

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

New Oriental Education (EDU US)

Koolearn to lift 1Q23E

- Recurring business stability and growth, plus Koolearn (1797 HK) success to boost upcoming New Oriental results
- New Oriental to report 1Q23E results, we forecast 24% qoq revenue growth, with positive net profit turnaround
- Reiterate BUY; Valuation remains attractive as discount to net cash at 9% and attractive from SOTP basis

Looking for robust 1Q23E results

New Oriental earnings has been under pressure since 2021 due to regulatory changes and subsequent restructuring challenges. 4Q22 was the first quarter with clean slate ending its exposure to K-9 academic tutoring segment plus related restructuring expenses. Koolearn's huge success in live commerce which started in June will get its first presentation in 1Q23E (June-August).

Koolearn to be a sizable portion in the mix

We forecast New Oriental's legacy tutoring and test prep segment to maintain stable, forecasted to see a combined 5% qoq with tutoring segment benefitting from summer high season (although growth on yoy basis is negative, which is due to discontinued K-9 segment). New businesses including: 1) STEAM courses (e.g. reading, coding, and arts); 2) Smart devices; 3) Study tour; 4) Koolearn's Dong Fang Zhen Xuan (DFZX, 东方甄选). Our model current assumes avg. daily GMV reached RMB26mn for 1Q23E and 2Q23E for DFZX. Going forward, we expect 1Q23E group revenue to reach USD647mn, +24% qoq, mainly driven by DFZX's incremental revenue contribution, at 17.5% of group revenue. Moreover, we forecast 1Q23E NG NP to reach USD27mn, a turnaround after 4 quarters of significant losses due to restructuring.

Management outlook could be a near term catalyst

Given strong success in 1Q23E of Koolearn, market will focus on Koolearn regarding its development strategy as well as profit profile and outlook. While we are fundamentally positive on Koolearn and New Oriental, we find New Oriental valuation more attractive on: 1) Discount to net cash of 9%, and 2) SOTP basis, where New Oriental's current market value of its Koolearn's stake plus most recent net cash is equivalent to USD4.19bn, which is 74% above current New Oriental market cap, while not factoring in its traditional tutoring businesses which have stabilized with moderate growth. We trimmed our forecast for New Oriental factoring recent estimate changes for Koolearn (Figure 7). We lowered TP from USD33 to USD29 from FX and earnings changes, our new TP implies 57x FY23E P/E. **Key Risks:** 1) New business' competition; 2) Exit from senior high segment; 3) Regulatory.

Financials

Year ended 31 May (USD mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	4,277	3,105	2,437	2,668	2,928
Growth (%)	20%	-27%	-22%	9%	10%
Gross profit	2,240	1,351	1,310	1,487	1,691
Growth (%)	13%	-40%	-3%	14%	14%
Non-GAAP OP	186	-850	26	215	382
Growth (%)	-60%	n.a.	n.a.	734%	77%
Non-GAAP NI	389	-1,046	86	199	318
Growth (%)	-20%	n.a.	n.a.	131%	59%
Non-GAAP EPADS (USD)	2.35	-6.17	0.51	1.18	1.87
P/E (x)	9.3	n.a.	43.9	19.0	11.9
ROE	10%	-24%	2%	5%	8%

Sources: Company data, CMS (HK) estimates; share price as of Oct. 19, 2022

Tommy WONG
+852 3189 6634
tommywong@cmschina.com.hk

Crystal LI, CFA
+852 3189 6122
crystalli@cmschina.com.hk

Kaia ZHANG
+852 3189 6176
kaiazhang@cmschina.com.hk

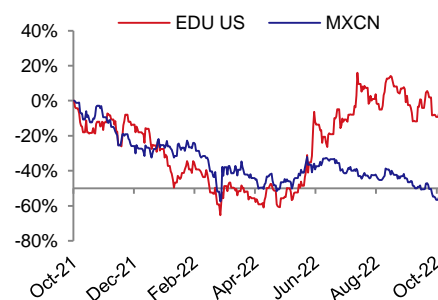
WHAT'S NEW

1Q23 Preview; Earnings/TP revision

BUY

Previous	BUY
Price (Oct. 19, 2022)	USD22.3
12-month Target Price (Potential up/downside)	USD29 (+30%)
Previous	USD33

