

Hong Kong

HOLD (previously ADD)

Consensus ratings*: Buy 10 Hold 1 Sell 2

Current price:	HK\$11.74
Target price:	HK\$12.60
Previous target:	HK\$130.2
Up/downside:	7.3%
CGI / Consensus:	-28.3%
Reuters:	9901.HK
Bloomberg:	9901 HK
Market cap:	US\$2,553m
	HK\$19,922m
Average daily turnover:	US\$4.05m
	HK\$31.27m
Current shares o/s:	16,455m
Free float:	85.4%

*Source: Bloomberg

Key changes in this note

- FY5/22F net profit changed to net loss.
- FY5/23F net profit changed to net loss.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-11.2	-35.1	-91.8
Relative (%)	-6	-31.1	-69

Major shareholders	% held
Mr. Michael M Yu	14.6

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New Oriental Education

Reforms on the way

- EDU reported 1H FY5/22 revenue of US\$1,967m, up by 5% yoy, and a non-GAAP net loss of US\$787m, below our expectations, because of reform measures amid the “double reduction” policy in the K–9 education segment.
- EDU will explore opportunities in the education sector, while Koolearn (1797 HK) will explore more business opportunities in the e-commerce sector. We expect EDU to continue to report a net loss in 2H FY5/22F but to be close to breakeven in FY5/23F.
- Downgrade to Hold with a new DCF-based TP of HK\$12.6. We believe the risks related to “double reduction” have been largely released, but EDU still needs time to find a more efficient way to turn around its business.

Impacted by the “double reduction” policy

EDU ended its K–9 after-school tutoring business on Jan 1, 2022. While it is still providing high school after school tutoring services, management said it will closely watch specific policies of local governments for this segment. Before the “double reduction” policy, its K–9 business accounted for 55–60% of EDU’s total revenue and the high school segment accounted for 20%. The gross margin for the period was 42.4%, dropping by 8.6% pts yoy. The selling and marketing expenses ratio and admin expenses ratio rose 13.4% pts and 31.3% pts, respectively, because of the reform measures amid the “double reduction” policy, so EDU recorded a non-GAAP net loss of US\$787m in 1H FY5/22, below our expectation. Leveraging its advantages of reputable brand recognition, strong management, and an adequate cash position (US\$4.8bn cash on hand at the end of 1H FY5/22), EDU is actively seeking reform opportunities in the education sector.

EDU reform measures

In EDU’s 1H FY5/22 results, it recorded the one-time loss for closing half to two-thirds of its learning centers and cutting over half of its staff nationwide. Thereafter, learning center closings and staff cuts will be limited to local areas. EDU’s high-school subject tutoring business was terminated in some provinces/cities. Currently, there is no unified standard from the national government regarding tutoring for high-school subjects, but EDU will comply closely with all local policies. Currently, one of EDU’s major focuses for reform measure is to actively develop its adult education business, including overseas test prep, postgraduate entrance exam prep, and English certificate exam prep, which were its core business when EDU was established in 1993. Meanwhile, EDU will continue to explore non-subject training opportunities, such as art, sports and STEAM courses, tutoring, and overseas study tour business.

Koolearn reform measures

All of Koolearn’s K–12 online education business ended. The outlook for its adult business remains unchanged, delivering 5-10% yoy growth. Currently, Koolearn’s major reform focus is live-broadcasting e-commerce, using its own live-broadcasting system and tutors as live-broadcasting hosts. EDU founder Mr. Yu Min Hong is the largest KOL for Koolearn’s live-broadcasting business. Major product categories of this business include agricultural products, liquor, dairy, food, snacks and other hot consumer products. Koolearn will establish its own supply chain for the business and make good use of its over 100k members. Another focus of Koolearn will be smart hardware, such as scan pens, which help English learning, and other learning instruments. Koolearn will also provide online education support for EDU’s “to B” business, such as providing after-school tutoring services for public schools and supporting vocational education. EDU and Koolearn are preparing to publish reputable teaching materials they developed based on their almost 30 years of teaching experience.

