mn)	124.28
Shareholding (%)	
Yu Guo	33.0
Xie Ketao	33.0

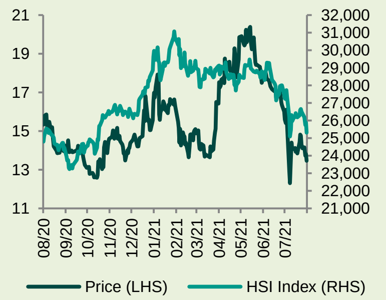
Source(s): Bloomberg, the Group, ABCI Securities

Price performance (%)

	Absolute	Relative (HSI)*
1-mth	(15.88)	(8.07)
3-mth	(32.23)	(21.97)
6-mth	(16.48)	(0.75)

Source(s):Bloomberg

1-yr price performance



Source(s):Bloomberg, ABCI Securities

Note: market data as of Aug 19, 2021
RMB/HKD= 1.1989

Exhibit 1: Changes in assumptions, projections, and valuations

	Current report		Previous report		Rationale
FY ends at Aug 31	FY21E	FY22E	FY21E	FY22E	
Assumptions					
D/E (%)	60.0	60.6	43.0	42.1	Adjusted based on latest financial figures
D/A (%)	29.0	29.5	23.3	23.8	
Tax rate (%)	2.6	2.6	2.6	2.6	N/A
Valuations					
TP (HK$)	22.6		20.0		Increase in TP and valuation due to higher growth projections with the new acquisition
P/E (x)	37.08	28.02	32.88	24.57	
P/B (x)	3.62	3.42	3.35	3.08	

Note: Previous report was published on Jan 29, 2021
Source(s): The Group, ABCI Securities estimates

Exhibit 2: Changes in major forecasts

	Current report			Previous report			Change (%)		
FY ends at Aug 31	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue (RMB mn)	3,809	4,897	5,314	3,809	4,355	4,709	0.0	12.4	12.9
Net profit (to owners of the Company) (RMB mn)	1,155	1,569	1,819	1,155	1,546	1,750	0.0	1.5	3.9
EPS (RMB cent)	50.83	67.27	78.00	50.84	68.04	77.00	0.0	(1.1)	1.3

Source(s): ABCI Securities estimates

Financial statements

Consolidated income statement

FY ends at Aug 31 (RMB mn otherwise specified)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	**1,955**	**2,678**	**3,809**	**4,897**	**5,314**
- Tuition fees	1,774	2,453	3,444	4,424	4,797
- Boarding fees	153	180	236	301	323
- Ancillary services	27	45	129	172	194
COGS	(833)	(1,077)	(1,563)	(1,824)	(1,953)
Gross profit	**1,121**	**1,601**	**2,246**	**3,073**	**3,361**
Selling expenses	(53)	(135)	(158)	(202)	(219)
Admin expenses	(353)	(372)	(555)	(720)	(770)
Others	38	(272)	(39)	77	103
Finance costs	(86)	(93)	(302)	(407)	(389)
Pretax profit	**668**	**730**	**1,192**	**1,821**	**2,085**
Tax	19	(19)	(31)	(47)	(54)
Net profit	**687**	**710**	**1,161**	**1,774**	**2,032**
- Profit attributable to shareholders	593	633	1,155	1,569	1,819
- Minority interest	95	77	6	205	213
Dividend	**253**	**570**	**416**	**564**	**654**
EPS (RMB cents)					
- Basic	29.33	31.28	50.83	67.27	78.00
- Diluted	29.20	31.05	43.00	57.13	66.24
DPS (HK cents)	12.50	27.30	21.92	29.01	33.63

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

FY ends at Aug 31 (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Bank balances and cash	3,497	3,443	3,677	776	1,203
Trade receivables, deposits, prepayments and other receivables	571	594	830	909	997
Others	839	1,004	2,738	1,472	1,355
Current assets	**4,906**	**5,041**	**7,245**	**3,157**	**3,554**
PP&E	5,851	6,847	10,865	15,921	17,353
LT Prepaid lease payment	1,051	0	0	0	0
Goodwill	1,566	1,792	3,305	3,845	3,845
Intangible assets	1,708	2,299	3,338	3,439	3,542
Others	257	1,996	1,535	2,208	2,467
Non-current assets	**10,433**	**12,934**	**19,043**	**25,412**	**27,207**
Total assets	**15,339**	**17,975**	**26,288**	**28,570**	**30,761**
ST Contracted liabilities	1,617	1,239	1,814	1,835	2,024
ST Borrowing	285	292	1,359	1,386	1,400
Trade payables, other payables and accrued expenses	1,530	1,480	2,089	2,208	2,105
Others	297	368	498	535	566
Current liabilities	**3,729**	**3,379**	**5,760**	**5,964**	**6,094**
LT Borrowing	1,838	2,387	4,046	4,982	5,753
Convertible bonds	2,144	2,428	2,210	2,055	1,911
Others	620	874	1,584	1,670	1,727
Non-current liabilities	**4,602**	**5,689**	**7,839**	**8,707**	**9,391**
Equity to owners of the Company	6,595	8,573	11,846	12,851	14,015
Minority interest	414	334	843	1,048	1,261
Equity	**7,008**	**8,907**	**12,689**	**13,899**	**15,276**
Total liabilities and equity	**15,339**	**17,975**	**26,288**	**28,570**	**30,761**

Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement

FY ends at Aug 31 (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net profit for the period	668	730	1,192	1,821	2,085
Depreciation	236	322	606	931	1,084
Change in working capital	44	(549)	30	290	203
Others	193	408	271	359	336
Cash flow from operating activities	**1,141**	**911**	**2,099**	**3,401**	**3,708**
Capex	(808)	(969)	(2,048)	(2,900)	(1,220)
Others	(1,460)	(1,622)	(4,065)	(3,236)	(1,663)
Cash flow from investing activities	**(2,268)**	**(2,591)**	**(6,113)**	**(6,135)**	**(2,883)**
Change in borrowings	1,074	594	2,508	809	640
Interest paid	(32)	(139)	(302)	(407)	(389)
Others	1,768	1,175	2,048	(564)	(654)
Cash flow from financing activities	**2,810**	**1,630**	**4,254**	**(162)**	**(403)**
Net change in cash	**1,684**	**(49)**	**240**	**(2,896)**	**422**
Cash and cash equivalent - beg	1,738	3,497	3,391	3,677	776
ForEx impact	74	(56)	45	(5)	5
Cash and cash equivalent - end	**3,497**	**3,391**	**3,677**	**776**	**1,203**

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

FY ends at Aug 31	FY19A	FY20A	FY21E	FY22E	FY23E
Growth (YoY %)					
Revenue	51.1	37.0	42.2	28.6	8.5
- Tuition fees	51.3	38.3	40.4	28.4	8.4
- Boarding fees	51.5	17.4	30.9	27.5	7.5
- Ancillary services	25.4	65.2	184.9	33.9	12.7
Gross profit	40.7	42.8	40.3	36.8	9.4
Pretax profit	17.9	9.2	63.4	52.8	14.5
Total net profit (to owners of the Company)	18.6	6.8	82.5	35.8	16.0
Profitability ratios (%)					
GPM	57.4	59.8	59.0	62.8	63.2
Pretax margin	34.2	27.2	31.3	37.2	39.2
Total NPM (to shareholders of the Company)	30.3	23.6	30.3	32.0	34.2
Revenue contribution (%)					
Tuition fees	90.7	91.6	90.4	90.3	90.3
Boarding fees	7.9	6.7	6.2	6.1	6.1
Ancillary services	1.4	1.7	3.4	3.5	3.7
Return ratios (%)					
ROAA	5.7	4.3	5.2	6.5	6.8
ROAE	9.3	8.3	11.3	12.7	13.5
Liquidity ratio (x)					
Current ratio	1.3	1.5	1.3	0.5	0.6
Cash ratio	0.9	1.0	0.6	0.1	0.2
Leverage ratios (%)					
Total debt to Equity	60.9	57.3	60.0	60.6	59.3
Total debt to Total assets	27.8	28.4	29.0	29.5	29.5
Net debt/(cash) to Equity	11.0	18.7	31.0	55.0	51.5
Net debt/(cash) to total assets	5.0	9.3	15.0	26.8	25.6

Source(s): The Group, ABCI Securities estimates

Edvantage Group (382 HK)
9M21 revenue growth reached 47.9% YoY

- 9M21 revenue and student enrollment grew 47.9% YoY and 76.2% YoY, attributable to increased vocational education revenue and consolidation of the two acquired schools in Sichuan
- Supportive policy environment will benefit the Group
- Expect revenue CAGR of 34.8% in FY20-23E
- Maintain **BUY**; current TP implies 27.36x/18.62x 21E/22E P/E, or 4.52x/3.64x 21E/22E P/B

Company Report

Aug 23, 2021
Rating: BUY
TP: HK$ 13.1

Analyst: Paul Pan
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9M21 performance demonstrates ability to deliver growth. In 9M21, the Group's revenue and student enrollment reached RMB 901.3mn and 62,442, representing growth of 47.9% YoY and 76.2% YoY; gross profit grew by 50.3% YoY and GPM reached 49.9%. According to the Group, the high growth can be attributable to: 1) consolidation of the two acquired Sichuan schools (Sichuan Vocational College and Sichuan Technician College); 2) 9M21 revenue from vocational education grew 270% YoY. We expect revenue growth to be supported by the continuous expansion resulting from the conversion of Huashang College, the two new campuses located in Sihui, Zhaoqing City, and Xinhui District, Jiangmen City, Guangdong, and the development of the two acquired schools in Sichuan. We maintain our previous forecasts and project a revenue CAGR of 34.8% in FY20-23E, supported by the CAGRs of student enrollment and revenue per student at 32.3% and 1.9%. We also expect margins to improve - GPM and NPM (to shareholders of the Company) would reach 56.0% and 40.0% in FY23E.

Supportive policy environment beneficial to the Group's future development. The announcement of "Revised Implementation Measures for the Law on the Promotion of Private Education" lays out the legal framework for development of higher education segment and reaffirms the government's supportive stance. Policies to develop vocational education and encourage conversion of independent colleges would provide additional benefits to the higher education players.

Maintain BUY; TP at HK$ 13.1. As the "Revised Measures" has been announced, policy uncertainty for the higher education segment has receded. We believe the Group would benefit from the supportive policy environment. Maintain **BUY**. Our DCF-derived TP represents 27.36x/18.62x 21E/22E P/E, or 4.52x/3.64x 21E/22E P/B.

Risk factors: 1) Growth risk; 2) Acquisition risk; 3) Education quality risk; 4) Regulatory risk; 5) Prolonged pandemic risk; 6) EPS dilution effect from share placement.

Results and Valuation

FY ended Aug 31	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	704	800	1,230	1,669	1,958
Change (YoY %)	10.7	13.6	53.7	35.7	17.3
Net Profit – to owners of the Company (RMB mn)	217	291	429	630	783
Change (YoY %)	34.1	34.5	47.0	46.9	24.3
Basic EPS (RMB cent)	27.68	28.66	39.98	58.75	73.02
Change (YoY %)	28.4	3.5	39.5	46.9	24.3
P/E (x)	15.88	15.34	10.99	7.48	6.02
BVPS (RMB cent)	157.67	180.18	242.03	300.77	373.79
P/B (x)	2.79	2.44	1.82	1.46	1.18
Dividend (HK cent)	1.00	9.80	17.24	25.33	31.48
Dividend yield	0.2	1.9	3.3	4.8	6.0
ROAA (%)	8.1	8.8	9.6	10.7	11.2
ROAE (%)	19.4	18.9	19.4	21.6	21.6

