

Hong Kong

**ADD** (previously HOLD)

Consensus ratings\*: Buy 8 Hold 2 Sell 2

Current price:	HK\$16.00
Target price:	HK\$21.00
Previous target:	HK\$12.60
Up/downside:	31.2%
CGI / Consensus:	28.3%
Reuters:	9901.HK
Bloomberg:	9901 HK
Market cap:	US\$3,459m
	HK\$27,151m
Average daily turnover:	US\$6.12m
	HK\$48.05m
Current shares o/s:	1,645m
Free float:	85.4%

\*Source: Bloomberg

**Key changes in this note**

- FY5/22F net loss decreased by 11.8%.
- FY5/23F net loss changed to net profit.
- FY5/24F net profit increased by 33.8%.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	62.4	67.5	-75
Relative (%)	61	71.5	-49.2

Major shareholders	% held
Mr. Michael M Yu	14.6

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# New Oriental Education

## Business transformation better than expected

- We hosted a conference call with New Oriental Education & Technology Group Inc. (EDU), which indicated that its business transformation is better than we expected.
- We expect revenue from its overseas test prep and consulting business to grow by high-single digits yoy in FY5/23F and account for about 30% of total revenue.
- EDU will focus on domestic test preparation, which management expected to provide 30–40% yoy segment revenue growth, accounting for 15% of revenue in FY5/23F.
- Upgrade to Add with new DCF-based TP of HK\$21.0, since we believe EDU's business transformation is on a good trend, resulting in better margin expansion.

### Reformation of the old business

EDU ended its K–9 after-school tutoring business on Jan 1, 2022. In EDU's 1H FY5/22 results, it recorded about US\$700–800m in one-off expenses for closing half to two-thirds of its learning centers (about 600 centers remain open) and cutting over half of its staff nationwide. Thereafter, learning center closings and staff cuts will be limited to local areas. The remaining old businesses include 1) overseas test prep and consulting; 2) domestic test prep; and 3) high school after-school tutoring, which management expects to contribute about 70% of total revenue in FY5/23F.

### Demand for overseas test prep and consulting business to recover

Revenue from overseas test prep is more sensitive to the pandemic situation, as students for this business are usually less determined to study abroad than students for the overseas consulting business. Revenue from the overseas consulting business has been more resilient during the current pandemic. We expect the segment to return to fast growth when the pandemic situation improves. Management expects the margin of the overseas test prep and consulting business to be over 10% in FY5/23F.

### Domestic test prep has great growth potential

EDU is expanding its course offerings from English tests for university students to cover more vocational test prep business, like tests for college students to enter university. Because of the weak job market and government support in developing vocational skills among undergraduate students, we expect demand for EDU's adult education business to increase in the next few years. Management expects the margin of this segment to be over 10% in FY5/23F.

### High school tutoring to closely comply with government policy

Since there is no nationwide policy guidance for high school after-school tutoring yet, EDU is continuing this business following local government guidance. But EDU will not expand this business and will closely watch specific policies of local governments. We expect the high school tutoring business to account for 25% of FY5/23F total revenue.

### Expanding new business in a prudent way

EDU is exploring various new businesses, leveraging its existing resources, and expects new business to contribute about 30% of total revenue in FY5/23F. The new businesses include 1) non-subject tutoring; 2) tutoring machines and systems; 3) study tours; 4) to B business and 5) Koolearn's new business, including live-broadcasting. We believe the new business is still in the early stage and will take some time to bear fruit.

### Upgrade to Add with new DCF-based TP of HK\$21.0

We narrowed our FY5/22F net loss forecast by 11.8%, changed our FY5/23F net loss forecast to net profit, and raised our FY5/24F net profit forecast by 33.8% to factor in better margin expansion. We upgraded our rating to Add and adjusted up our TP to HK\$21.0 (risk free rate: 3.0%, beta: 1.1, WACC: 10.9%) since EDU's business transformation progress is likely to be better than we expected. A key positive catalyst is better cost control and stronger growth of new business. A key risk is further policy changes.

