



# TAL (TAL US)

## A rising contender in the after-school education market

- The Group is a rising contender in the after-school education industry with average student enrollment of normal priced long-term course per quarter of ~3.0mn in FY20, growing at 55.2% YoY
- The Group achieved scale and market position by actively seeking acquisitions and investment opportunities; continuous investment in the integration of technology and new teaching methods were able to translate into growth
- Our projected FY20-23E revenue CAGR is 38.7%
- Initiate with **BUY**; current TP represents 155.55x/80.56x 21E/22E P/E, or 18.06x/14.75x 21E/22E P/B

**A rising contender in the after-school education industry.** The Group's revenue and average student enrollment of normal priced long-term course per quarter reached US\$ 3,273.3mn and ~3.0mn in FY20. The number of learning centers and service centers reached 871 and 767 by end-FY20, covering 69 cities throughout China and one city in the US. FY17-20 revenue CAGR reached 46.4%.

**Increasing student enrollment in China implies more potential customers for the Group.** According to MOE, total number of student enrollment in primary school, G7-9, and high school increased by 2.2% YoY, 3.8% YoY, and 1.5% YoY to 105.6mn, 48.3mn, and 39.9mn in 2019. In addition, the admission rate at higher education institutions remained lower than other levels of education in China – stiff competition for admission means that the demand for after-school education would remain strong. Moreover, with smaller players closing down after the COVID-19 outbreak, larger competitions should be able to seize market share.

**Successful execution of expansion strategy.** We believe the Group's success can be attributed to its expansion strategy. It has made major acquisitions to expand its course offerings, and has been investing in infrastructure that enables online learning and implementation of the “dual-teacher classroom” model.

**FY20-23E revenue CAGR at 38.7%.** We expect revenue would be mainly supported by growth of in student enrollment. We project GPM and NPM (to shareholders of the Company) to be 57.2% and 11.4% in FY23E.

**Initiate with BUY, TP at US\$ 85.7.** We believe continuous investment in school network, IT infrastructure, and educational content would help stimulate growth and strengthen market position. Initiate with **BUY**. Our DCF-derived TP represents 155.55x/80.56x 21E/22E P/E, or 18.06x/14.75x 21E/22E P/B.

**Risk factors:** 1) Macroeconomic risk; 2) Regulatory risk; 3) Pandemic risk; 4) Demographic risk; 5) Changing industry landscape; 6) Education quality risk; 7) Expansion risk; 8) Seasonality of business; 9) High growth of SG&A expenses presents challenge to profitability; 10) Non-GAAP financial metrics; 11) Lack of dividend payout; 12) Dual-class voting structure.

### Results and Valuation

	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (US\$ mn)	2,563	3,273	4,423	6,390	8,737
Chg (YoY %)	49.44	27.71	35.12	44.47	36.73
Net Profit – to shareholders of the Company (US\$ mn)	367	(110)	330	638	995
Change (% YoY)	85.06	(130.01)	N/A	93.07	55.89
Basic net profit per common share (US\$)	1.93	(0.56)	1.65	3.19	4.98
Change (YoY %)	70.80	(129.02)	N/A	93.07	55.89
Basic net profit per ADS (US\$)	0.64	(0.19)	0.55	1.06	1.66
Change (YoY %)	68.42	(129.69)	N/A	93.07	55.89
P/E (x)	115.77	(389.95)	134.47	69.65	44.68
BVPS (US\$)	13.08	12.69	14.24	17.43	22.40
P/B (x)	17.00	17.51	15.61	12.75	9.92
Dividend (US\$)	0	0	0	0	0
Dividend yield (%)	0	0	0	0	0
ROAA (%)	10.74	(2.74)	4.65	6.69	7.79
ROAE (%)	17.89	(4.41)	12.33	20.16	24.98

Note: FY ends on the last day of Feb

Source(s): The Group, ABCI Securities estimates

## Company Report Initiation

Aug 24, 2020

Rating: BUY

TP: US\$ 85.7

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Share price (HK\$)	74.09
52WK H/L (HK\$)	82.49/33.35
Est. share price return	15.68%
Est. dividend yield	0.00%
Est. total returns	15.68%
Previous rating&TP	N/A
Previous report date	N/A

Source(s): Bloomberg, ABCI Securities estimates

### Key data

# of ADS – Class A (mn)	399.50
Class A mkt cap (US\$ mn)	29,599.22
3-mth avg ADT (US\$mn)	223.63
Major shareholders (%)	
Bright Unison Limited	24.0

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

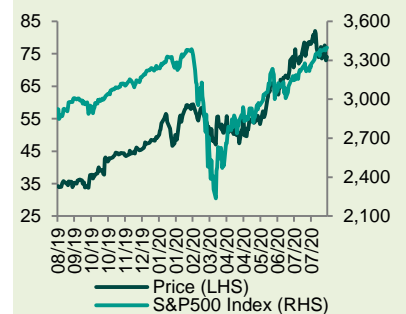
### Price performance (%)

	Absolute	Relative*
1-mth	(2.18)	(8.00)
3-mth	39.01	23.55
6-mth	28.65	22.31

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 21, 2020; 2) Three ADSs represent one Class A common Share