Source(s): The Company, ABCI Securities estimates

Share price (HK$)	5.27
52WK H/L (HK$)	10.68/4.8
Est. share price return	148.84%
Est. dividend yield	3.27%
Est. total returns	152.11%
Previous rating/TP	BUY / HK$ 13.1
Previous report date	Jan 29, 2021

Source(s): Bloomberg, ABCI Securities estimates

Key data

Issued shares (mn)	1,071.86
Mkt cap (HK$ mn)	5,648.70
3-month ADT(HK$mn)	13.88
Major shareholding (%)	
Debo Education Investment HLD	70.07

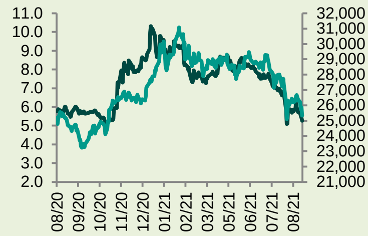
Source(s): Bloomberg, the Group

Price performance (%)

	Absolute	Relative*
1-mth	(21.34)	(13.54)
3-mth	(37.78)	(27.52)
6-mth	(42.59)	(26.86)

* Relative to HSI
Source(s):Bloomberg

1-yr price performance



Source(s):Bloomberg, ABCI Securities

Note: Market data as of Aug 19, 2021
RMB/HKD=1.1989

Exhibit 1: Changes in assumptions and valuations

FY ends at Aug 31	Current report FY21E	Current report FY22E	Previous report FY21E	Previous report FY22E	Rationale
Assumptions					
D/E (%)	30.1	28.5	37.3	33.3	Adjusted based on latest available financial figures
D/A (%)	15.6	16.1	17.0	17.3	
Tax rate (%)	7.9	7.9	7.9	7.9	N/A
Valuations					
TP (HK$)	13.1		13.1		The combined effect of lower leverage and lower profit level results in unchanged TP and higher valuation multiple
P/E (x)	27.36	18.62	25.66	17.44	
P/B (x)	4.52	3.64	4.99	3.88	

Note: Previous report was published on Jan 29, 2021
Source(s): The Group, ABCI Securities estimates

Exhibit 2: Changes in major forecasts

FY ends at Aug 31	Current report FY21E	Current report FY22E	Current report FY23E	Previous report FY21E	Previous report FY22E	Previous report FY23E	Change (%) FY21E	Change (%) FY22E	Change (%) FY23E
Revenue (RMB mn)	1,230	1,669	1,958	1,230	1,669	1,958	0.0	0.0	0.0
Net profit (to owners of the Company) (RMB mn)	429	630	783	457	672	837	(6.2)	(6.3)	(6.5)
EPS (RMB cent)	39.98	58.75	73.02	42.64	62.73	78.08	(6.2)	(6.4)	(6.5)

Source(s): ABCI Securities estimates

Financial statements

Consolidated income statement

FY ends at Aug 31 (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	**704**	**800**	**1,230**	**1,669**	**1,958**
- Tuition fees	647	763	1,116	1,513	1,773
- Boarding fees & other services	57	37	114	156	185
Cost of sales	(362)	(404)	(602)	(774)	(862)
Gross profit	**342**	**396**	**628**	**895**	**1,096**
Selling expenses	(7)	(8)	(12)	(16)	(19)
Admin expenses	(82)	(110)	(146)	(197)	(232)
Others	17	46	46	68	84
Finance costs	(28)	(16)	(21)	(22)	(25)
Pretax profit	**243**	**308**	**495**	**727**	**904**
Tax	(28)	(16)	(39)	(57)	(72)
Net profit (continuing operation)	**215**	**291**	**456**	**670**	**833**
- Owners	209	291	456	670	833
- MI	6	0	0	0	0
Net profit/losses from discontinued operations	**7**	**0**	**0**	**0**	**0**
- Owners	7	0	0	0	0
- MI	(0)	0	0	0	0
Total net profit	**223**	**291**	**456**	**670**	**833**
- Owners	217	291	429	630	783
- MI	6	0	27	40	50
Dividend	**10**	**96**	**154**	**226**	**281**
EPS (RMB cent)					
- Basic	27.68	28.66	39.98	58.75	73.02
- Diluted	27.68	28.62	37.12	54.54	67.78
DPS (HK cent)	1.00	9.80	17.24	25.33	31.48

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

FY ends at Aug 31 (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Bank balances and cash	1,352	1,186	1,645	1,628	2,210
Financial assets at fair value through profit or loss	253	88	93	99	105
Trade receivables, deposits, prepayments and other receivables	32	58	82	106	115
Others	58	4	1	1	1
Current assets	**1,695**	**1,336**	**1,821**	**1,834**	**2,431**
PP&E	1,180	1,660	3,120	3,677	4,541
Prepaid lease payments	199	0	0	0	0
Others	53	533	998	1,114	1,296
Non-current assets	**1,432**	**2,193**	**4,118**	**4,791**	**5,838**
Total assets	**3,127**	**3,528**	**5,939**	**6,625**	**8,269**
Contracted liabilities	682	623	1,345	1,136	1,645
ST Borrowing	166	290	268	315	359
Others	171	178	320	371	452
Current liabilities	**1,019**	**1,092**	**1,934**	**1,821**	**2,456**
Deferred tax liabilities	113	119	220	245	297
LT Borrowing	390	457	658	753	864
LT lease liabilities	0	26	49	57	71
Non-current liabilities	**502**	**601**	**927**	**1,056**	**1,232**
Shareholders' equity	1,606	1,835	2,594	3,224	4,006
MI	0	0	484	524	574
Equity	**1,606**	**1,835**	**3,078**	**3,748**	**4,581**
Total liabilities and equity	**3,127**	**3,528**	**5,939**	**6,625**	**8,269**

Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement

FY ends at Aug 31 (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Profit for the period	223	291	456	670	833
Depreciation and amortization	64	58	85	98	106
Change in working capital	130	(83)	828	(232)	587
Others	6	38	44	57	69
Cash flow from operating activities	**423**	**305**	**1,413**	**593**	**1,596**
Change in PP&E	(102)	(321)	(950)	(485)	(609)
Others	534	(220)	(744)	7	7
Cash flow from investing activities	**433**	**(541)**	**(1,693)**	**(479)**	**(603)**
Change in borrowing	(227)	191	179	142	155
Others	559	(114)	560	(273)	(568)
Cash flow from financing activities	**332**	**78**	**740**	**(131)**	**(413)**
Net change in cash	**1,188**	**(158)**	**460**	**(17)**	**580**
Cash and cash equivalent - beg	149	1,352	1,186	1,645	1,628
ForEx impact	16	(8)	(1)	0	2
Cash and cash equivalent - end	**1,352**	**1,186**	**1,645**	**1,628**	**2,210**

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

FY ends at Aug 31	FY19A	FY20A	FY21E	FY22E	FY23E
Growth (YoY %)					
Revenue	10.7	13.6	53.7	35.7	17.3
- Tuition fees	11.6	17.8	46.3	35.6	17.2
- Boarding fees	0.8	(34.5)	205.0	36.9	18.3
Gross profit	17.9	15.7	58.4	42.5	22.5
Pretax profit	8.2	26.6	60.7	46.9	24.4
Total net profit (to shareholders of the company)	34.1	34.5	47.0	46.9	24.3
Profitability ratios (%)					
GPM	48.6	49.5	51.0	53.6	56.0
Pretax profit	34.5	38.5	40.2	43.6	46.2
Total NPM (to shareholders of the company)	30.8	36.4	34.8	37.7	40.0
Return ratios (%)					
ROAA	8.1	8.8	9.6	10.7	11.2
ROAE	19.4	18.9	19.4	21.6	21.6
Liquidity ratio (x)					
Current ratio	1.7	1.2	0.9	1.0	1.0
Cash ratio	1.3	1.1	0.9	0.9	0.9
Leverage ratios (%)					
Total debt to Equity	34.6	40.7	30.1	28.5	26.7
Total debt to Total assets	17.8	21.2	15.6	16.1	14.8
Net debt to Equity	(49.6)	(23.9)	(23.3)	(14.9)	(21.6)
Net debt to Total assets	(25.5)	(12.4)	(12.1)	(8.4)	(11.9)

Source(s): The Group, ABCI Securities estimates

New Oriental (EDU US / 9901 HK)
New policy to weigh on growth; downgrade to HOLD

- New policies to lessen academic burdens (especially in compulsory education or G1-9) will change the competitive landscape of the after-school education industry. Available course hours will be significantly slashed since academic subject tutoring is prohibited on weekends, public holidays, and summer/winter vacations; expansion through M&A for academic subject tutoring providers is also prohibited
- We lower revenue projection in the short term due to the new policies with FY20-23E revenue CAGR at 0.8%
- Downgrade to **HOLD**; current TP represents 7.25x/7.67x 21E/22E P/E, or 0.67x/0.61x 21E/22E P/B

Company Report

Aug 23, 2021

Rating (US): HOLD
Rating (HK): HOLD
TP (US): US$ 1.97
TP (HK): HK$ 15.4

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Policy to weigh on performance. The recently announced "Opinion on Reducing In-school and After-school Education Burdens for Students in Compulsory Education" (《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》) ("Opinion") states that academic subject tutoring for G1-9 students will be prohibited on weekends, public holidays, and summer/winter vacations; according to "Notice on On-campus Post-school Activities in Compulsory Education Schools" issued by the Department of Education of Guangdong Province (《广东省教育厅关于进一步做好义务教育校内课后服务工作的通知》), academic subject tutoring will not be allowed for on-campus post-school activities. The reduced available course hours would mean lower revenue growth in the short term. In addition, academic subject tutoring institutions are required to register as not-for-profit organization, which will limit their ability to distribute profits. Moreover, the "Opinion" also prohibits after-school education institutions to pursue listing or financing through capital market; listed institutions are also prohibited from using cash reserve or funds from share issuance to acquire academic tutoring institutions. The "Opinion" would greatly alter the competitive landscape of the after-school education industry and possibly lead to a new era of consolidation. The Group's focus on academic subject tutoring means business would suffer under the new policy.

Lower revenue projection due to new policy. The reduction of available course hours will mean reduced enrollment and income for its existing K-12 tutoring business The Group needs to seek out new growth drivers, such as non-academic subject tutoring, professional training, or language training, among others. Assuming the Group maintains the current business portfolio in our projection horizon and 50% decline of projected student enrollment per year as a result of the new policies, FY20-23E revenue CAGR would be 0.8% (previous: 28.8%).

Downgrade to HOLD; TP at US$1.97/HK$15.4. We reduced our DCF-derived TP because the Group has conducted a 10-for-1 share subdivision and we project lower revenue forecasts as a result of the policy change. Current TP represents 7.25x/7.67x 21E/22E P/E, or 0.67x/0.61x 21E/22E P/B.

Risk factors: 1) Macroeconomic risk; 2) Regulatory risk; 3) Pandemic risk; 4) Demographic risk; 5) Rapidly changing industry; 6) Education quality risk; 7) Expansion risk; 8) Seasonality of business; 9) Concentration risk; 10) Non-GAAP financial metrics; 11) Lack of dividend payout; 12) EPS dilution from new share issuance.