Price Performance



Source: Bloomberg

%	1m	6m	12m
EDU US	(8.5)	108.9	(10.7)
MXCN	(17.2)	(22.7)	(52.2)

Sector: Education

Hang Seng Index (Oct. 19, 2022)	16,511
HSCEI (Oct. 19, 2022)	5,598

Key Data

52-week range (USD)	8.4 - 29.8
Market cap (USD mn)	3,795
Avg. daily volume (mn)	1.28
BVPS (HKD)	170.9

Shareholding Structure

Michael Minhong Yu	10%
No. of shares outstanding (mn)	1,697
% outstanding	90%

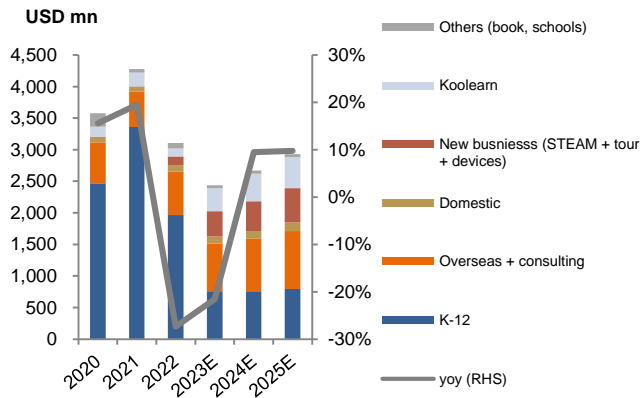
Sources: Company data, Bloomberg

Related Research

1. New Oriental Education (EDU US) - A clean slate for a brighter new start (BUY) (July 28, 2022)
2. New Oriental Education (EDU US) - 3Q22 tail of restructuring phase (BUY) (Apr 27, 2022)
3. New Oriental Education (EDU US) - Scaling back to its roots (BUY) (Oct 13, 2021)
4. New Oriental Education (EDU US) - Solid 3Q21 with positive outlook (BUY) (Apr 21, 2021)

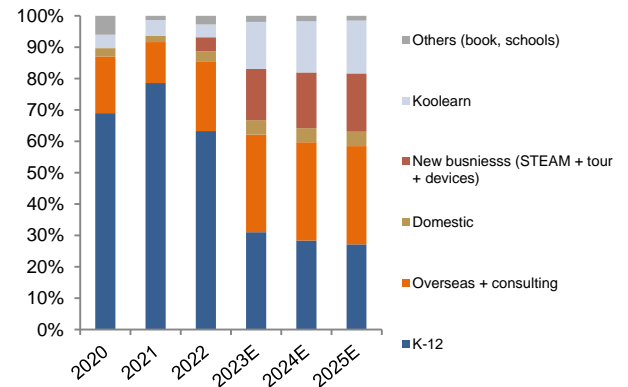
Focus charts

Figure 1: New Oriental's total revenue growth to recover in FY24E driven by legacy and new businesses



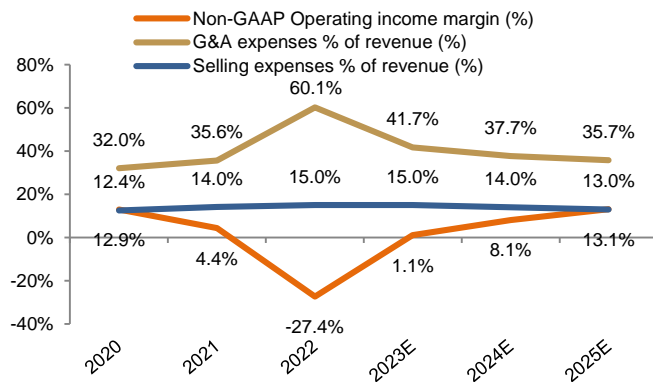
Sources: Company data, CMS (HK) estimates