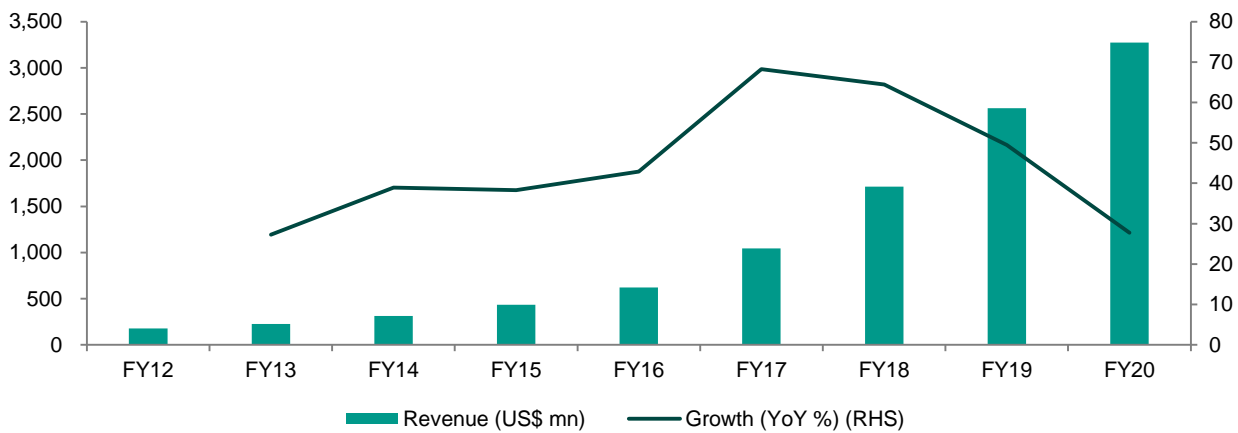


## Investment highlights

### 1. A rapidly expanding player in the after-school education market with a comprehensive service portfolio

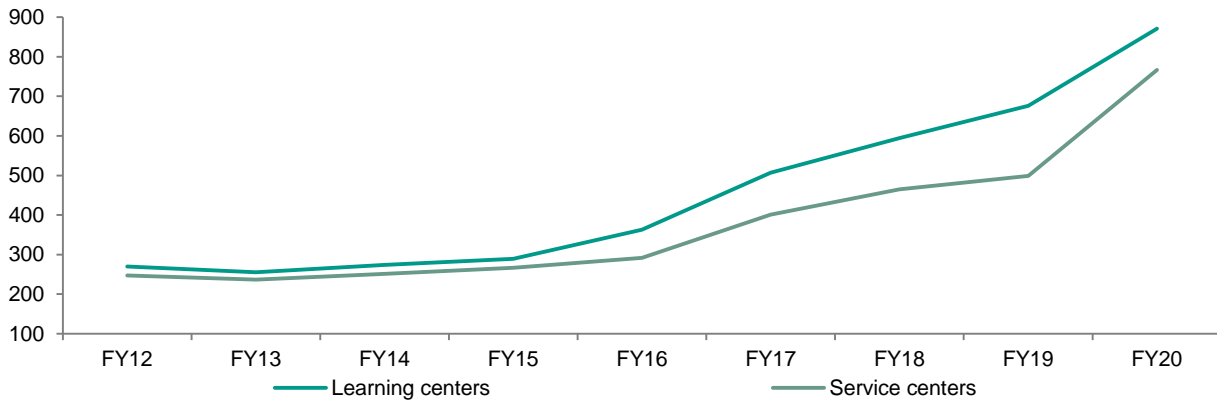
The Group's revenue and average student enrollment of normal priced long-term course per quarter reached US\$ 3,273.3mn and ~3.0mn in FY20 (FY ends on last day of Feb), up 27.7% YoY and 55.2% YoY. The Group's revenue has experienced rapid growth over the years. In FY17 and FY18, total revenue growth jumped over 60% YoY, while FY19 revenue growth was ~49% YoY. The further decline in growth rate in FY20 was partly due to the COVID-19 outbreak impacts. In addition, the number of learning centers and service centers reached 871 and 767 by end-FY20, covering 69 cities throughout China and one city in the US.

Exhibit 1: Revenue size and growth of the Group



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

Exhibit 2: Learning centers and service centers



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

The Group's after-school tutoring courses cover all core subjects in PRC school curricula at each grade level of the K-12 system. The subjects covered include mathematics, physics, chemistry, biology, history, geography, political science, English, Chinese, and more.



The Group offers different services under the umbrella brand of “Haoweilai”, which also carries several sub-brands. The following table shows the different brands and services provided under the brands.

**Exhibit 3: Service offerings by the Group under different brands**

Educational program	Description
“Xueersi,” “Mobby” and “Firstleap”	small-class services
“Izhikang”	personalized premium services
“Shunshun Liuxue”	consulting services on overseas studies

Source(s): The Group, ABCI Securities

## 2. Industry continues to provide room for growth

According to MOE, student enrollment in China’s formal education system increased to 282mn in 2019 from 276mn in 2018, up 2.4% YoY. Total enrollment in primary school, G7-9, and high school increased by 2.2% YoY, 3.8% YoY, and 1.5% YoY to 105.6mn, 48.3mn, and 39.9mn in 2019. We believe growing enrollment indicates a larger pool of potential customers for the after-school education industry.

Also, competition in standardized tests in China intensifies as students move upward. According to the MOE, the gross enrollment rate at the higher education level was 51.6% in 2019, the lowest among all levels. The relatively low enrollment rate at higher education means students would need to excel in exams for admission, engendering the demand for quality after-school education programs. This trend would continue to benefit industry players, especially leaders with a vast school network and a reliable reputation.