#### 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	(855.3)	163.1	333.5
Net Profit (US\$m)	413	334	(1,099)	(11)	109
Core EPS (US\$)	0.31	0.24	(0.61)	0.03	0.10
Core EPS Growth	18%	(22%)	(356%)		242%
FD Core P/E (x)	6.67	8.43	NA	67.79	19.84
DPS (US\$)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	4.19	2.48	NA	11.78	5.42
P/FCFE (x)	NA	NA	NA	NA	29.70
Net Gearing	(37.7%)	(50.4%)	(38.6%)	(37.8%)	(39.0%)
P/BV (x)	1.18	0.68	0.86	0.85	0.81
ROE	19.0%	10.2%	(22.6%)	1.3%	4.2%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

# Business transformation better than expected

## New business development

EDU is exploring various new businesses, leveraging its existing resources, and expects new business to contribute about 30% of total revenue in FY5/23F. The new businesses include 1) non-subject tutoring; 2) tutoring machines and systems; 3) study tours; 4) toB business; and 5) Koolearn's new business, including live-broadcasting. The non-subject tutoring will focus more on a well-rounded education (such as sports, arts and music) and skills training (such as reading and communication skills), which are supported by government policies. The tutoring machines and systems use teaching materials that EDU previously developed for its K-9 business; the machines and systems are sold to students for self-study. Study tours and the toB business focus on cooperation with local educational facilities, such as museums and public schools, to provide tutoring services under different scenarios.

Koolearn's live-broadcasting has been a hot topic recently, with the number of fans growing by about 10 times in one week to over 10m people, with daily GMV of over Rmb10m. It has established a good relationship with both brands and academic institutions, such as the Academy of Agricultural Sciences. The close relationship with academic institutions could help EDU and Koolearn improve their product development. Currently, Koolearn's live-broadcasting business is mainly 3P business and is still loss-making. Going forward, management may introduce some 1P products and further improve its supply chain and logistics network. With the increased contribution of self-operated products, we expect there to be large room for margin improvement and for this business to become profitable.

In addition, EDU still had US\$4.4bn at the end of 3QFY5/22, and management expects some further one-off expenses in 4QFY5/22F because of the pandemic situation. But the one-off expenses in 4QFY5/22F will be limited, and management expects cash on hand to remain at US\$4bn at the end of FY5/22F. Management did not rule out the possibility of using part of this cash on hand to return to shareholders.

Key risks are 1) further policy changes that have negative impact on EDU's existing businesses; 2) fail to expand market share in existing businesses; and 3) the development of new businesses to be below expectation.

We adjusted up our TP to HK\$21.0 (risk free rate: 3.0%, beta: 1.1, WACC: 10.9%) since EDU's business transformation progress, such as the growth of domestic test prep business and the successful development of new businesses, is likely to be better than we expected.

**Figure 1: New Oriental Education earnings revision**

US\$m	FY5/22F			FY5/23F			FY5/24F		
	Old	New	% change	Old	New	% change	Old	New	% change
Net revenue	2,934.3	2,934.3	0.0%	2,387.9	2,387.9	0.0%	2,734.7	2,734.7	0.0%
Gross margin	44.0%	41.4%	-2.6% pts	37.6%	43.2%	5.6% pts	42.8%	46.8%	4.0% pts
Operating margin (non-GAAP)	-34.9%	-30.7%	4.3% pts	-4.2%	1.9%	6.1% pts	5.4%	7.5%	2.1% pts
Net income (GAAP)	-1,193.1	-1,099.3	7.9%	-120.5	-10.5	91.3%	66.3	109.1	64.4%
Net income (non-GAAP)	-1,133.1	-999.3	11.8%	-60.5	49.5	181.7%	126.3	169.1	33.8%