Figure 2: New businesses' revenue contribution is increasing



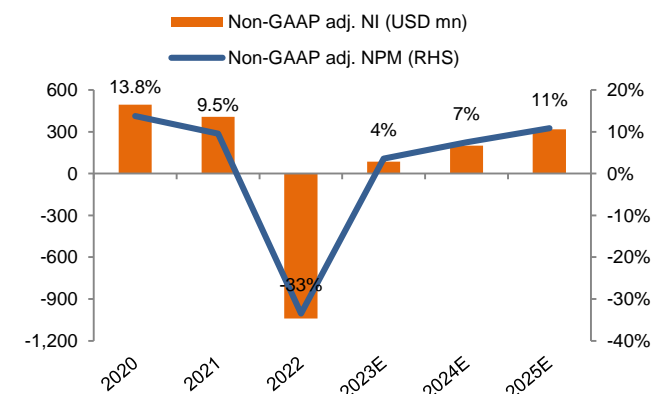
Sources: Company data, CMS (HK) estimates

Figure 3: New Oriental's OPEX and NG OPM



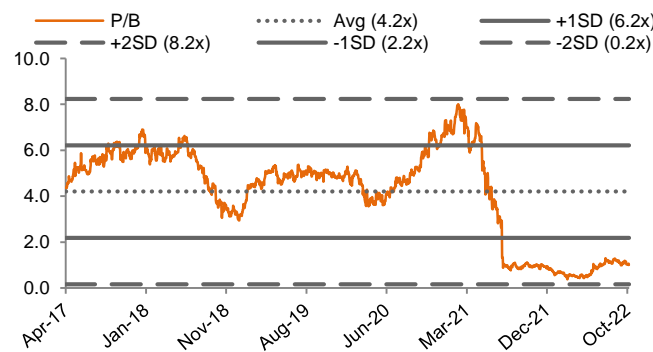
Sources: Company data, CMS (HK) estimates

Figure 4: We forecast New Oriental to near breakeven in FY23E



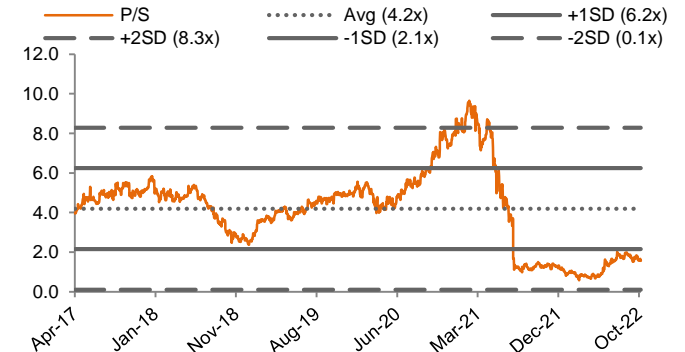
Sources: Company data, CMS (HK) estimates