**Exhibit 4: Admission rates in different levels of education in China**

	2014	2015	2016	2017	2018	2019
Higher education	37.5	40.0	42.7	45.7	48.1	51.6
High school (G10-12)	86.5	87.0	87.5	88.3	88.8	89.5
Middle school (G7-9)	103.5	104.0	104.0	103.5	100.9	102.6
Primary school (G1-6)	99.81	99.88	99.92	99.91	99.95	99.94
Preschool	70.5	75.0	77.4	79.6	81.7	83.4

Note: Primary school uses net rate; others use gross rate

Source(s): MOE, ABCI Securities

Moreover, the after-school education market is likely to consolidate after the pandemic. Numerous players with less financial resources have closed down due to liquidity issues and student dropouts during the COVID-19 outbreak; as a result, we believe leading players would be able to expand their market shares by acquiring struggling companies or penetrating into previously unreachable markets.



### 3. A strong contender in the after-school education market in China

The Group's FY20 revenue size is comparable to that of New Oriental (EDU US), which is a strong incumbent in China's after-school education market. We believe the Group's capability in expansion and technology integration allows it to compete with this strong rival.

**Exhibit 5: Competitive landscape overview**

	New Oriental (EDU US) Market Cap: US\$ 21.95bn			TAL (TAL US) Market Cap: US\$ 29.60bn		
	FY18A	FY19A	FY20A	FY18A	FY19A	FY20A
Net revenue size (US\$ mn)	2,447	3,096	3,579	1,715	2,563	3,273
GPM (%)	56.5	55.6	55.6	48.6	54.6	55.1
OPM (%)	10.7	9.9	11.1	12.2	13.3	4.2
NPM (to shareholders of the Company) (%)	12.1	7.4	9.9	11.6	14.3	(3.4)
ROAA (%)	8.6	5.3	6.3	8.0	10.7	(2.7)
ROAE (%)	16.1	10.9	16.2	17.5	17.9	(4.4)
Scope of business	Offers a wide range of educational programs, services and products, consisting primarily of language training and test preparation, preschool, primary and secondary school education, online education, content development and distribution, overseas study consulting services, and study tour.			Offers comprehensive tutoring services to K-12 students covering core academic subjects; provides consulting services for overseas studies and preparation courses for major standardized tests; operates several online community platforms; supports educational institutions and public schools in China.		

Note: 1) New Oriental's FY ends on May 31; TAL's FY ends on the last day of Feb; 2) Market cap data is as of Aug 21, 2020; 3) TAL's market cap is for ADSs representing Class A common shares only  
Source(s): Companies, ABCI Securities

The Group has been actively expanding its course offering through internal development and acquisition. The Group grew from primarily offering tutoring classes in mathematics to offering comprehensive course offerings covering all core subjects. In Jan 2016, the Group acquired a 100% stake in Firstleap Education, which delivers all-subject small-class tutoring in English to students aged from two to 15. The Group also has made investments in other companies. The following chart shows some notable investments made by the Group.

**Exhibit 6: Notable investments made by the Group**



Source(s): The Group, ABCI Securities

The Group has emphasized the importance of integrating technology in learning. It launched the Intelligent Classroom System (ICS), a proprietary classroom teaching solution used in instruction, in 2010. Through ICS, teachers can upload all of the internally developed multi-media teaching content (instructional videos and audio materials) and project this content to enhance the efficiency of instructional process. The Group has been developing its online learning platform as early as 2010 through the launch of xueersi.com. Since 2015, it has offered "dual-teacher classroom" courses - a lecturing teacher would deliver the course remotely in a host classroom online via live-streaming, while another teacher would serve as a teaching assistant in the guest classroom where students participate. The introduction of these dual-teacher classroom courses has helped the Group penetrate into different cities across China.



**Exhibit 7: Domain names owned by the Group**

Website domain name	Topic
www.jzb.com (formerly www.eduu.com)	The Group's main webpage which mainly has links to the websites listed below
www.xueersi.com	Online courses
www.gaokao.com	College entrance examinations
www.zhongkao.com	High school entrance examinations
www.jiajiaoban.com	Personalized premium services
www.aoshu.com	Mathematics for primary and middle schools; specialized training for competition mathematics
www.yingyu.com	English language
www.youjiao.com	Preschool and kindergarten education
www.speiyou.com	Small-class tutoring under our Xueersi brand
www.mobby.cn	Tutoring services for students aged two through fifteen under our Mobby brand
www.yuer.com	Raising infants and toddlers
www.kaoyan.com	Post-graduate degree entrance examination
www.firstleap.cn	All-subject tutoring services in English to children aged from two to fifteen years old
www.kmf.com	Preparation of English tests for study abroad purposes
www.vjpx.com	Online one-on-one English tutoring services from foreign teachers
www.liuxue.com	Overseas studies services
www.mmbang.com	Communication platform related to pregnant preparations, pregnancy and raising infants and toddlers
www.xesvl.com (formerly www.dahai.com)	Online one-on-one tutoring services for secondary schools students