Financial Summary

	May-20A	May-21A	May-22F	May-23F	May-24F
Revenue (US\$m)	3,579	4,277	2,934	2,388	2,735
Operating EBITDA (US\$m)	545.3	374.7	(940.5)	16.4	276.6
Net Profit (US\$m)	413	334	(1,193)	(121)	66
Core EPS (US\$)	0.31	0.02	(0.07)	(0.00)	0.01
Core EPS Growth	18%	(93%)	(435%)	(95%)	
FD Core P/E (x)	4.9	40.1	NA	NA	196.0
DPS (US\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	3	60	NA	1,435	85
P/FCFE (x)	NA	NA	NA	NA	418.4
Net Gearing	(37.7%)	(50.4%)	(36.4%)	(34.0%)	(34.5%)
P/BV (x)	0.87	5.04	6.55	6.66	6.44
ROE	19.0%	8.8%	(26.1%)	(1.6%)	3.3%
% Change In Core EPS Estimates			(114%)	(101%)	
CGI/consensus EPS (x)			(1.39)	(0.06)	

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Reforms on the way

Downgrade to Hold with new DCF-based TP of HK\$12.6

We changed our FY5/22–23F net profit forecast to a net loss to factor in both revenue and margin pressure during the reform period. We rolled over our forecasts to FY5/24F and downgraded our rating to Hold, since we believe it will take EDU some time to explore reform measures and for the measures to bear fruit. A key positive catalyst is better cost control. A key risk is reform failure.

Figure 1: New Oriental Education earnings results

FYE May (US\$m)	1H FY5/21	1H FY5/22	yoy%
Net revenue	2,113.7	1,967.1	-6.9%
Cost of revenues	(938.1)	(1,133.7)	20.8%
Gross profit	1,175.6	833.4	-29.1%
Gross profit margin	55.6%	42.4%	-13.3% pts
Selling and marketing	(274.3)	(277.4)	1.1%
As % of revenue	-13.0%	14.1%	27.1% pts
General and administrative	(682.6)	(1,291.7)	89.2%
As % of revenue	-32.3%	65.7%	98.0% pts
Operating profit (GAAP)	218.7	(735.7)	N/A
Operating profit margin (GAAP)	10.3%	-37.4%	-47.7% pts
Operating profit (non-GAAP)	243.1	(661.4)	N/A
Operating profit margin (non-GAAP)	11.5%	-33.6%	-45.1% pts
Other income, net	98.5	(2.4)	N/A
Loss from fair value change of long-term investments	1.6	(14.3)	N/A
Profit before tax (GAAP)	318.8	(752.4)	N/A
Provision for income taxes	(80.2)	(113.8)	41.9%
Loss from equity method investments	5.3	(41.8)	N/A
Net loss (gain) attributable to noncontrolling interests	45.2	32.0	-29.2%
Net income attributable to shareholders (GAAP)	289.0	(876.0)	N/A
Net profit margin (GAAP)	13.7%	-44.5%	-58.2% pts
Net income attributable to shareholders (non-GAAP)	311.7	(787.4)	N/A
Net profit margin (non-GAAP)	14.7%	-40.0%	-54.8% pts

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 2: New Oriental Education earnings revision

US\$m	FY5/22F			FY5/23F			FY5/24F		
	Old	New	% change	Old	New	% change	Old	New	% change
Net revenue	5,512.7	2,934.3	-46.8%	6,997.9	2,387.9	-65.9%	N/A	2,734.7	N/A
Gross margin	55.5%	44.0%	-11.5% pts	56.1%	37.6%	-18.5% pts	N/A	42.8%	N/A
Operating margin (non-GAAP)	11.0%	-34.9%	-45.9% pts	12.8%	-4.2%	-17.0% pts	N/A	5.4%	N/A
Net income (GAAP)	704.0	-1,193.1	-269.5%	943.2	-120.5	-112.8%	N/A	66.3	N/A
Net income (non-GAAP)	764.0	-1,133.1	-248.3%	1,003.2	-60.5	-106.0%	N/A	126.3	N/A
Non-GAAP EPS (US\$)	0.48	-0.07	-114.3%	0.63	0.00	-100.6%	N/A	0.01	N/A

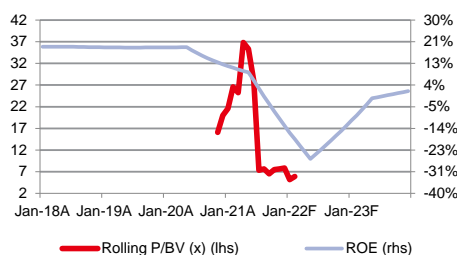
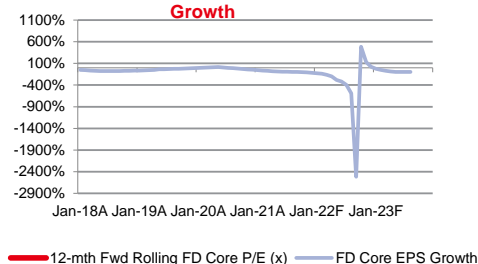
SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