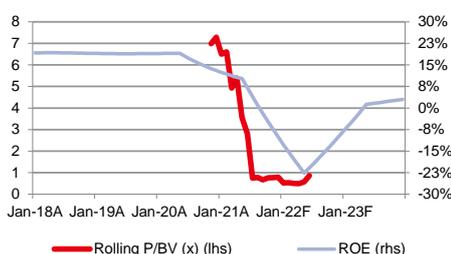
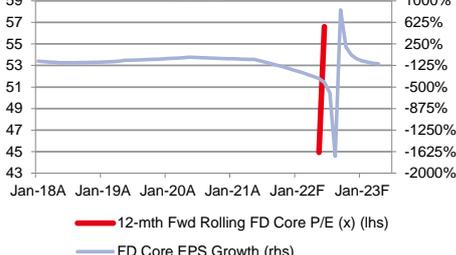
SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG

**Figure 2: New Oriental Education DCF valuation**

FCF computation (US\$ m)	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	FY32F	FY33F	FY34F
<b>EBIT</b>	<b>-899.4</b>	<b>46.0</b>	<b>205.4</b>	<b>328.7</b>	<b>525.9</b>	<b>788.9</b>	<b>1,183.3</b>	<b>1,775.0</b>	<b>2,662.5</b>	<b>3,993.7</b>	<b>5,651.1</b>	<b>7,911.5</b>	<b>11,076.1</b>
Taxes	-99.9	3.5	-36.4	-58.2	-93.1	-139.6	-209.4	-314.1	-471.2	-706.8	-1,000.1	-1,400.2	-1,960.3
<b>NOPAT</b>	<b>-999.3</b>	<b>49.5</b>	<b>169.1</b>	<b>270.5</b>	<b>432.8</b>	<b>649.3</b>	<b>973.9</b>	<b>1,460.8</b>	<b>2,191.2</b>	<b>3,286.9</b>	<b>4,650.9</b>	<b>6,511.3</b>	<b>9,115.8</b>
<b>NOPAT growth</b>	<b>-1143.9%</b>	<b>-105.0%</b>	<b>241.8%</b>	<b>60.0%</b>	<b>60.0%</b>	<b>50.0%</b>	<b>50.0%</b>	<b>50.0%</b>	<b>50.0%</b>	<b>50.0%</b>	<b>41.5%</b>	<b>40.0%</b>	<b>40.0%</b>
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
<b>Funds from operation</b>	<b>-855.2</b>	<b>226.6</b>	<b>357.2</b>	<b>460.5</b>	<b>624.7</b>	<b>843.1</b>	<b>1,169.6</b>	<b>1,658.5</b>	<b>2,390.9</b>	<b>3,488.5</b>	<b>4,854.6</b>	<b>6,717.0</b>	<b>9,323.6</b>
Change in net working Capital	-22.7	-3.7	-9.3	-9.4	-9.5	-9.6	-9.7	-9.8	-9.9	-9.9	-10.0	-10.1	-10.3
<b>Cash flow from operation</b>	<b>-878.0</b>	<b>222.9</b>	<b>347.9</b>	<b>451.1</b>	<b>615.3</b>	<b>833.5</b>	<b>1,160.0</b>	<b>1,648.8</b>	<b>2,381.1</b>	<b>3,478.6</b>	<b>4,844.6</b>	<b>6,706.9</b>	<b>9,313.3</b>
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
<b>Free cash flow from operation</b>	<b>-978.2</b>	<b>-12.1</b>	<b>112.9</b>	<b>213.8</b>	<b>375.5</b>	<b>591.4</b>	<b>915.4</b>	<b>1,401.8</b>	<b>2,131.6</b>	<b>3,226.6</b>	<b>4,590.1</b>	<b>6,449.8</b>	<b>9,053.7</b>
<b>FCF growth</b>	<b>-332.3%</b>	<b>-98.8%</b>	<b>-1030.1%</b>	<b>89.4%</b>	<b>75.7%</b>	<b>57.5%</b>	<b>54.8%</b>	<b>53.1%</b>	<b>52.1%</b>	<b>51.4%</b>	<b>42.3%</b>	<b>40.5%</b>	<b>40.4%</b>
Terminal free cash flow	118,154.5				<b>Assumptions</b>								
Total discounted free cash flow	8,797.4				<b>Cost of equity</b>					<b>10.9%</b>			
Present value of terminal free cash flow	31,455.9				Risk free rate					3.0%			
					Market Risk Premium					7.2%			
<b>Total present value of forecasted free cash flows</b>	<b>40,253.3</b>				Beta					1.10			
Less: Net Debt	-1,550.4				<b>Cost of debt (after tax)</b>					<b>4.5%</b>			
<b>Equity Value</b>	<b>41,803.7</b>				<b>Target Debt / (Debt + Equity)</b>					<b>0%</b>			
No. of outstanding ADRs (millions)	1,652.0				WACC					10.9%			
<b>Target price (HK\$)</b>	<b>21.00</b>				<b>Terminal growth</b>					<b>3.0%</b>			

