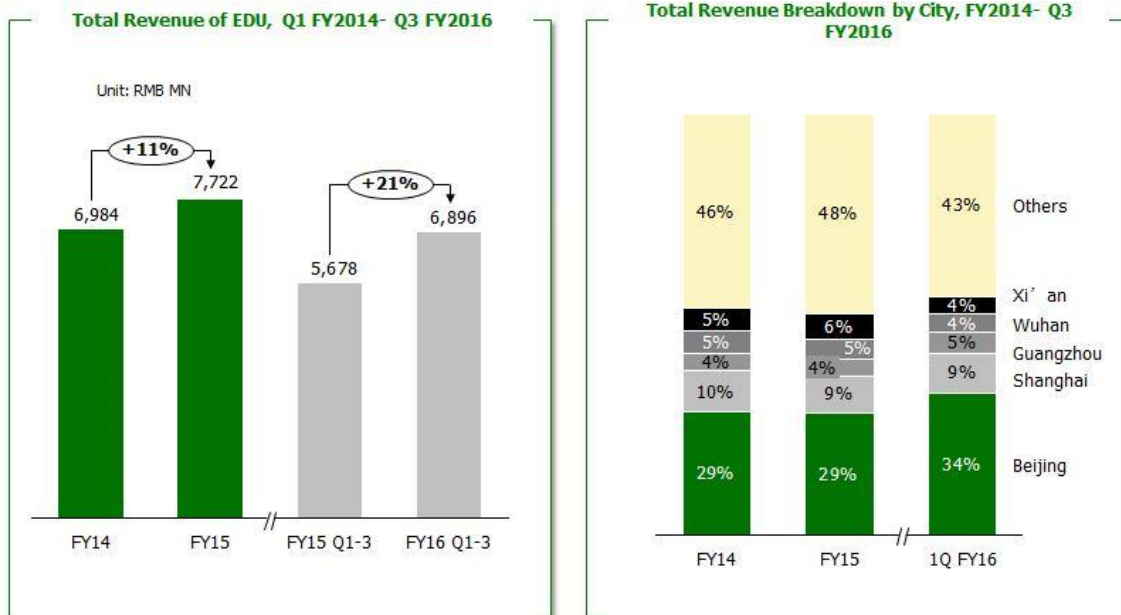


Deep Dive on EDU – Phase I Key Findings

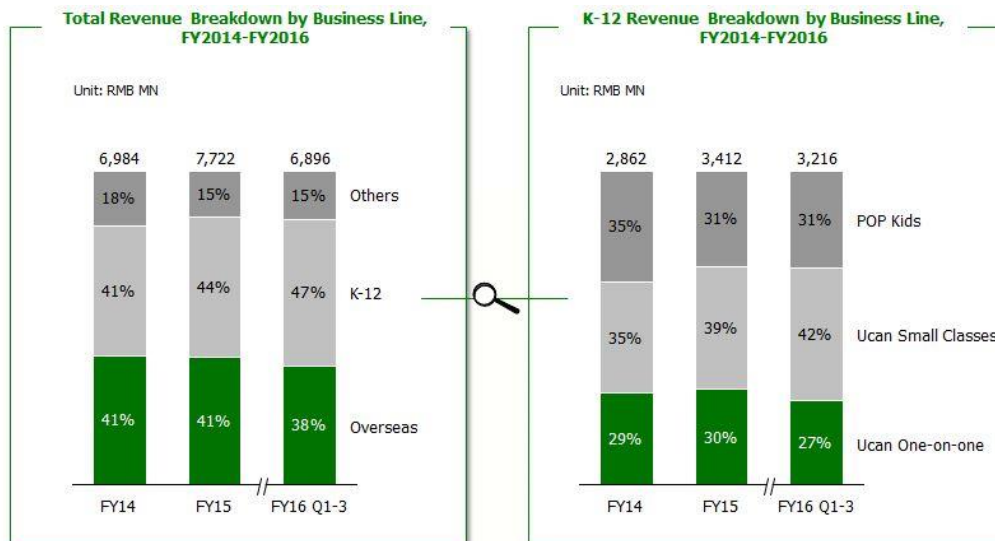
1. Historical Performance of EDU

- EDU has exhibited an accelerated revenue growth since FY 2014 while nearly half of its revenue is attributable to its top five cities.