Source(s): The Group, ABCI Securities

**Exhibit 8: Key development milestones of the Group**

Year	Event
2003	➤ First Xueersi class opened
	➤ A branch was established in Shenzhen
	➤ Xueersi was listed on the New York Stock Exchange
2010	➤ Intelligent teaching system (ICS) was launched
	➤ eduu.com were unified and launched officially
	➤ xueersi.com was launched
2011	➤ Small-class courses were renamed as Speiyou
	➤ Branches were established in Chengdu, Hangzhou, Nanjing, and Xi'an
	➤ ICS2.0 was launched
	➤ Mobby, a preschool education program of Xueersi, was launched
2012	➤ Large-scale educational support activities were held in Qinghai, Sichuan, Guizhou, and Xinjiang
	➤ A social responsibility department was established to be responsible for public welfare activities
	➤ A brand new education concept was released: interest arising, habit cultivation, and personality building
2013	➤ TAL Public Welfare Foundation was established, a non-public foundation approved by Beijing Civil Affairs Bureau
	➤ Xueersi Education was renamed as TAL
	➤ The Xueersi Education headquarters was moved into Danling SOHO, located in the center of Zhongguancun
2014	➤ eduu.com was renamed as jzb.com, and JZB APP was launched
	➤ TAL launched haibian.com
	➤ TAL launched the education CEO training camp: Edstars
2015	➤ TAL acquired full shares of First Leap
	➤ TAL launched gaokao.com and kaoyan.com
	➤ TAL launched "Lewaijiao", a new online education product which was created to be the first brand for youth education delivered by foreign teachers
2016	➤ TAL was listed among the Top 100 Chinese Brands by BRANDZ, and recognized as an education brand with the fastest brand value growth rate
	➤ TAL increased shares of liuxue.com, which became a member institution of TAL
	➤ TAL cooperated with Didi Taxi to promote the education sharing plan

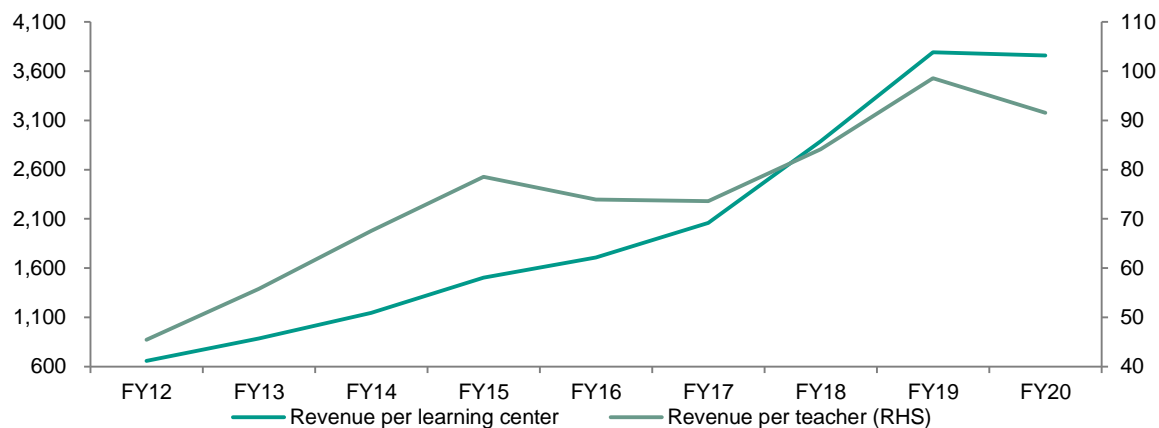
Source(s): The Group, ABCI Securities



#### 4. Improving efficiency

Over the years, the Group's efficiency has been improving. Revenue per learning center increased from US\$ 1.5mn in FY15 to US\$ 3.8mn in FY20, representing a CAGR of 20.1%. Revenue per teacher increased from US\$ 79K in FY15 to US\$ 92K in FY20, representing a CAGR of 3.1%. Nonetheless, revenue per teacher saw more volatility over the years. We believe the general improvement in efficiency is mainly due to the Group's ability to leverage its expanding scale and various education models.

**Exhibit 9: Efficiency metrics of the Group (US\$ k)**



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

#### 5. Prudent financial management

The Group's leverage has been trending down in recent years. As of end-FY20, the Group recorded a debt-to-equity ratio of 10.3% and a net cash position of US\$ 1,653.2mn. The ratio further declined to 10.1% as of end-1Q21 and net cash position rose to US\$ 2,098.9mn.

The Group's deferred revenue, which is course fee paid in advanced, fluctuated over the years and reached US\$ 781.0m as of end-FY20, representing 23.9% of total revenue. Before FY19, the ratio was generally at ~50%. We believe the general decline was mainly due to the change in regulatory requirement that limits the amount of prepaid tuition collected.

Dividends were made only in 2010, 2012, and 2017. We believe the Group withholds dividends for capital expenditure as well as liquidity needs for investments.

**Exhibit 10: Dividend history**

Payment date	Nov 2010	Dec 2012	May 2017
Dividend per ADS (US\$) declared	N/A	0.25	0.25
Total dividends paid (US\$ mn)	30.0	39.0	41.2
Payout ratio (%)	124.8	116.6	20.8

Source(s): The Group, ABCI Securities



## Growth and profitability outlook

### FY20-23E revenue CAGR to reach 38.7%

According to our estimates, the Group's revenue CAGR in FY20-23E would be 38.7%. The growth is based on the following assumptions: 1) the Group's expansion will translate into further growth in student enrollment; 2) the Group would be able to strengthen its market position through investment in school network, educational platforms, and educational contents. We expect that the major growth driver would be student enrollment of normal priced long-term course, which would increase at a CAGR of 37.4% in FY20-23E. We also expect revenue per student enrollment would face more pressure in FY21 due to the COVID-19 outbreak.

#### Exhibit 11: Revenue projections and assumptions

	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (US\$ mn)	2,563	3,273	4,423	6,390	8,737
Average student enrollment of normal priced long-term course per quarter (mn)	1.9	3.0	4.3	6.1	7.9
Revenue per student enrollment (US\$ k)	0.329	0.271	0.256	0.262	0.278

Note: FY ends on the last day of Feb

Source(s): The Group, ABCI Securities estimates

### SG&A expenses and uncertainty on investments may exert pressure on margins

The Group's margins have been pressured by rising SG&A expenses resulted mainly from proactive expansion. We expect the selling & marketing expenses/net revenue ratio would keep increasing to 27.1% in FY23E, as the Group's growth requires further expansion. Meanwhile, general & admin. expenses/net revenue ratio would decline to 18.8% in FY23E, as we project the Group would benefit from cost savings from economies of scale and innovation in education model.