Figure 5: P/B range for New Oriental



Sources: Bloomberg, Company data, CMS (HK) estimates

Figure 6: P/S range for New Oriental



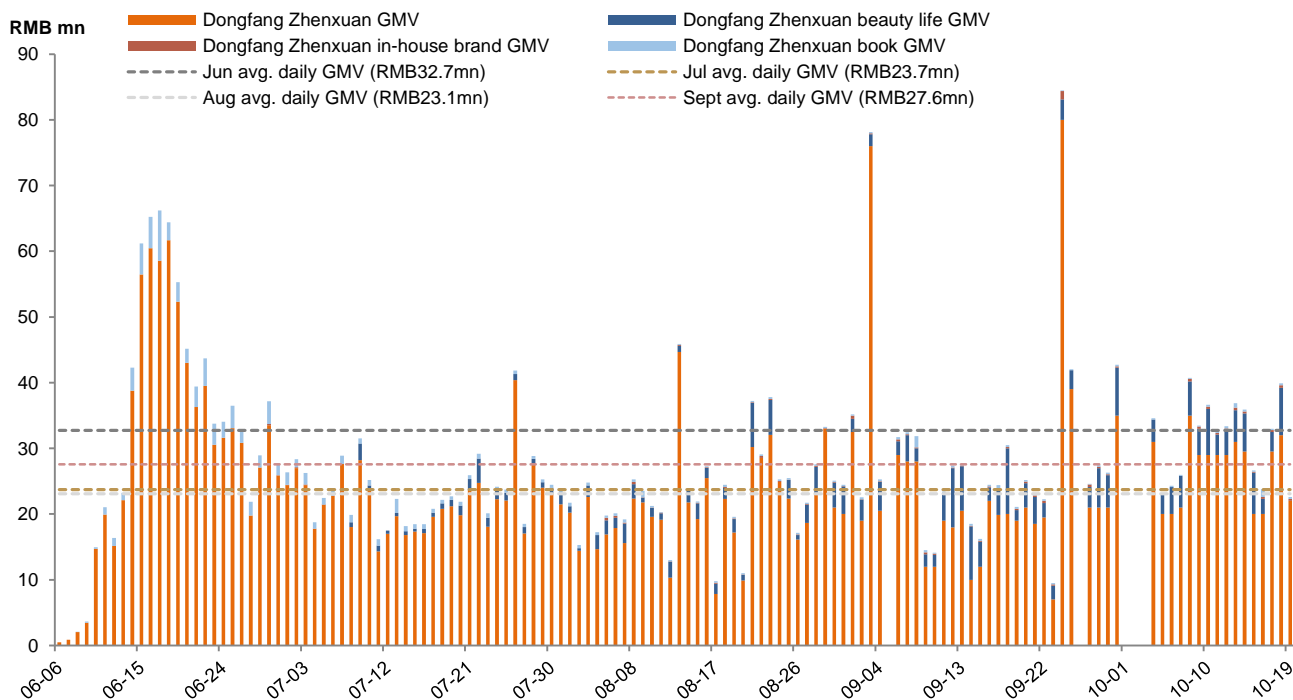
Sources: Bloomberg, Company data, CMS (HK) estimates

Figure 7: New Oriental's earnings revision

USD mn	FY23E			FY24E			FY25E		
	Previous	Revised	change	Previous	Revised	change	Previous	Revised	change
Revenue	2,588	2,437	-5.8%	2,845	2,668	-6.2%	3,126	2,928	-6.3%
Gross profit	1,391	1,310	-5.8%	1,586	1,487	-6.3%	1,806	1,691	-6.4%
Non - GAAP OP	28	26	-7.4%	230	215	-6.4%	409	382	-6.5%
Non-GAAP Net income	92	86	-5.9%	213	199	-6.3%	340	318	-6.5%
Non-GAAP Core NI	92	86	-5.9%	213	199	-6.3%	340	318	-6.5%
GPM	53.8%	53.7%	0 ppt	55.8%	55.7%	0 ppt	57.8%	57.7%	0 ppt
Non-GAAP OPM	1.1%	1.1%	0 ppt	8.1%	8.1%	0 ppt	13.1%	13.1%	0 ppt
Non-GAAP NPM	3.6%	3.5%	0 ppt	7.5%	7.5%	0 ppt	10.9%	10.9%	0 ppt
Non-GAAP Core NPM	3.6%	3.5%	0 ppt	7.5%	7.5%	0 ppt	10.9%	10.9%	0 ppt

Sources: Company data, CMS (HK) estimates

Figure 8: Koolearn's Dong Fang Zhen Xuan's GMV in recent months



Sources: Huitun Data, CMS (HK)