Results and Valuation

FY ended May 30	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (US$ mn)	3,096	3,579	4,242	2,757	3,667
Chg (%,YoY)	26.5	15.6	18.5	(35.0)	33.0
Net profit (US$ mn)[1]	238	413	460	434	425
Chg (%,YoY)	(19.6)	73.6	11.2	(5.5)	(2.1)
EPS (US$)	0.15	0.26	0.27	0.26	0.25
Chg (%,YoY)	(19.8)	74.0	4.2	(5.5)	(2.1)
BVPS (US$)	1.5	1.7	3.0	3.2	3.5
Chg (%,YoY)	18.4	15.8	71.1	8.7	7.8
P/E (x) – US	12.07	6.93	6.65	7.04	7.19
P/E (x) – HK	11.93	6.86	6.58	6.96	7.11
P/B (x)– US	1.21	1.05	0.61	0.56	0.52
P/B (x) – HK	1.20	1.04	0.61	0.56	0.52
ROAA (%)	5.3	6.3	4.5	4.1	4.4
ROAE (%)	10.9	16.2	11.9	8.3	7.5
DPS (US$)	0	0	0	0	0
Yield (%) - US	0.0	0.0	0.0	0.0	0.0
Yield (%) - HK	0.0	0.0	0.0	0.0	0.0

Note: Each ADS represents one common share
Source(s): The Group, ABCI Securities estimates

Price (US/HK)	US$ 1.81/HK$ 13.94
Est. price return (US/HK)	8.97%/10.22%
Est. dividend yield (US/HK)	0.0%/0.0%
Est. total return (US/HK)	8.97%/10.22%
Last Rating &TP (US/HK)	BUY/US$222.3, HK$1,722.9
Previous Report Date	Jan 29, 2021

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (US$) (US shr)	19.974/1.74
52Wk H/L (HK$) (HK shr)	158.8/13.52
Total issued shares (mn)	1,689.7
Issued US shr (mn)	1,679.9
Issued HK shr(mn)	9.8
US-shr market cap (US$ mn)	3,041
H-shr market cap (HK$ mn)	137
3-mth avg daily turnover (US$ mn) (US shr)	349.73
Avg daily turnover since IPO (HK$ mn) (HK shr)	262.49
Major shareholder(s) (%):	
Minhong Yu	11.5

Source(s): Bloomberg, ABCI Securities

Price performance – US (%)

	Absolute	Relative*
1-mth	(69.01)	(72.60)
3-mth	(84.36)	(91.78)
6-mth	(90.61)	(104.19)

*Relative to S&P 500 Index
Source(s): Bloomberg, ABCI Securities

Price performance – HK (%)

	Absolute	Relative*
1-mth	(69.60)	(62.29)
3-mth	(84.51)	(74.39)
6-mth	(90.80)	(74.81)

*Relative to HSI
Source(s): Bloomberg, ABCI Securities

Note:
1) refers to net profit to shareholders of the Company ;
2) US$/HK$= 7.7900;
3) Market data as of Aug 19, 2021

Exhibit 1: Changes in assumptions and valuations

As of May 31	Current report FY21E	Current report FY22E	Previous report FY21E	Previous report FY22E	Rationale
Assumptions					
D/E (%)	5.8	5.4	6.0	5.2	Adjusted based on 3Q21 data
D/A (%)	2.8	3.3	2.8	2.5	
Tax rate (%)	26.8	26.5	26.8	26.5	N/A
Valuations					
TP (US$)	1.97		222.3		TP and valuation are reduced due to the 10-for-1 share subdivision by the Group and lower revenue growth forecasts
TP (HK$)	15.4		1,722.9		
P/E (x)	7.25	7.67	90.68	58.68	
P/B (x)	0.67	0.61	7.73	6.83	

Note: Previous report was published on Jan 29, 2021
Source(s): The Group, ABCI Securities estimates

Exhibit 2: Changes in major forecasts

As of May 31	Current report FY21E	Current report FY22E	Current report FY23E	Previous report FY21E	Previous report FY22E	Previous report FY23E	Change (%) FY21E	Change (%) FY22E	Change (%) FY23E
Revenue (US$ mn)	4,242	2,757	3,667	4,342	5,669	7,582	(2.3)	(51.4)	(51.6)
Net profit (to owners of the Company) (US$ mn)	460	434	425	417	645	977	10.2	(32.6)	(56.4)
EPS (US$)	0.27	0.26	0.25	2.45	3.79	5.74	(88.9)	(93.2)	(95.6)

Source(s): ABCI Securities estimates

Financial statements

Consolidated income statement

As of May 31 (US$ mn, except per share data)	FY19A	FY20A	FY21E	FY22E	FY23E
Net revenue	**3,096**	**3,579**	**4,242**	**2,757**	**3,667**
Cost of revenue	(1,376)	(1,589)	(1,974)	(1,278)	(1,733)
Gross profit	**1,720**	**1,990**	**2,268**	**1,479**	**1,934**
Selling and marketing expenses	(384)	(445)	(541)	(341)	(450)
General and admin expenses	(1,034)	(1,146)	(1,389)	(837)	(1,110)
Gain/loss on disposal of subsidiaries	4	0	0	0	0
Operating profit	**306**	**399**	**337**	**301**	**375**
Other income, net	10	89	189	244	183
Profit before tax provision and gain(loss) from investments	**316**	**488**	**527**	**545**	**557**
Tax	(86)	(134)	(141)	(145)	(147)
Income/(Loss) from equity method investments	(2)	1	(1)	(1)	(1)
Net profit	**228**	**355**	**385**	**400**	**409**
- Owners	238	413	460	434	425
- MI	(10)	(58)	(75)	(35)	(16)
Net profit per common share/ADS (US$)					
- Basic	0.15	0.26	0.27	0.26	0.25
- Diluted	0.15	0.26	0.27	0.26	0.25

Note: Each ADS represents one common share; historical and projected net profit per common share/ADS has been adjusted for the 10-for1 share subdivision
Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