SOURCES: CGS-CIMB RESEARCH ESTIMATES, COMPANY REPORTS, BLOOMBERG

## 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
<b>Total Net Revenues</b>	<b>3,579</b>	<b>4,277</b>	<b>2,934</b>	<b>2,388</b>	<b>2,735</b>
<b>Gross Profit</b>	<b>1,990</b>	<b>2,240</b>	<b>1,216</b>	<b>1,032</b>	<b>1,280</b>
<b>Operating EBITDA</b>	<b>545</b>	<b>375</b>	<b>(855)</b>	<b>163</b>	<b>334</b>
Depreciation And Amortisation	(146)	(226)	(144)	(177)	(188)
<b>Operating EBIT</b>	<b>399</b>	<b>149</b>	<b>(999)</b>	<b>(14)</b>	<b>145</b>
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
<b>Profit Before Tax (pre-EI)</b>	<b>488</b>	<b>315</b>	<b>(999)</b>	<b>(14)</b>	<b>145</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>488</b>	<b>315</b>	<b>(999)</b>	<b>(14)</b>	<b>145</b>
Taxation	(134)	(84)	(100)	4	(36)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>353</b>	<b>231</b>	<b>(1,099)</b>	<b>(11)</b>	<b>109</b>
Minority Interests	58	104	0	0	0
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax	1	(1)	0	0	0
<b>Net Profit</b>	<b>413</b>	<b>334</b>	<b>(1,099)</b>	<b>(11)</b>	<b>109</b>
Recurring Net Profit	484	391	(999)	49	169
<b>Fully Diluted Recurring Net Profit</b>	<b>484</b>	<b>391</b>	<b>(999)</b>	<b>49</b>	<b>169</b>

### Cash Flow

(US\$m)	May-20A	May-21A	May-22F	May-23F	May-24F
<b>EBITDA</b>	<b>545</b>	<b>375</b>	<b>(855)</b>	<b>163</b>	<b>334</b>
Cash Flow from Invt. & Assoc.					
Change In Working Capital	191	529	(23)	(4)	(9)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	68	226	0	64	24
Net Interest (Paid)/Received	0	0	0	0	0
Tax Paid					
<b>Cashflow From Operations</b>	<b>804</b>	<b>1,130</b>	<b>(878)</b>	<b>223</b>	<b>348</b>
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
<b>Cash Flow From Investing</b>	<b>(1,256)</b>	<b>(2,178)</b>	<b>(100)</b>	<b>(235)</b>	<b>(235)</b>
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
<b>Cash Flow From Financing</b>	<b>(18)</b>	<b>1,654</b>	<b>0</b>	<b>0</b>	<b>0</b>
Total Cash Generated	(470)	607	(978)	(12)	113
<b>Free Cashflow To Equity</b>	<b>(432)</b>	<b>(870)</b>	<b>(978)</b>	<b>(12)</b>	<b>113</b>
<b>Free Cashflow To Firm</b>	<b>(452)</b>	<b>(1,048)</b>	<b>(978)</b>	<b>(12)</b>	<b>113</b>