Figure 9: Tutoring sector peers comparison

Company	CN name	Ticker	Price (local currency)	CMS			Mkt cap (USDm)	3-mth avg t/o (Loc\$m)	P/E (x)		PEG*	P/S (x)		PSG*	Sales CAGR (%) 2022-2024 CAGR	EPS CAGR (%) 2022-2024 CAGR
				Rating	TP(Local currency)	Up/(Dn) side (%)			FY22E	FY23E		FY22E	FY23E			
HSI			16,511					9.0	7.9	0.6	0.8	0.7	0.1	9.3	12.4	
HSCEI			5,598					7.6	6.8	0.6	0.6	0.6	0.1	9.6	11.2	
Offline tutoring - China																
NEW ORIENTAL	新东方	EDU US 9901 HK	22.3 18.8	BUY BUY	29.0 23.0	29.9 22.3	3,795	50.8	n.a.	43.9	n.a.	1.2	1.6	n.a.	(7.3)	n.a.
TAL	好未来	TAL US	3.8	BUY	5.0	30.5	2,485	30.7	n.a.	n.a.	n.a.	0.6	2.4	n.a.	(46.9)	(82.3)
OFFCN	中公教育	002607 CH	4.6	NR	n.a.	n.a.	3,942	174.9	33.4	22.0	n.a.	3.1	2.6	n.a.	n.a.	n.a.
EAST	东方	667 HK	2.6	NR	n.a.	n.a.	721	4.9	8.5	7.3	n.a.	1.0	0.9	n.a.	n.a.	n.a.
ONLY	昂立	600661 CH	8.6	NR	n.a.	n.a.	339	42.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
SCHOLAR	思考乐	1769 HK	0.7	NR	n.a.	n.a.	52	1.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
BESTSTUDY	卓越	3978 HK	0.5	NR	n.a.	n.a.	56	0.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Online tutoring - China																
GAOTU	高途	GOTU US	0.9	BUY	2.3	152.7	234	2.8	29.8	6.1	0.0	0.7	0.6	0.0	21.3	188.6
KOOLEARN	新东方在线	1797 HK	34.5	HOLD	UR	n.a.	4,413	725.0	n.m.	48.5	0.2	53.1	12.2	0.1	129.8	299.3
YOUDAO	有道	DAO US	4.2	NR	n.a.	n.a.	524	0.6	n.a.	30.6	n.a.	0.6	0.5	n.a.	n.a.	n.a.
SUNLAND	尚德机构	STG US	4.2	NR	n.a.	n.a.	58	0.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
51 TALK	51 Talk	COE US	1.7	NR	n.a.	n.a.	38	0.1	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Education (US listed Non-China)																
PEARSON		PSO US	10.0	NR	n.a.	n.a.	7,223	3.3	15.2	14.0	n.a.	1.5	1.5	n.a.	n.a.	n.a.
GRAHAM		GHC US	588.8	NR	n.a.	n.a.	2,851	8.0	11.1	7.7	n.a.	0.7	0.7	n.a.	n.a.	n.a.
GRAND		LOPE US	84.8	NR	n.a.	n.a.	2,710	20.8	13.9	12.9	n.a.	2.8	2.7	n.a.	n.a.	n.a.
LAUREATE		LAUR US	10.8	NR	n.a.	n.a.	1,780	9.5	11.3	8.1	n.a.	1.3	1.2	n.a.	n.a.	n.a.
ADTALEM		ATGE US	37.9	NR	n.a.	n.a.	1,721	13.7	13.2	9.0	2.2	1.2	1.1	n.a.	n.a.	4.1
K12		LRN US	46.5	NR	n.a.	n.a.	1,988	23.6	18.6	15.0	0.6	1.1	1.0	0.1	8.5	24.7
STRATEGIC		STRA US	64.4	NR	n.a.	n.a.	1,587	6.9	18.7	15.1	n.a.	1.4	1.4	n.a.	n.a.	n.a.
Average - Offline tutoring - China									14.0	18.3	n.a.	1.2	1.5	n.a.	(18.1)	(41.1)
Average - Online tutoring - China									29.8	28.4	0.1	18.1	4.4	0.1	75.6	244.0
Average - Tutoring - Non-China									14.6	11.7	1.4	1.4	1.4	0.1	8.5	14.4
Average (all)									15.8	17.2	0.8	4.7	2.0	0.1	17.6	72.4