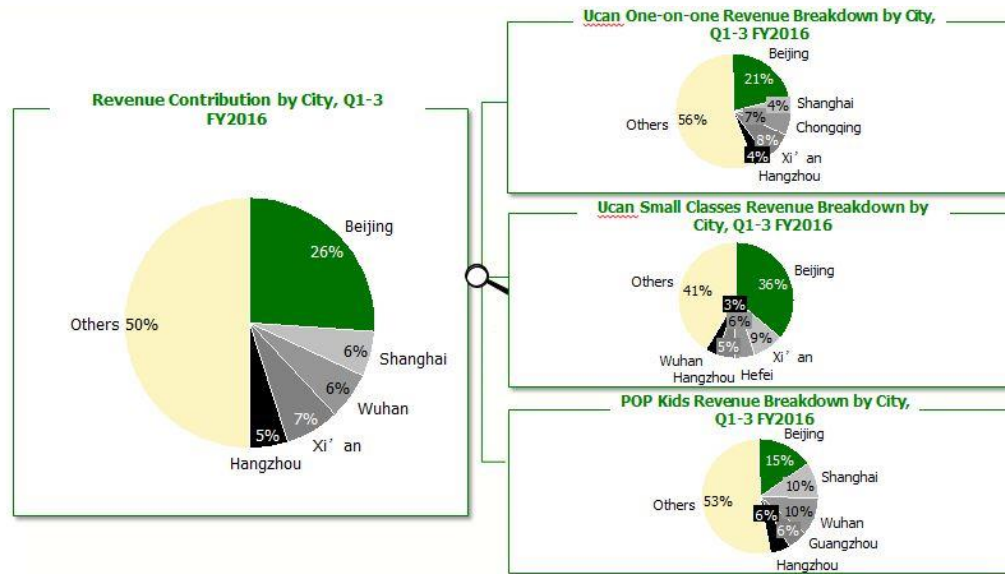
Source: BDA Analysis

- Revenue breakdown:** EDU business can be classified into its traditional overseas test preparation and consulting service, K-12 education service and other minor revenue contributors. The K-12 education service has replaced its traditional business and becomes the core business of EDU by contributing to nearly 50% of revenue.
 - The K-12 can be further divided into Ucan one-on-one, Ucan small-classes business and POP kids to cater to students of diversified ages and subjects. Ucan series is aimed at middle and high school students while POP is for kindergarten and preliminary school students. Its one-on-one business takes much larger share in K12 than XRS.



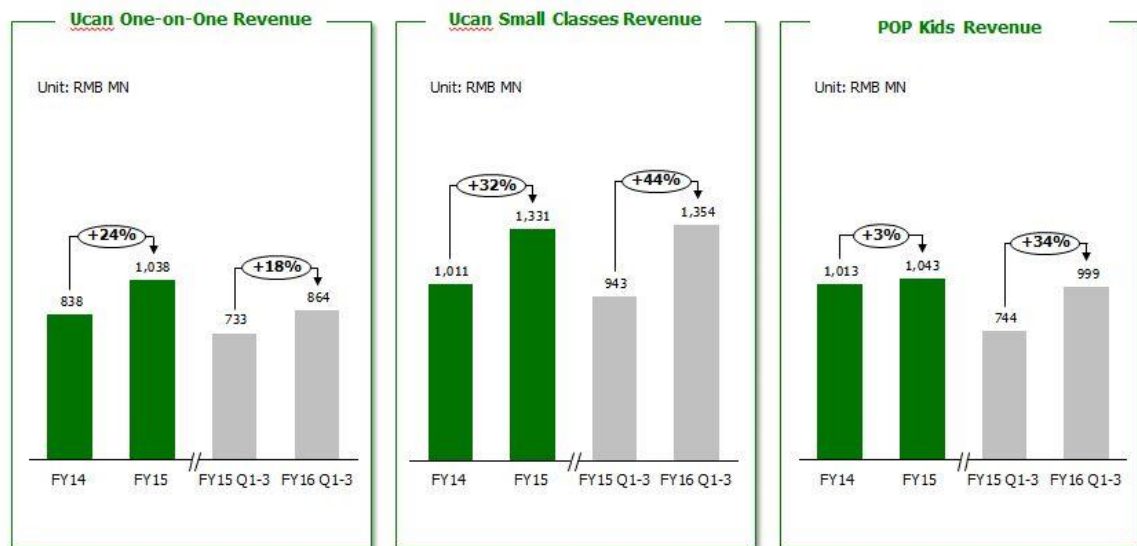
Source: BDA Analysis

- i. The top five performers contribute to 50% of K-12 total revenue and take up half shares of revenue in each sub-category; Beijing is the dominating player in each sub-category, especially in the Ucan small-classes segment.