Moreover, the Group's increased impairment loss of long-term investments also contributed to the net loss in FY20. As such losses on investments are highly uncertain, the Group's net profit may experience more volatility the future. However, in our forecast horizon, we assume the impairment loss on long-term investments to be relatively stable.

Based on the above assumptions, we project GPM, OPM, and NPM (to shareholders of the Company) would be 57.2%, 11.6%, and 11.4% for FY23E vs. 55.1%, 4.2%, and -3.4% in FY20. We also project that the non-GAAP OPM and non-GAAP NPM (to shareholders of the Company) would reach 14.8% and 14.6% in FY23E.

#### Exhibit 12: Margin projections (%)

	FY19A	FY20A	FY21E	FY22E	FY23E
GPM	54.6	55.1	55.7	56.7	57.2
OPM	13.3	4.2	6.9	10.0	11.6
NPM (to shareholders of the Company)	14.3	(3.4)	7.5	10.0	11.4
Non-GAAP OPM	16.3	7.8	10.3	13.3	14.8
Non-GAAP NPM (to shareholders of the Company)	17.3	0.2	10.9	13.2	14.6

Note: 1) Non-GAAP measures exclude the impact of share-based compensation expenses on operating costs and expenses;

2) FY ends on the last day of Feb

Source(s): The Group, ABCI Securities estimates



## Valuation

### TP at US\$ 85.7/ADS; initiate with BUY

We apply the DCF valuation approach to derive our TP. The assumptions of our DCF model include: 1) a beta of 0.9; 2) a risk-free rate of 2.95%; 3) an expected market return of 11.22%; 4) a target debt/asset ratio of 0.6%; 5) a terminal growth rate of 5%; 6) based on 1-5, a WACC of 10.4%.

Our DCF model yields a TP at US\$ 85.7/ADS, which represents 155.55x/80.56x 21E/22E P/E, or 18.06x/14.75x 21E/22E P/B. Initiate with **BUY**.

### Peer valuation analysis

The Group has only a few comparable peers, and they are mostly US-listed. We consider New Oriental Education (EDU US) to be its closest peer for the similarity in market segments in which they operate. According to our estimates, the two companies had an average valuation of 90.68x/51.01x 21E/22E P/E as of Aug 21, 2020.

**Exhibit 13: Peer valuation comparison**

Ticker	Name	FY end	P/E (x)		P/B (x)		Yield (%)		ROAA (%)		ROAE (%)	
			2021	2022	2021	2022	2021	2022	2021	2022	2021	2022
EDU US	New Oriental	May-31	46.89	32.37	6.85	5.65	0.0	0.0	6.5	7.7	15.8	19.1
TAL US	TAL Education	Feb-28	134.47	69.65	15.61	12.75	0.0	0.0	4.6	6.7	12.3	20.2
<b>Average</b>			<b>90.68</b>	<b>51.01</b>	<b>11.23</b>	<b>9.2</b>	<b>0</b>	<b>0</b>	<b>5.55</b>	<b>7.2</b>	<b>14.05</b>	<b>19.65</b>

Note: Data as of Aug 21, 2020

Source(s): ABCI Securities estimates





## Risk factors

### Macroeconomic risk

China's economy suffered from the impact of the COVID-19 pandemic. According to the NBS, the 1H20 median/average personal disposable incomes were RMB 13,347/RMB 15,666, up only by 0.5%/2.4% YoY. In terms of consumption category, spending on "Education, cultural, & entertainment services" declined by 35.7% in 1H20 vs. 36.1% in 1Q20, indicating that consumers are still cautious.

**Exhibit 14: Per capita average spending on "Education, cultural, & entertainment services"**

	1Q19	1H19	2019	1Q20	1H20
Average spending (RMB)	548	1,033	2,513	350	664
Change (YoY%)	20.6	10.9	12.9	(36.1)	(35.7)

Source(s): NBS, ABCI Securities

### Regulatory risk

The after-school education industry is facing a more stringent regulatory environment. The authorities in 2018 issued several new policies to regulate the after-school education business. In Feb 2018, MOE released the "Circular on Special Enforcement Campaign concerning After-school Training Institutions to Alleviate Extracurricular Burden on Students of Primary Schools and Middle School" (《关于切实减轻中小學生課外負擔開展校外培訓機構專項治理行動的通知》), aiming to alleviate after-school burden on primary and middle school students through inspection and rectification on after-school tutoring institutions.

In Aug 2018, the State Council released the "Opinion on Regulating the Tutoring Industry" (the Opinion) (《國務院辦公廳關於規範校外培訓機構發展的意見》). The Opinion states that 1) course information should be filed with the local education authorities and made publicly available; 2) Contents of tutorial courses should not surpass the national guideline; students should be placed in courses that matches their grade levels; 3) course schedule should not be in conflict with regular school time; 4) tutorial centers should not offer tutoring courses after 8:30 p.m. and instructors should not assign homework for students; 5) no examination, competition, and any related rankings should be conducted for the courses of primary school and secondary school subjects; 6) tutorial centers cannot receive students' tuition payments for more than 3 months in advance; 7) instructors who teach Chinese, mathematics, foreign language, physics, chemistry and other subjects in the compulsory education system shall obtain teacher qualifications; 8) avg. floor space per student during one tutorial session should be no less than 3 sqm.; 9) public school teachers should not be employed by after-school tutoring institutions.

Moreover, the likelihood of stringent reporting requirements for US-listed Chinese companies is increasing. We believe that such requirements may also affect the Group and compliance costs would increase.