Sources: Company data, CMS (HK) estimates; share prices as of Oct. 19 2022. Note: All information of Non-rated stocks was sourced from Bloomberg. *PEG was calculated based on FY21E P/E and FY20-22E EPS CAGR; PSG was calculated based on FY21E P/S and FY20-22E sales CAGR.

Financial Summary: New Oriental (EDU US)

Balance Sheet

(USD mn)	FY21	FY22	FY23E	FY24E	FY25E
Year ended	31 May	31 May	31 May	31 May	31 May
Plant, property, equipment	865	403	453	525	623
Intangible assets & goodwill	78	74	74	74	74
LT investments	538	438	447	456	465
Other LT assets	2,096	646	659	673	686
Non-current assets	3,577	1,561	1,632	1,727	1,848
Cash & Equivalent	1,612	1,149	2,293	2,384	2,562
Restricted cash & Term deposits	1,214	1,140	684	684	684
ST investments	3,435	1,902	951	951	951
Accounts & Receivables	9	16	22	21	23
Inventories	31	28	32	32	33
Other current assets	273	239	243	248	253
Current assets	6,574	4,474	4,225	4,319	4,506
Total assets	10,151	6,035	5,858	6,046	6,354
ST Debt	0	0	0	0	0
Accounts & Notes payable	38	22	32	32	33
Deferred revenue	1,926	933	732	802	880
Other current liabilities	1,507	755	770	785	801
Current liabilities	3,471	1,710	1,534	1,618	1,714
LT Debt	0	0	0	0	0
Other non current liability	1,661	531	542	552	564
Non-current liabilities	1,661	531	542	552	564
Total liabilities	5,133	2,241	2,075	2,171	2,277
Total net assets	5,018	3,794	3,783	3,875	4,076
Share capital	2	2	2	2	2
Reserves	4,912	3,704	3,693	3,786	3,986
Shareholder's equity	4,913	3,706	3,694	3,787	3,988
Non-controlling interest	105	88	88	88	88
Total Equity	5,018	3,794	3,783	3,875	4,076
Total debts	0	0	0	0	0
Net cash/(debts)*	6,261	4,191	3,928	4,019	4,197

Cashflow Statement

(USD mn)	FY21	FY22	FY23E	FY24E	FY25E
Year ended	31 May	31 May	31 May	31 May	31 May
Pretax Income	334	-1,188	-11	93	201
Dep. & Amort.	230	605	105	105	105
Chg in working cap	603	-1,014	-201	71	76
Others	-38	317	10	11	11
Net cash from operations	1,130	-1,280	-97	279	393
CAPEX	-384	-138	-150	-172	-198
Acquisition	1	-3	-5	-5	-5
Investment	-2,152	1,706	1,398	-9	-9
Others	358	-397	-13	-13	-13
Net cash from investments	-2,178	1,169	1,231	-199	-226
Dividend paid	0	0	0	0	0
Shares issued (cancelled)	0	0	0	0	0
Debt issued (repaid)	0	0	0	0	0
Others	1,654	-231	11	11	11
Net cash from financing	1,654	-231	11	11	11
Exchange impact	106	-95	0	0	0
Net change in cash	713	-438	1,144	91	178
Opening cash	919	1,632	1,195	2,339	2,429
Closing cash	1,632	1,195	2,339	2,429	2,607
Closing cash (excl. restricted cash)	1,612	1,149	2,293	2,384	2,562