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## BY THE NUMBERS... cont'd

<b>Balance Sheet</b>					
<b>(US\$m)</b>	<b>May-20A</b>	<b>May-21A</b>	<b>May-22F</b>	<b>May-23F</b>	<b>May-24F</b>
Total Cash And Equivalents	1,200	2,826	1,848	1,836	1,949
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
<b>Total Current Assets</b>	<b>3,756</b>	<b>6,574</b>	<b>5,602</b>	<b>5,598</b>	<b>5,719</b>
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
<b>Total Non-current Assets</b>	<b>2,800</b>	<b>3,577</b>	<b>3,533</b>	<b>3,591</b>	<b>3,638</b>
Short-term Debt					
Current Portion of Long-Term Debt					
Total Creditors	669	947	930	934	934
Other Current Liabilities	1,810	2,525	2,525	2,525	2,525
<b>Total Current Liabilities</b>	<b>2,479</b>	<b>3,471</b>	<b>3,455</b>	<b>3,459</b>	<b>3,458</b>
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
<b>Total Non-current Liabilities</b>	<b>1,196</b>	<b>1,648</b>	<b>1,648</b>	<b>1,648</b>	<b>1,648</b>
Total Provisions	12	13	13	13	13
<b>Total Liabilities</b>	<b>3,687</b>	<b>5,133</b>	<b>5,116</b>	<b>5,120</b>	<b>5,120</b>
Shareholders' Equity	2,733	4,913	3,914	3,963	4,132
Minority Interests	137	105	105	105	105
<b>Total Equity</b>	<b>2,870</b>	<b>5,018</b>	<b>4,019</b>	<b>4,068</b>	<b>4,237</b>

<b>Key Ratios</b>					
	<b>May-20A</b>	<b>May-21A</b>	<b>May-22F</b>	<b>May-23F</b>	<b>May-24F</b>
Revenue Growth	15.6%	19.5%	(31.4%)	(18.6%)	14.5%
Operating EBITDA Growth	32%	(31%)	(328%)	N/A	105%
Operating EBITDA Margin	15.2%	8.8%	(29.1%)	6.8%	12.2%
Net Cash Per Share (US\$)	0.68	1.54	0.94	0.93	1.00
BVPS (US\$)	1.73	2.99	2.38	2.41	2.51
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	7.28	11.08	12.43
Accounts Payables Days	7.74	6.41	6.41	6.41	6.43
ROIC (%)	40.6%	4.5%	(33.2%)	(0.3%)	3.3%
ROCE (%)	18.0%	8.4%	(20.7%)	(0.3%)	3.3%
Return On Average Assets	4.9%	1.0%	(11.4%)	(0.1%)	1.2%

<b>Key Drivers</b>					
	<b>May-20A</b>	<b>May-21A</b>	<b>May-22F</b>	<b>May-23F</b>	<b>May-24F</b>
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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As of the end of the month immediately preceding the date of publication of this report, CGS-CIMB Securities (USA) Inc. beneficially owns 1% or more of any class of common equity securities of .

**Other jurisdictions:** In any other jurisdictions, except if otherwise restricted by laws or regulations, this report is only for distribution to professional, institutional or sophisticated investors as defined in the laws and regulations of such jurisdictions.

Distribution of stock ratings and investment banking clients for quarter ended on 31 Mar 2022		
632 companies under coverage for quarter ended on 31 Mar 2022		
	Rating Distribution (%)	Investment Banking clients (%)
Add	70.3%	0.8%
Hold	22.0%	0.0%
Reduce	7.8%	0.2%

**Spitzer Chart for stock being researched ( 2 year data )**

**New Oriental Education (9901 HK)**

## RECOMMENDATION FRAMEWORK

### Stock Ratings Definition:

Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

*The total expected return of a stock is defined as the sum of the:(i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.*

### Sector Ratings Definition:

Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

### Country Ratings Definition:

Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

## Analyst Certification

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

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