As of May 31 (US$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash, cash equivalents, and restricted cash	1,414	915	2,761	2,141	1,557
ST investments	1,669	2,318	2,802	3,639	4,377
Others	383	523	1,201	535	813
Current assets	**3,466**	**3,756**	**6,764**	**6,315**	**6,747**
PP&E	532	672	766	538	572
LT investments	405	431	574	637	745
Right-of-use assets	0	1,425	1,992	1,129	1,201
Others	244	271	406	274	396
Non-current assets	**1,180**	**2,800**	**3,738**	**2,577**	**2,913**
Total assets	**4,647**	**6,557**	**10,502**	**8,892**	**9,660**
Deferred revenue	1,301	1,324	2,122	1,154	1,185
Others	705	1,155	1,396	927	1,147
Current liabilities	**2,006**	**2,479**	**3,517**	**2,081**	**2,333**
LT borrowing	96	118	297	297	297
Non-current operating lease liabilities	0	1,078	1,532	968	1,029
Others	19	12	30	5	42
Non-current liabilities	**115**	**1,208**	**1,860**	**1,270**	**1,369**
Shareholders' capital	2,361	2,737	4,995	5,430	5,855
MI	164	133	129	112	104
Total equity	**2,525**	**2,870**	**5,124**	**5,541**	**5,959**
Total liabilities and equity	**4,647**	**6,557**	**10,502**	**8,892**	**9,660**

Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement

As of May 31 (US$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net profit	228	355	385	400	409
Depreciation and amortization	114	151	160	142	132
Change in working capital	311	191	767	(951)	(79)
Others	153	107	48	26	42
Cash flow from operating activities	**806**	**804**	**1,360**	**(383)**	**504**
Change in PP&E and land use right	(260)	(285)	(393)	(447)	(410)
Change in investments	(245)	(800)	(481)	(398)	(846)
Others	(70)	(172)	(631)	402	55
Cash flow from investing activities	**(575)**	**(1,256)**	**(1,505)**	**(442)**	**(1,201)**
Change in borrowing	96	20	180	0	0
Others	170	(38)	1,769	199	135
Cash flow from financing activities	**267**	**(18)**	**1,949**	**199**	**135**
Effect of foreign exchange rate changes	(66)	(29)	48	5	(24)
Net change in cash, cash equivalent, and restricted cash	431	(499)	1,851	(623)	(586)
Cash, cash equivalent, and restricted cash - end	**1,418**	**919**	**2,771**	**2,148**	**1,563**

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

As of May 31	FY19A	FY20A	FY21E	FY22E	FY23E
Growth (YoY %)					
Net revenue	26.5	15.6	18.5	(35.0)	33.0
Gross profit	24.5	15.7	14.0	(34.8)	30.8
Operating profit	16.2	30.6	(15.4)	(10.8)	24.5
Net profit (to shareholders of the Company)	(19.6)	73.6	11.2	(5.5)	(2.1)
Profitability ratios (%)					
GPM	55.6	55.6	53.5	53.6	52.7
OPM	9.9	11.1	8.0	10.9	10.2
NPM (to owners of the Company)	7.4	9.9	9.1	14.5	11.2
Non-GAAP OPM	12.2	12.9	9.5	12.4	11.6
Non-GAAP NPM (to owners of the Company)	13.3	13.5	12.4	17.3	13.0
Return ratios (%)					
ROAA	5.3	6.3	4.5	4.1	4.4
ROAE	10.9	16.2	11.9	8.3	7.5
Liquidity ratio (x)					
Current ratio	1.7	1.5	1.9	3.0	2.9
Cash ratio	0.8	0.5	1.0	1.3	0.9
Leverage ratios (%)					
Total debt to Equity	3.8	4.1	5.8	5.4	5.0
Total debt to Total assets	2.1	1.8	2.8	3.3	3.1
Net debt/(cash) to Equity	(56.5)	(37.7)	(66.0)	(42.5)	(28.8)
Net debt/(cash) to Total assets	(30.7)	(16.5)	(32.2)	(26.5)	(17.8)

Source(s): The Group, ABCI Securities estimates

TAL (TAL US)

Lower growth outlook expected; downgrade to HOLD

- New policies targeting the after-school education industry will reduce the available course hours and limit the ability of players in raising funds in capital market for expansion via M&A
- The Group's business model focusing on K-12 academic tutoring will be adversely affected by the new policies and finding new growth drivers become a must; in the short term, the Group would face more revenue growth volatility and we expect revenue CAGR to be 11.4% in FY21-24E
- Downgrade to **HOLD**; current TP represents 0.61x/0.62x 22E/23E P/B

Company Report

Aug 23, 2021
Rating: HOLD
TP: US$ 5.25

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New policy brings changes to industry. Under the newly announced "Opinion on Reducing In-school and After-school Education Burdens for Students in Compulsory Education" (《关于进一步减轻义务教育阶段学生作业负担和校外培训负担的意见》) ("Opinion"), academic subject tutoring for students in compulsory education (G1-9) would be heavily regulated. No academic subject tutoring is allowed during weekends, public holidays, and summer/winter vacation, meaning available course hours would be reduced significantly. The requirement for academic subject tutoring institutions to register as not-for-profit organization would limit their ability to distribute profits. In addition, the new policy also prohibits listed after-school education institutions to use cash reserves or funds from share issuance to acquire academic subject tutoring institutions, limiting the ability to grow through M&A. According to "Notice on On-campus Post-school Activities in Compulsory Education Schools" issued by the Department of Education of Guangdong Province (《广东省教育厅关于进一步做好义务教育校内课后服务工作的通知》), schools or third-party service providers cannot offer paid academic subject tutoring during on-campus post-school activities. Since the Group's business is heavily concentrated on K-12 academic subject tutoring, we believe its business will be severely impacted.

Lower revenue projection due to new policy. The Group's business relies heavily on K-12 academic subject tutoring. Its survival will be dependent on the ability to seek for new drivers Assuming the Group maintains the current business portfolio in our projection horizon and 50% decline of projected student enrollment per year as a result of the new policies, we project FY21-FY24E revenue CAGR would be 11.4%.