### Pandemic risk

The COVID-19 outbreak has led to the suspension of classes for both the formal and informal education industries in China. Resurgence of the outbreak would mean that certain regions may have to extend social distancing measures. According to the MOE, resumption of offline courses for after-school education providers would depend on the full-reopening of local formal education schools.

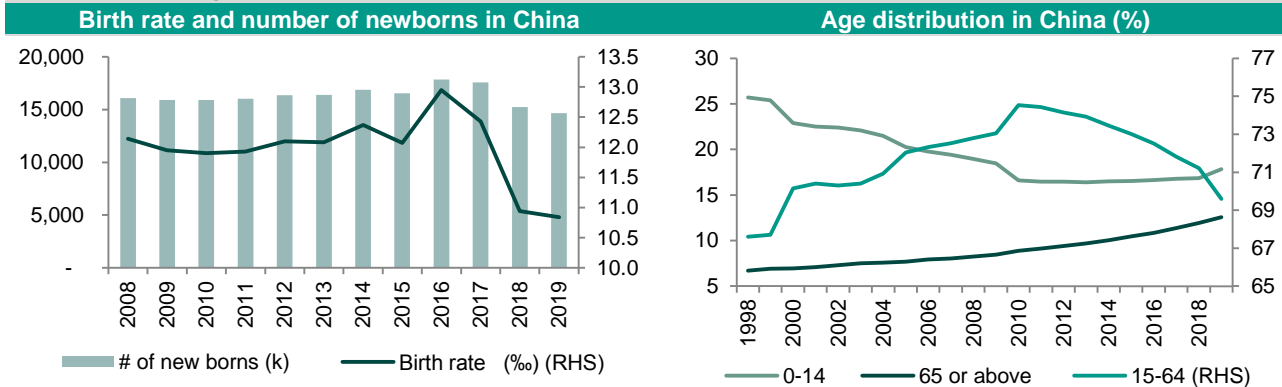
### Demographic risk

The birth rate and the number of newborns in China hit new lows at 10.84‰ and 14.65mn in 2019. Meanwhile, the Chinese population is aging. The percentage of population aged 65 or above



trended up to 12.6% in 2019, while the percentage of those aged between 15 and 64 has been steadily declining to 69.6%. The declining birth rate and growing aged population may mean the downtrend in newborns would continue, which may negatively impact the future growth of students population and potential customers for the after-school education industry.

Exhibit 15: Demographics in China



Source(s): NBS, ABCI Securities

### Changing industry landscape

The after-school education industry is undergoing rapid changes due to a multitude of factors, including the regulatory ones. As social distancing measures were implemented due to the COVID-19 outbreak, teaching has shifted from offline to online, meaning that education providers that are less equipped with online teaching capability and IT support may be disadvantaged. Besides, the pandemic also led to changes in the application process for overseas educational institutions and potential postponement of overseas study plans for PRC students. Therefore, revenue from overseas test preparation courses may drop in the coming fiscal year. Social, political, and economic changes in the domestic and overseas markets mean it is crucial to remain flexible.

### Education quality risk

Maintaining education quality is crucial for the Group to retain and recruit students. If the Group cannot maintain its education quality, existing students may switch to courses offered by competitors and recruiting new students may become more challenging.

### Expansion risk

The Group has been increasing the number of school and learning centers to expand its geographical coverage. TAL's expenses may grow faster than its revenue as a result of the expansion of business and physical network. Margins would ultimately be impacted.

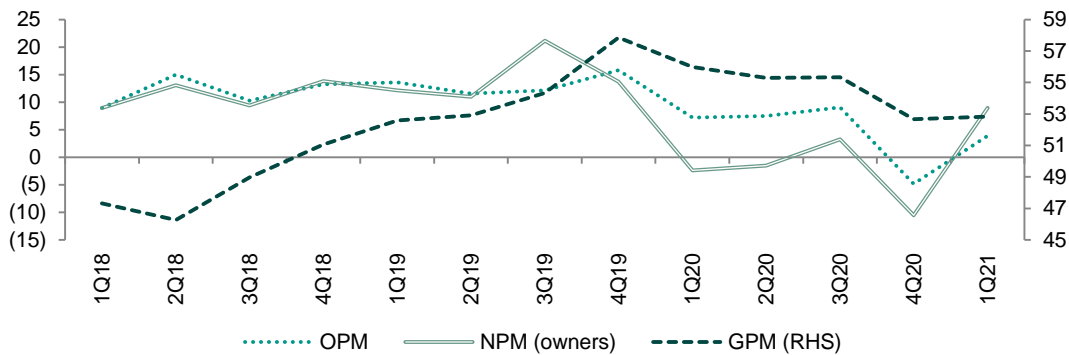
The Group has also been expanding its business through acquisition and investments in other companies. The Group's financial performance would be negatively impacted by if financial performance by these targets deteriorate. Impairment losses on long-term investments increased to US\$ 154.0mn in FY20 from US\$ 58.1mn in FY19, partly contributing to the full-year FY20 net loss.

### Seasonality of business

The Group's business is subject to seasonal patterns. The Group records higher revenue in certain quarters due to increased student enrollment and payment; its expenses, however, may not correspond with the revenue pattern. Therefore, margins may fluctuate from one quarter to another.