Profit & Loss Statement

(USD mn)	FY21	FY22	FY23E	FY24E	FY25E
Year ended	31 May	31 May	31 May	31 May	31 May
Revenue	4,277	3,105	2,437	2,668	2,928
Cost of revenue	-2,037	-1,754	-1,127	-1,181	-1,237
Gross profit	2,240	1,351	1,310	1,487	1,691
Selling expense	-601	-467	-366	-373	-381
G&A expense	-1,522	-1,867	-1,016	-1,005	-1,045
Total opex	-2,122	-2,333	-1,381	-1,378	-1,426
Gain on disposal of subsidiaries	0	0	0	0	0
Operating income	117	-983	-72	109	265
Net interest income	158	-32	44	48	53
Other income	40	-18	5	5	6
Pre-tax profit	315	-1,032	-23	162	324
Tax	-84	-136	6	-41	-81
Profit after tax	231	-1,169	-23	162	324
Loss from equity method investments	-1	-51	0	0	0
Non-controlling interests	104	33	6	-29	-42
Net profit - as reported	334	-1,188	-11	93	201
Non-GAAP items:					
Non - GAAP Operating income	186	-850	26	215	382
Non-GAAP Net income	389	-1,046	86	199	318
Non-GAAP Core NI	407	-1,040	86	199	318
Non-GAAP EPADS (USD)	2.35	-6.17	0.51	1.18	1.87
Non-GAAP Core EPADS (USD)	2.46	-6.13	0.51	1.18	1.87

Financial ratios

	FY21	FY22	FY23E	FY24E	FY25E
Year ended	31 May	31 May	31 May	31 May	31 May
yoY growth rate (%)					
Turnover	19.5	-27.4	-21.5	9.5	9.8
Gross Profit	12.6	-39.7	-3.1	13.5	13.7
Operating profit - as reported	-70.6	n.a.	-92.7	n.a.	143.7
Net profit - as reported	-19.1	n.a.	-99.1	n.a.	116.5
Non-GAAP OP	-59.6	n.a.	n.a.	734.1	77.4
Non-GAAP NI	-19.6	n.a.	n.a.	130.7	59.4
Non-GAAP Core NI	-17.6	n.a.	n.a.	130.7	59.4
Margins (%)					
Gross margin	52.4	43.5	53.7	55.7	57.7
OPM - as reported	2.7	-31.6	-2.9	4.1	9.1
NPM - as reported	7.8	-38.2	-0.5	3.5	6.9
OPM - Non-GAAP	4.4	-27.4	1.1	8.1	13.1
NPM - Non GAAP	9.1	-33.7	3.5	7.5	10.9
Core NPM- Non-GAAP	9.5	-33.5	3.5	7.5	10.9
Effective tax rate (%)	26.5	-13.2	25.0	25.0	25.0
Current ratio (x)	1.0	1.1	0.6	0.6	0.6
Net cash/equity (%)	124.8	110.5	103.8	103.7	1.0
Returns (%)					
Asset turnover (x)	0.5	0.4	0.4	0.4	0.5
Financial leverage (x)	2.1	1.8	1.6	1.6	1.6
EBIT margin (%)	2.7	-31.6	-2.9	4.1	9.1
Interest burden (x)	2.7	1.1	0.3	1.5	1.2
Tax burden (x)	1.3	1.0	-3.8	1.2	1.0
ROE (%)	10.3	-23.6	2.3	5.2	8.0
P/E (x)	9.3	n.a.	43.9	19.0	11.9
P/B (x)	0.8	1.0	1.0	1.0	0.9

Sources: Company data, CMS (HK) estimates; *Net cash includes Bank balance, ST investments and term deposits. Share price as of Oct. 19, 2022

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
HOLD	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

Analyst Disclosure

The analysts primarily responsible for the preparation of all or part of the research report contained herein hereby certify that: (i) the views expressed in this research report accurately reflect the personal views of each such analyst about the subject securities and issuers; and (ii) no part of the analyst's compensation was, is, or will be directly or indirectly, related to the specific recommendations or views expressed in this research report.