Downgrade to HOLD; TP at US$5.25. We downgrade the Group's rating to **HOLD** due to the lower revenue forecasts and the pervasive impacts on the Group's business under the new policies. As a result, our DCF-derived TP is lower from US$ 89.7 to US$ 5.25, which represents 0.61x/0.62x 22E/23E P/B.

Risk factors: 1) Macroeconomic risk; 2) Policy/Regulatory risk; 3) Pandemic risk; 4) Demographic risk; 5) Changing industry landscape; 6) Education quality risk; 7) Expansion risk; 8) Seasonality of business; 9) Non-GAAP financial metrics; 10) Lack of dividend payout; 11) Dual-class voting structure; 12) EPS dilution from new share issuance; 13) Potential financial distress risk caused by higher leverage.

Results and Valuation

	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (US$ mn)	3,273	4,496	3,314	4,540	6,221
Chg (YoY %)	27.7	37.3	(26.3)	37.0	37.0
Net Profit – to shareholders of the Company (US$ mn)	(110)	(116)	(22)	(6)	203
Change (%,YoY)	(130.0)	N/A	(81.4)	(73.5)	N/A
Basic net profit per common share (US$)	(0.56)	(0.57)	(0.11)	(0.03)	1.00
Change (YoY %)	(129.0)	N/A	(81.4)	(73.5)	N/A
Basic net profit per ADS (US$)	(0.19)	(0.19)	(0.04)	(0.01)	0.34
Change (YoY %)	(129.7)	N/A	(81.4)	(73.5)	N/A
P/E (x)	N/A	N/A	N/A	N/A	15.13
BVPS (US$)	12.69	25.55	25.44	25.41	26.41
P/B (x)	1.20	0.60	0.60	0.60	0.58
Dividend (US$)	0	0	0	0	0
Dividend yield (%)	0	0	0	0	0
ROAA (%)	(2.7)	(1.6)	(0.2)	(0.1)	2.4
ROAE (%)	(4.4)	(3.0)	(0.4)	(0.1)	3.8

Note: FY ends on the last day of Feb
Source(s): The Group, ABCI Securities estimates

Share price (HK$)	5.07
52WK H/L (HK$)	90.96/4.03
Est. share price return	3.64%
Est. dividend yield	0.00%
Est. total returns	3.64%
Previous rating&TP	BUY/US$ 89.7
Previous report date	Jan 29, 2021

Source(s): Bloomberg, ABCI Securities estimates

Key data

# of ADS – Class A (mn)	444.00
Class A mkt cap (US$ mn)	3,269.22
3-mth avg ADT (US$mn)	491.80
Major shareholders (%)	
Bai Yunfeng	26.4

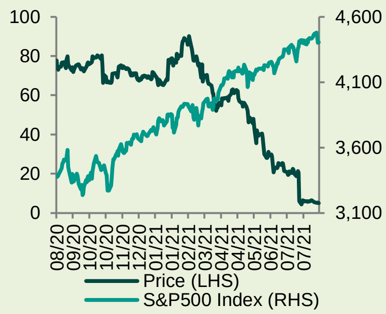
Source(s): Bloomberg, the Group, ABCI Securities

Price performance (%)

	Absolute	Relative*
1-mth	(72.89)	(76.49)
3-mth	(88.92)	(96.35)
6-mth	(94.38)	(107.96)

Note: relative to S&P 500 Index
Source(s): Bloomberg

1-yr price performance



Source(s):Bloomberg, ABCI Securities

Note: 1) Market data as of Aug 19, 2021; 2) Three ADSs represent one Class A common Share; 3) non-GAAP financial metrics exclude the impact of share-based compensation expenses on operating costs and expenses

Exhibit 1: Changes in assumptions and valuations

	Current report		Previous report		Rationale
	FY22E	FY23E	FY22E	FY23E	
Assumptions					
D/E (%)	43.5	42.7	53.1	46.6	Adjusted based on FY21 figures
D/A (%)	23.3	21.5	17.4	13.2	
Tax rate (%)	19.7	19.0	19.7	19.0	N/A
Valuations					
TP (HK$)	5.25		89.7		Lower TP was mainly due to the lower growth projections
P/E (x)	N/A	N/A	133.64	77.33	
P/B (x)	0.61	0.62	11.34	9.89	

Note: FY ends on the last day of Feb
Source(s): The Group, ABCI Securities estimates

Exhibit 2: Changes in major forecasts

	Current report			Previous report			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue (US$ mn)	3,314	4,540	6,221	6,628	9,081	N/A	(50.0)	(50.0)	N/A
Net profit (to owners of the Company) (US$ mn)	(22)	(6)	203	407	704	N/A	(105.3)	(100.8)	N/A
EPS (US$)	(0.11)	(0.03)	1.00	2.01	3.48	N/A	(105.3)	(100.8)	N/A

Note: Previous report was published on Jan 29, 2021; FY ends on the last day of Feb
Source(s): ABCI Securities estimates

Financial statements

Consolidated income statement

(US$ mn, except per share data)	FY20A	FY21A	FY22E	FY23E	FY24E
Net revenue	**3,273**	**4,496**	**3,314**	**4,540**	**6,221**
Cost of revenue	(1,469)	(2,049)	(1,486)	(1,968)	(2,663)
Gross profit	**1,805**	**2,447**	**1,829**	**2,572**	**3,557**
Selling and marketing expenses	(853)	(1,680)	(1,227)	(1,677)	(2,123)
General and admin expenses	(795)	(1,117)	(772)	(1,050)	(1,213)
Others	(20)	(88)	10	6	3
Operating profit	**137**	**(438)**	**(161)**	**(149)**	**225**
Net financial expenses	61	97	145	149	137
Other gains/(losses)	(249)	116	(11)	(4)	(56)
Pretax profit	**(51)**	**(225)**	**(27)**	**(4)**	**305**
Tax	(69)	70	5	1	(60)
Loss from equity method investments	(8)	12	(4)	(3)	(1)
Net profit	**(128)**	**(143)**	**(26)**	**(7)**	**245**
- Owners	(110)	(116)	(22)	(6)	203
- MI	(17)	(27)	(4)	(1)	41
Net profit per common share (US$)					
- Basic	(0.56)	(0.57)	(0.11)	(0.03)	1.00
- Diluted	(0.56)	(0.57)	(0.11)	(0.03)	1.00
Net profit per common ADS (US$)					
- Basic	(0.19)	(0.19)	(0.04)	(0.01)	0.34
- Diluted	(0.19)	(0.19)	(0.04)	(0.01)	0.34