Figure 3: New Oriental Education DCF Valuation

FCF computation (US\$ m)	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	FY32F	FY33F	FY34F
EBIT	-1,024.6	-100.7	148.4	222.7	334.0	501.0	751.5	1,127.2	1,690.9	2,536.3	3,804.4	5,706.7	7,989.3
Taxes	-108.5	40.2	-22.1	-33.2	-49.7	-74.6	-111.9	-167.9	-251.9	-377.8	-566.7	-850.0	-1,190.0
NOPAT	-1,133.1	-60.5	126.3	189.5	284.2	426.4	639.6	959.3	1,439.0	2,158.5	3,237.8	4,856.6	6,799.3
NOPAT growth	-1283.5%	-94.7%	-308.8%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	40.0%
D&A	144.1	177.1	188.1	190.0	191.9	193.8	195.8	197.7	199.7	201.7	203.7	205.7	207.8
Funds from operation	-989.0	116.6	314.4	379.5	476.1	620.2	835.3	1,157.0	1,638.7	2,360.2	3,441.5	5,062.4	7,007.1
Change in net working Capital	-25.4	6.4	-20.3	-20.5	-20.7	-20.9	-21.1	-21.3	-21.5	-21.7	-22.0	-22.2	-22.4
Cash flow from operation	-1,014.4	123.0	294.2	359.0	455.5	599.3	814.2	1,135.7	1,617.2	2,338.5	3,419.5	5,040.2	6,984.7
Capex	-100.2	-235.0	-235.0	-237.4	-239.7	-242.1	-244.5	-247.0	-249.5	-252.0	-254.5	-257.0	-259.6
Free cash flow from operation	-1,114.6	-112.0	59.2	121.7	215.7	357.2	569.7	888.7	1,367.7	2,086.5	3,165.0	4,783.2	6,725.1
FCF growth	-364.7%	-89.9%	-152.8%	105.6%	77.3%	65.6%	59.5%	56.0%	53.9%	52.6%	51.7%	51.1%	40.6%
Terminal free cash flow	87,765.1				Assumptions								
Total discounted free cash flow	5,560.4				Cost of equity					10.9%			
Present value of terminal free cash flow	23,365.5				Risk free rate					3.0%			
					Market Risk Premium					7.2%			
					Beta					1.10			
Total present value of forecasted free cash flows	28,925.8				Cost of debt (after tax)					4.5%			
Less: Net Debt	-1,414.0				Target Debt / (Debt + Equity)					0%			
Equity Value	30,339.8				WACC					10.9%			
No. of outstanding ADRs (millions)	16,519.8				Terminal growth					3.0%			
Target price (HK\$)	12.60												

SOURCES: CGS-CIMB RESEARCH, COMPANY REPORTS

BY THE NUMBERS

P/BV vs ROE

12-mth Fwd FD Core P/E vs FD Core EPS Growth


Profit & Loss

(US\$m)	May-20A	May-21A	May-22F	May-23F	May-24F
Total Net Revenues	3,579	4,277	2,934	2,388	2,735
Gross Profit	1,990	2,240	1,292	897	1,171
Operating EBITDA	545	375	(940)	16	277
Depreciation And Amortisation	(146)	(226)	(144)	(177)	(188)
Operating EBIT	399	149	(1,085)	(161)	88
Financial Income/(Expense)	107	202	0	0	0
Pretax Income/(Loss) from Assoc.	0	0	0	0	0
Non-Operating Income/(Expense)	(18)	(36)	0	0	0
Profit Before Tax (pre-EI)	488	315	(1,085)	(161)	88
Exceptional Items					
Pre-tax Profit	488	315	(1,085)	(161)	88
Taxation	(134)	(84)	(108)	40	(22)
Exceptional Income - post-tax					
Profit After Tax	353	231	(1,193)	(121)	66
Minority Interests	58	104	0	0	0
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax	1	(1)	0	0	0
Net Profit	413	334	(1,193)	(121)	66
Recurring Net Profit	484	338	(1,133)	(61)	126
Fully Diluted Recurring Net Profit	484	338	(1,133)	(61)	126