Source: BDA Analysis

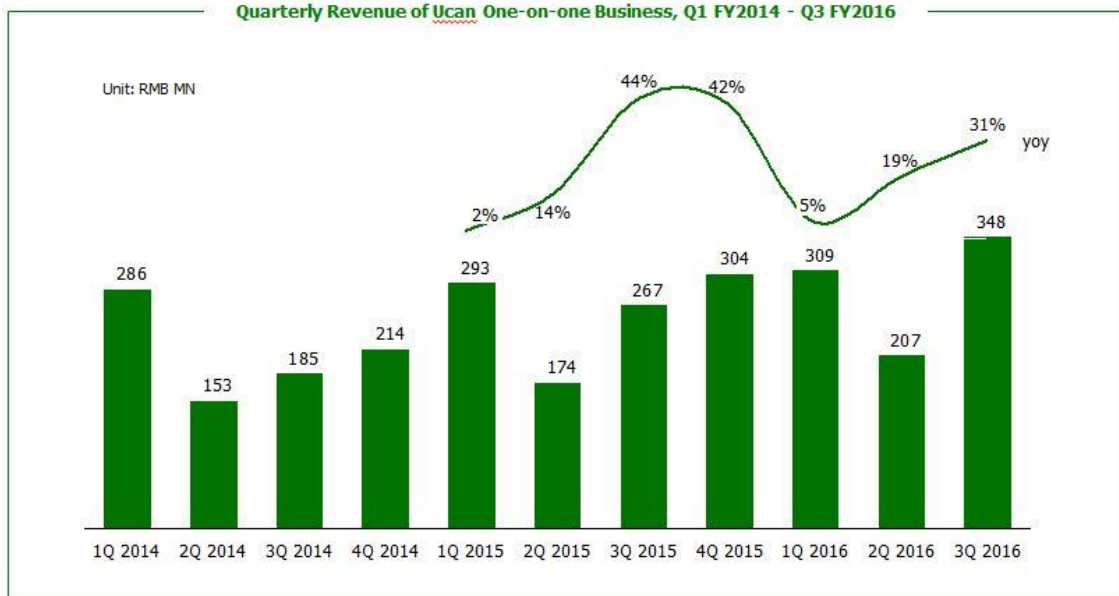
- a) In terms of revenue growth, Ucan small-classes segment has witnessed a rapid growth and the momentum intensified in FY2016; the POP demonstrates a boosted performance in particular.