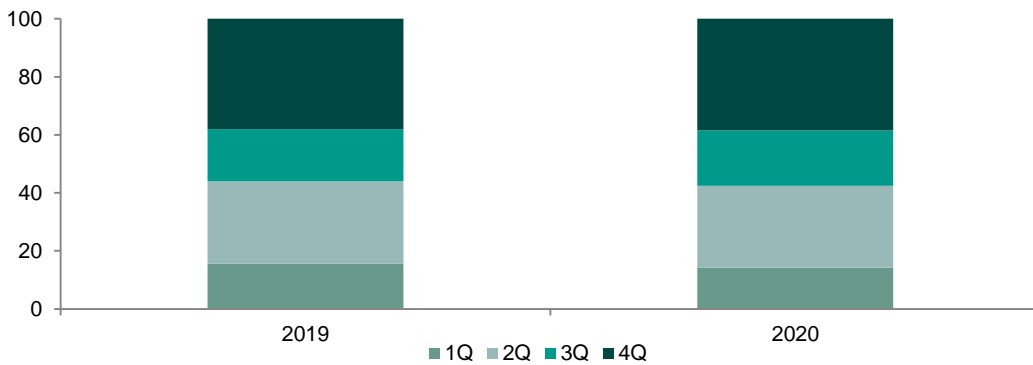


**Exhibit 16: Quarterly margin change (%)**



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

**Exhibit 17: Normal priced long-term course student enrollment contribution by quarter (%)**



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

**High growth of SG&A expenses presents challenge to profitability**

The Group has been aggressive on expansion. Growth in SG&A was higher than that in its close rival, New Oriental. If the Group ramps up its expansion pace further, the increase in SG&A may lead to margin erosion.

**Exhibit 18: SG&A expenses analysis**

	FY18	FY19	FY20
<b>Growth (YoY %)</b>			
TAL Edu			
Selling & marketing expenses	92.1	99.9	76.2
General & admin. expenses	46.7	50.1	37.1
New Oriental			
Selling & marketing expenses	39.3	18.5	15.9
General & admin. expenses	43.2	30.2	10.8
<b>% of total net revenue</b>			
TAL Edu			
Selling & marketing expenses	14.1	18.9	26.1
General & admin. expenses	22.5	22.6	24.3
New Oriental			
Selling & marketing expenses	13.2	12.4	12.4
General & admin. expenses	32.5	33.4	32.0

Note: New Oriental FY ends on May 31; TAL Edu FY ends on the last day of Feb  
 Source(s): The Group, ABCI Securities



### Non-GAAP financial metrics

The Group also discloses non-GAAP financial metrics that exclude the impact of share-based compensation expenses on operating costs and expenses. There are discrepancies between the reported figures and the non-GAAP figures. We believe investors should exercise caution when interpreting the non-GAAP financial metrics.

### Lack of dividend payout

The Group only paid special cash dividends in 2010, 2012, and 2017. We believe that the lack of potential dividend payouts would lower the total return for investors, thus reducing the counter's appeal.

### Dual-class voting structure

As of Jun 8, 2020, the Group's issued and outstanding share capital consisted of 133,167,853 Class A common shares and 66,941,204 Class B common shares; holders of Class B common shares (excluding any Class A common shares such holder may hold in the form of ADSs) collectively held approximately 83.4% the voting power of outstanding shares. Each holder of Class B common shares is entitled to ten votes per Class B common share and each holder of Class A common shares is entitled to one vote per Class A common share held by the Group's shareholders on all matters submitted to them for a vote. Class B common shares are convertible at any time by the holder into Class A common shares on a 1:1 basis. Class A common shares are not convertible into Class B common shares under any circumstances.

We believe the dual-class voting structure would limit the influence that holders of Class A common shares in the form of ADSs can exert on corporate matters of the Group.

#### Exhibit 19: Share ownership

Principal shareholders	Number of shares	% of total shares	% of voting power
Bright Unison Limited	48,005,204	24.0	59.8
Morgan Stanley entities	30,233,411	15.1	3.8
Baillie Gifford & Co	15,729,456	7.9	2.0
UBS Asset Management division of UBS Group AG	17,203,377	8.6	2.1

Note: As of Jun 8, 2020

Source(s): The Group, ABCI Securities



## Financial statements

### Consolidated income statement

(US\$ mn, except per share data)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Net revenue</b>	<b>2,563</b>	<b>3,273</b>	<b>4,423</b>	<b>6,390</b>	<b>8,737</b>
Cost of revenue	(1,164)	(1,469)	(1,960)	(2,767)	(3,741)
<b>Gross profit</b>	<b>1,399</b>	<b>1,805</b>	<b>2,463</b>	<b>3,623</b>	<b>4,996</b>
Selling and marketing expenses	(484)	(853)	(1,180)	(1,712)	(2,364)
General and admin expenses	(580)	(795)	(992)	(1,287)	(1,644)
Others	7	(20)	12	18	24
<b>Operating profit</b>	<b>342</b>	<b>137</b>	<b>303</b>	<b>641</b>	<b>1,012</b>
Net financial expenses	42	61	99	154	212
Other gains/(losses)	74	(249)	14	20	41
<b>Pretax profit</b>	<b>457</b>	<b>(51)</b>	<b>416</b>	<b>815</b>	<b>1,265</b>
Tax	(77)	(69)	(81)	(161)	(240)
Loss from equity method investments	(16)	(8)	(10)	(9)	(9)
<b>Net profit</b>	<b>365</b>	<b>(128)</b>	<b>325</b>	<b>645</b>	<b>1,016</b>
- Owners	367	(110)	330	638	995
- MI	(3)	(17)	(5)	7	21
<b>Net profit per common share (US\$)</b>					
- Basic	1.93	(0.56)	1.65	3.19	4.98
- Diluted	1.83	(0.56)	1.59	3.06	4.78
<b>Net profit per common ADS (US\$)</b>					
- Basic	0.64	(0.19)	0.55	1.06	1.66
- Diluted	0.61	(0.19)	0.53	1.02	1.59