Cash Flow

(US\$m)	May-20A	May-21A	May-22F	May-23F	May-24F
EBITDA	545	375	(940)	16	277
Cash Flow from Inv. & Assoc.					
Change In Working Capital	191	529	(25)	6	(20)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	68	226	(48)	100	38
Net Interest (Paid)/Received	0	0	0	0	0
Tax Paid					
Cashflow From Operations	804	1,130	(1,014)	123	294
Capex	(310)	(429)	(100)	(235)	(235)
Disposals Of FAs/subsidiaries	24	45	0	0	0
Acq. Of Subsidiaries/investments	(76)	(85)	0	0	0
Other Investing Cashflow	(895)	(1,709)	0	0	0
Cash Flow From Investing	(1,256)	(2,178)	(100)	(235)	(235)
Debt Raised/(repaid)	20	177	0	0	0
Proceeds From Issue Of Shares	(25)	1,467	0	0	0
Shares Repurchased	0	0	0	0	0
Dividends Paid	0	0	0	0	0
Preferred Dividends					
Other Financing Cashflow	(13)	10	0	0	0
Cash Flow From Financing	(18)	1,654	0	0	0
Total Cash Generated	(470)	607	(1,115)	(112)	59
Free Cashflow To Equity	(432)	(870)	(1,115)	(112)	59
Free Cashflow To Firm	(452)	(1,048)	(1,115)	(112)	59

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS... cont'd

Balance Sheet

(US\$m)	May-20A	May-21A	May-22F	May-23F	May-24F
Total Cash And Equivalents	1,200	2,826	1,712	1,600	1,659
Total Debtors	4	9	9	9	9
Inventories	31	31	37	45	54
Total Other Current Assets	2,521	3,708	3,708	3,708	3,708
Total Current Assets	3,756	6,574	5,466	5,361	5,429
Fixed Assets	672	865	821	879	926
Total Investments	431	538	538	538	538
Intangible Assets	91	78	78	78	78
Total Other Non-Current Assets	1,606	2,096	2,096	2,096	2,096
Total Non-current Assets	2,800	3,577	3,533	3,591	3,638
Short-term Debt					
Current Portion of Long-Term Debt					
Total Creditors	669	947	928	941	930
Other Current Liabilities	1,810	2,525	2,525	2,525	2,525
Total Current Liabilities	2,479	3,471	3,452	3,466	3,455
Total Long-term Debt	118	298	298	298	298
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	1,078	1,351	1,351	1,351	1,351
Total Non-current Liabilities	1,196	1,648	1,648	1,648	1,648
Total Provisions	12	13	13	13	13
Total Liabilities	3,687	5,133	5,114	5,128	5,116
Shareholders' Equity	2,733	4,913	3,780	3,720	3,846
Minority Interests	137	105	105	105	105
Total Equity	2,870	5,018	3,885	3,825	3,951

Key Ratios

	May-20A	May-21A	May-22F	May-23F	May-24F
Revenue Growth	15.6%	19.5%	(31.4%)	(18.6%)	14.5%
Operating EBITDA Growth	32%	(31%)	(351%)	N/A	1584%
Operating EBITDA Margin	15.2%	8.8%	(32.1%)	0.7%	10.1%
Net Cash Per Share (US\$)	0.68	0.15	0.09	0.08	0.08
BVPS (US\$)	1.73	0.30	0.23	0.23	0.23
Gross Interest Cover	N/A	N/A	N/A	N/A	N/A
Effective Tax Rate	27.5%	26.5%	0.0%	0.0%	25.0%
Net Dividend Payout Ratio	NA	NA	NA	NA	NA
Accounts Receivables Days	0.38	0.55	1.08	1.32	1.16
Inventory Days	6.95	5.60	7.62	10.08	11.56
Accounts Payables Days	7.74	6.41	6.41	6.41	6.43
ROIC (%)	40.6%	4.5%	(36.0%)	(3.7%)	2.0%
ROCE (%)	18.0%	8.4%	(22.8%)	(3.9%)	2.1%
Return On Average Assets	4.9%	1.0%	(12.5%)	(1.3%)	0.7%

Key Drivers

	May-20A	May-21A	May-22F	May-23F	May-24F
Learning centre yoy change (%)	16.8%	0.0%	-59.0%	25.0%	25.0%
Student base yoy change (%)	32.8%	33.8%	-36.3%	-66.7%	9.0%
Overall ASP (USD) yoy change (%)	3.4%	5.8%	-24.0%	144.1%	5.0%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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619 companies under coverage for quarter ended on 31 Dec 2021		
	Rating Distribution (%)	Investment Banking clients (%)
Add	71.1%	1.5%
Hold	21.8%	0.0%
Reduce	7.1%	0.0%

Spitzer Chart for stock being researched (2 year data)

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RECOMMENDATION FRAMEWORK

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