Regulatory Disclosure

Please refer to the important disclosures on our website <http://www.newone.com.hk/cmshk/gb/disclosure.html> or <http://www.cmschina.com.hk/Research/Disclosure>.

Disclaimer

This document is prepared by China Merchants Securities (HK) Co Limited. The information contained herein has been obtained from or is based on sources believed to be reliable. China Merchant Securities (HK) Co Limited, its holding company or affiliated companies, or any of its or their directors, officers or employees (collectively "CMS") do not represent or warrant, expressly or impliedly, that it is accurate, correct or complete and it should not be relied upon. CMS will not accept any responsibility or liability whatsoever for any use of or reliance upon this document or any of the content thereof.

This document is for information purpose only. Neither the information nor opinion expressed shall be construed, expressly or impliedly, as an advice, offer or solicitation of an offer, invitation, advertisement, inducement, recommendation or representation of any kind or form whatsoever to buy or sell any security, financial instrument or any investment or other specific product. The securities, instruments or strategies discussed in this document may not be suitable for all investors, and certain investors may not be eligible to participate in some or all of them. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. CMS is not registered as a broker-dealer in the United States and its products and services are not available to U.S. persons except as permitted under SEC Rule 15a-6.

Opinions, and associated estimates and forecasts, or any content and information in this document are only current as of the date of their publication and will be subject to change without prior notice. Past performance is not indicative of future performance. Estimates of future performance are based on assumptions that may not be realized. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. Opinions expressed herein may differ or be contrary to those expressed by other business divisions or other members of CMS as a result of using different assumptions and/or criteria.

This document has been prepared without regard to the individual financial circumstances and investment objectives of the persons who receive it. Use of any information herein shall be at the sole discretion and risk of the user. Investors are advised to independently evaluate particular investments and strategies, take financial and/or tax advice as to the implications (including tax) of investing in any of the securities or products mentioned in this document, and make their own investment decisions without relying on this publication.

CMS may have a long or short position, make markets, act as principal or agent, or engage in transactions in securities of companies referred to in this document and may also perform or seek to perform investment banking services or provide advisory or other services for those companies.

This document is for the use of intended recipients only and this document may not be reproduced, distributed or published in whole or in part for any purpose without the prior consent of CMS. CMS will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document.

This document is for distribution only under such circumstances as may be permitted by applicable law. This document is not directed at you if CMS is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. In particular, this document is only made available to certain US persons to whom CMS is permitted to make available according to US securities laws, but cannot otherwise be made available, distributed or transmitted, whether directly or indirectly, into the US or to any US person.

In Hong Kong, this document is distributed by China Merchants Securities (HK) Co., Limited, which is a licensed corporation to carry on Type 1 (dealing in securities), Type 2 (dealing in futures), Type 4 (advising on securities), Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities under the Securities and Futures Ordinance (Chapter 571).

In South Korea, professional clients can get copies of this document (upon request) through China Merchants Securities (Korea) Co., Limited

In the United Kingdom, this document is distributed by China Merchants Securities (UK) Limited. This document is for distribution only to persons who: (i) are persons falling within the definition of "Investment Professionals" pursuant to Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended, the "Financial Promotion Order"); (ii) are persons falling within Article 49(2)(a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Financial Promotion Order; or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) may otherwise lawfully be communicated or caused to be communicated (all such persons together being referred to as "Relevant Persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not Relevant Persons. Any investment or investment activity to which this document relates is available only to Relevant Persons and will be engaged in only with Relevant Persons.

If there is any inconsistency or ambiguity between the English version and the Chinese version of this disclaimer, the English version shall prevail.

© China Merchant Securities (HK) Co., Limited. All rights reserved.

Hong Kong

China Merchants Securities (HK) Co., Ltd.
Address: 48/F, One Exchange Square, Central, Hong Kong
Tel: +852 3189 6888 Fax: +852 3101 0828