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)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash, cash equivalents, and restricted cash	1,247	1,874	2,821	3,955	6,048
ST investments	268	345	408	452	368
Others	230	276	402	502	730
<b>Current assets</b>	<b>1,746</b>	<b>2,496</b>	<b>3,631</b>	<b>4,909</b>	<b>7,147</b>
Property and equipment	288	367	638	798	1,214
Goodwill	414	379	379	379	379
Intangible assets	75	59	120	179	231
Operating lease right-of-use assets	0	1,244	2,106	2,632	4,008
Others	1,212	1,027	1,545	1,971	2,249
<b>Non-current assets</b>	<b>1,989</b>	<b>3,075</b>	<b>4,787</b>	<b>5,959</b>	<b>8,081</b>
<b>Total assets</b>	<b>3,735</b>	<b>5,571</b>	<b>8,419</b>	<b>10,868</b>	<b>15,228</b>
ST Deferred revenue	434	780	1,597	2,223	2,575
ST Operating lease liabilities	0	305	531	663	1,010
Others	750	721	1,413	1,988	3,464
<b>Current liabilities</b>	<b>1,184</b>	<b>1,807</b>	<b>3,541</b>	<b>4,874</b>	<b>7,049</b>
LT borrowing	0	262	286	344	417
LT Operating lease liabilities	0	950	1,653	2,067	3,146
Others	21	9	70	69	85
<b>Non-current liabilities</b>	<b>21</b>	<b>1,220</b>	<b>2,009</b>	<b>2,479</b>	<b>3,648</b>
Shareholders' capital	2,484	2,516	2,846	3,484	4,479
MI	47	28	23	30	51
<b>Total equity</b>	<b>2,530</b>	<b>2,544</b>	<b>2,869</b>	<b>3,514</b>	<b>4,530</b>
<b>Total liabilities and equity</b>	<b>3,735</b>	<b>5,571</b>	<b>8,419</b>	<b>10,868</b>	<b>15,228</b>

Note: FY ends on the last day of Feb

Source(s): The Group, ABCI Securities estimates



### Consolidated cash flow statement

(US\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net profit	365	(128)	325	645	1,016
Depreciation and amortization	89	118	143	222	328
Change in working capital	(272)	442	1,017	742	1,029
Others	13	423	317	342	557
<b>Cash flow from operating activities</b>	<b>194</b>	<b>856</b>	<b>1,802</b>	<b>1,952</b>	<b>2,930</b>
Change in property and equipment	(137)	(178)	(279)	(403)	(548)
Change in investments	283	(86)	(164)	(70)	135
Others	(313)	(76)	(124)	(119)	(141)
<b>Cash flow from investing activities</b>	<b>(167)</b>	<b>(339)</b>	<b>(567)</b>	<b>(591)</b>	<b>(554)</b>
Change in borrowing	(15)	61	58	74	86
Others	490	71	(384)	(307)	(420)
<b>Cash flow from financing activities</b>	<b>475</b>	<b>131</b>	<b>(326)</b>	<b>(234)</b>	<b>(334)</b>
Effect of foreign exchange rate changes	33	3	16	10	55
Net change in cash, cash equivalent, and restricted cash	267	536	651	909	1,127
<b>cash, cash equivalent, and restricted cash - end</b>	<b>1,264</b>	<b>1,915</b>	<b>2,841</b>	<b>3,977</b>	<b>6,073</b>

Note: FY ends on the last day of Feb

Source(s): The Group, ABCI Securities estimates

### Key operating and financial ratios

	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Growth (YoY %)</b>					
Net revenue	49.4	27.7	35.1	44.5	36.7
Gross profit	68.0	29.0	36.5	47.1	37.9
Operating profit	63.7	(59.8)	120.6	111.6	57.8
Net profit (to shareholders of the Company)	85.1	(130.0)	N/A	93.1	55.9
Non-GAAP operating profit	63.8	(39.0)	77.6	87.2	52.2
Non-GAAP net profit (to shareholders of the Company)	81.0	(98.3)	6,106.4	75.8	50.7
<b>Profitability ratios (%)</b>					
GPM	54.6	55.1	55.7	56.7	57.2
OPM	13.3	4.2	6.9	10.0	11.6
NPM (to owners of the Company)	14.3	(3.4)	7.5	10.0	11.4
Non-GAAP OPM	16.3	7.8	10.3	13.3	14.8
Non-GAAP NPM (to owners of the Company)	17.3	0.2	10.9	13.2	14.6
<b>Return ratios (%)</b>					
ROAA	10.7	(2.7)	4.6	6.7	7.8
ROAE	17.9	(4.4)	12.3	20.2	25.0
<b>Liquidity ratio (x)</b>					
Current ratio	1.5	1.4	1.0	1.0	1.0
Cash ratio	1.1	1.1	0.8	0.8	0.9
<b>Leverage ratios (%)</b>					
Total debt to Equity	8.5	10.3	10.0	9.8	9.2
Total debt to Total assets	5.8	4.7	3.4	3.2	2.7
Net debt/(cash) to Equity	(41.4)	(65.0)	(89.0)	(103.4)	(124.9)
Net debt/(cash) to Total assets	(28.1)	(29.7)	(30.3)	(33.4)	(37.1)

Note: FY ends on the last day of Feb

Source(s): The Group, ABCI Securities estimates



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Rating	Definition
Buy	Stock return rate $\geq$ Market return rate (10%)
Hold	- Market return rate (-10%) $\leq$ Stock return rate < 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 2008-19 CAGR at 10%)

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.

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