Note: 1) Three ADSs represent one Class A common Share; 2) FY ends on the last day of Feb
Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

(US$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash, cash equivalents, and restricted cash	1,874	3,243	4,865	5,029	4,609
ST investments	345	2,695	1,024	975	1,134
Others	276	2,219	724	809	994
Current assets	**2,496**	**8,157**	**6,612**	**6,812**	**6,736**
Property and equipment	367	511	356	340	293
Goodwill	379	454	454	454	454
Intangible assets	59	66	10	73	13
Operating lease right-of-use assets	1,244	1,546	1,142	1,090	939
Others	1,027	1,378	1,081	1,495	1,294
Non-current assets	**3,075**	**3,955**	**3,043**	**3,453**	**2,994**
Total assets	**5,571**	**12,112**	**9,656**	**10,265**	**9,730**
ST Deferred revenue	780	1,387	648	685	684
ST Operating lease liabilities	305	383	253	198	120
Others	721	1,604	474	1,173	899
Current liabilities	**1,807**	**3,374**	**1,376**	**2,057**	**1,703**
LT borrowing & convertible bond	262	2,300	2,254	2,209	2,165
LT Operating lease liabilities	950	1,194	831	794	410
Others	9	40	16	34	35
Non-current liabilities	**1,220**	**3,534**	**3,101**	**3,037**	**2,610**
Shareholders' capital	2,516	5,202	5,180	5,175	5,378
MI	28	1	(3)	(4)	37
Total equity	**2,544**	**5,203**	**5,177**	**5,170**	**5,415**
Mezzanine equity	**0**	**2**	**2**	**2**	**2**
Total liabilities and equity	**5,571**	**12,112**	**9,656**	**10,265**	**9,730**

Note: FY ends on the last day of Feb
Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement

(US$ mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net profit	(128)	(143)	(26)	(7)	245
Depreciation and amortization	118	119	113	101	90
Change in working capital	442	910	(926)	50	282
Others	423	69	152	378	352
Cash flow from operating activities	**856**	**955**	**(686)**	**522**	**968**
Change in property and equipment	(178)	(244)	(243)	(189)	(174)
Change in investments	(86)	(2,445)	1,642	101	(183)
Others	(76)	47	(119)	(141)	(151)
Cash flow from investing activities	**(339)**	**(2,641)**	**1,280**	**(230)**	**(509)**
Change in borrowing	61	2,296	0	0	0
Others	71	2,498	(299)	(67)	(766)
Cash flow from financing activities	**131**	**4,795**	**(299)**	**(67)**	**(766)**
Effect of foreign exchange rate changes	3	(5)	13	51	25
Net change in cash, cash equivalent, and restricted cash	651	3,103	308	276	(281)
cash, cash equivalent, and restricted cash - end	**1,915**	**5,018**	**5,326**	**5,602**	**5,320**

Note: FY ends on the last day of Feb
Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

	FY20A	FY21A	FY22E	FY23E	FY24E
Growth (YoY %)					
Net revenue	27.7	37.3	(26.3)	37.0	37.0
Gross profit	29.0	35.6	(25.3)	40.7	38.3
Operating profit	(59.8)	(418.8)	(63.3)	(7.0)	N/A
Net profit (to shareholders of the Company)	(130.0)	5.3	(81.4)	(73.5)	N/A
Non-GAAP operating profit	(39.0)	(191.3)	(77.2)	(92.4)	N/A
Non-GAAP net profit (to shareholders of the Company)	(98.3)	1,048.1	(3.3)	62.4	192.0
Profitability ratios (%)					
GPM	55.1	54.4	55.2	56.7	57.2
OPM	4.2	(9.7)	(4.8)	(3.3)	3.6
NPM (to owners of the Company)	(3.4)	(2.6)	(0.7)	(0.1)	3.3
Non-GAAP OPM	7.8	(5.2)	(1.6)	(0.1)	6.9
Non-GAAP NPM (to owners of the Company)	0.2	2.0	2.6	3.1	6.6
Return ratios (%)					
ROAA	(2.7)	(1.6)	(0.2)	(0.1)	2.4
ROAE	(4.4)	(3.0)	(0.4)	(0.1)	3.8
Liquidity ratio (x)					
Current ratio	1.4	2.4	4.8	3.3	4.0
Cash ratio	1.1	1.5	3.9	2.7	3.1
Leverage ratios (%)					
Total debt to Equity	10.3	49.4	43.5	42.7	40.0
Total debt to Total assets	4.7	21.2	23.3	21.5	22.2
Net debt/(cash) to Equity	(65.0)	(47.1)	(59.3)	(65.6)	(58.3)
Net debt/(cash) to Total assets	(29.7)	(20.2)	(31.8)	(33.1)	(32.4)

Note: FY ends on the last day of Feb
Source(s): The Group, ABCI Securities estimates

Disclosures

Analyst Certification
I,Pan Hongxing, Paul, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests
ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with New Oriental.

Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate (~10%)
Hold	- Market return (-~10%) ≤ Stock return < Market return rate (+~10%)
Sell	Stock return < - Market return (-~10%)

Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2008 (HSI total return index 2008-20 CAGR at 9.2%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

Disclaimers

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