Source: BDA Analysis

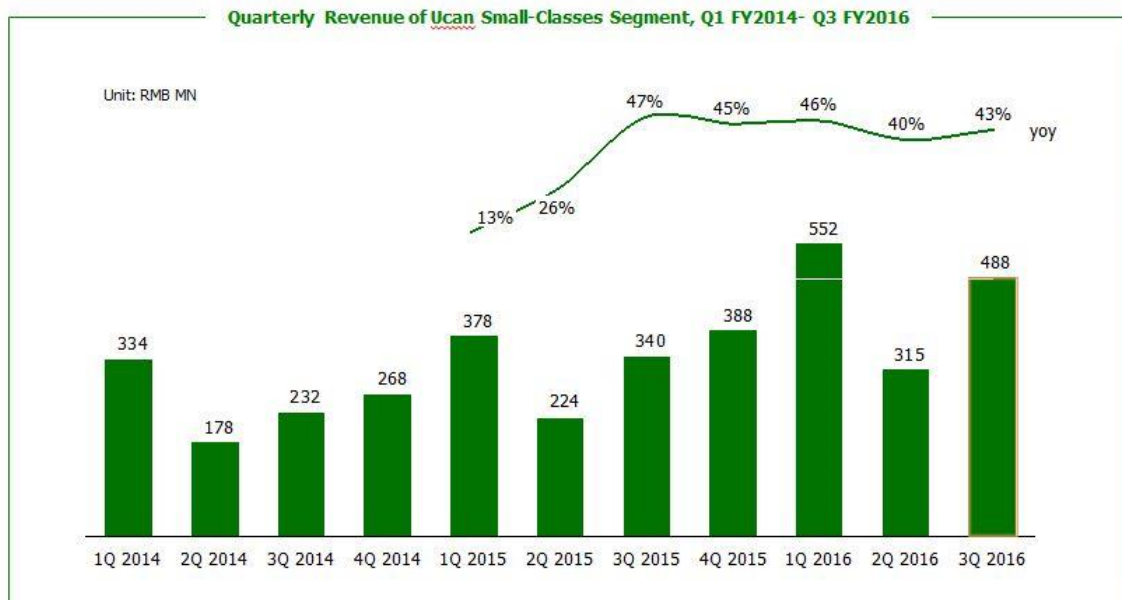
• **Performance by Segment:**

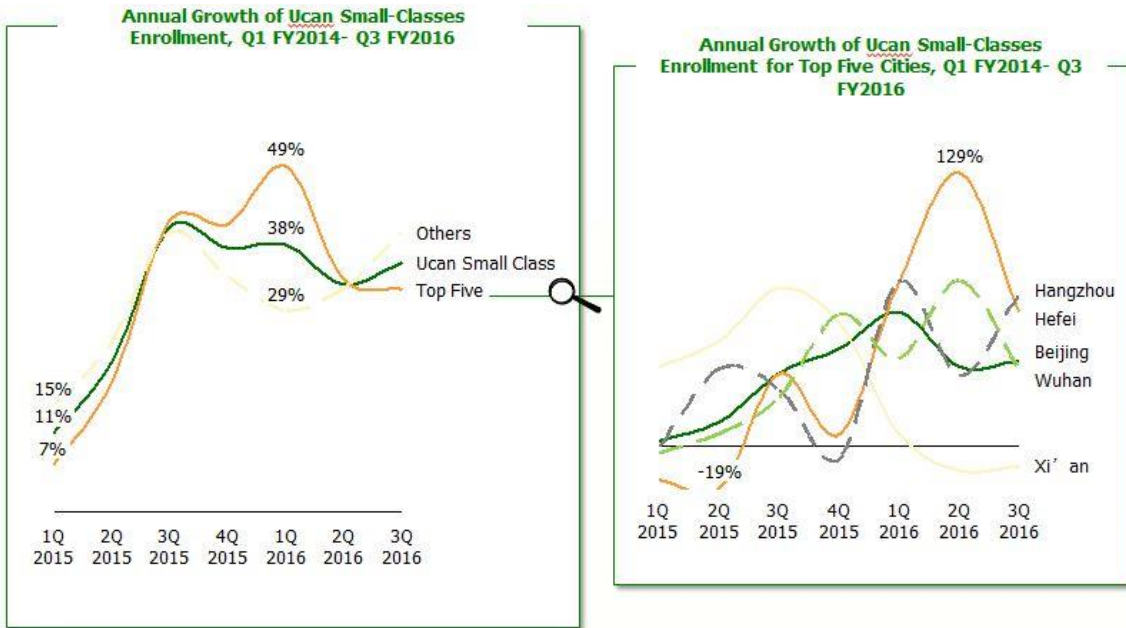
- **Ucan Education Service:** Ucan Education Service consists of one-on-one service and regular small classes while the regular small classes segment is its booster.
 - i. Ucan one-on-one segment: It experienced ups and downs in revenue growth



Source: BDA Analysis

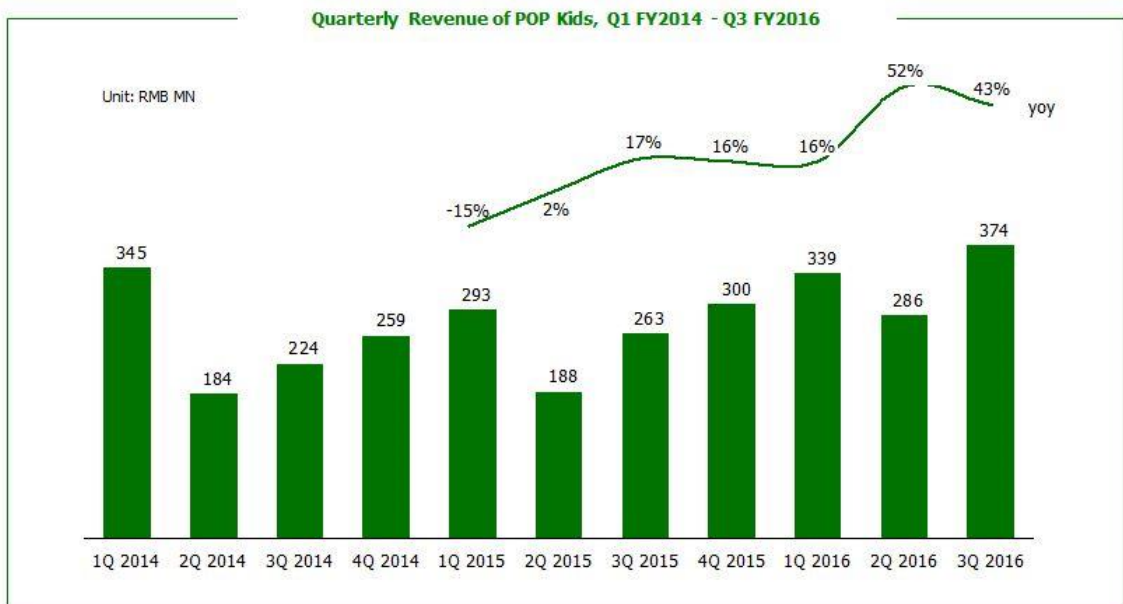
- ii. **Ucan small-classes segment: Ucan small-classes have witnessed robust growth of above 40% since Q3 FY15 while Q1 is the peak season for the business. Enrollment is the main revenue driver for Ucan small-classes; the top five performers outperformed the overall in terms of enrollment growth before Q2 FY16.**



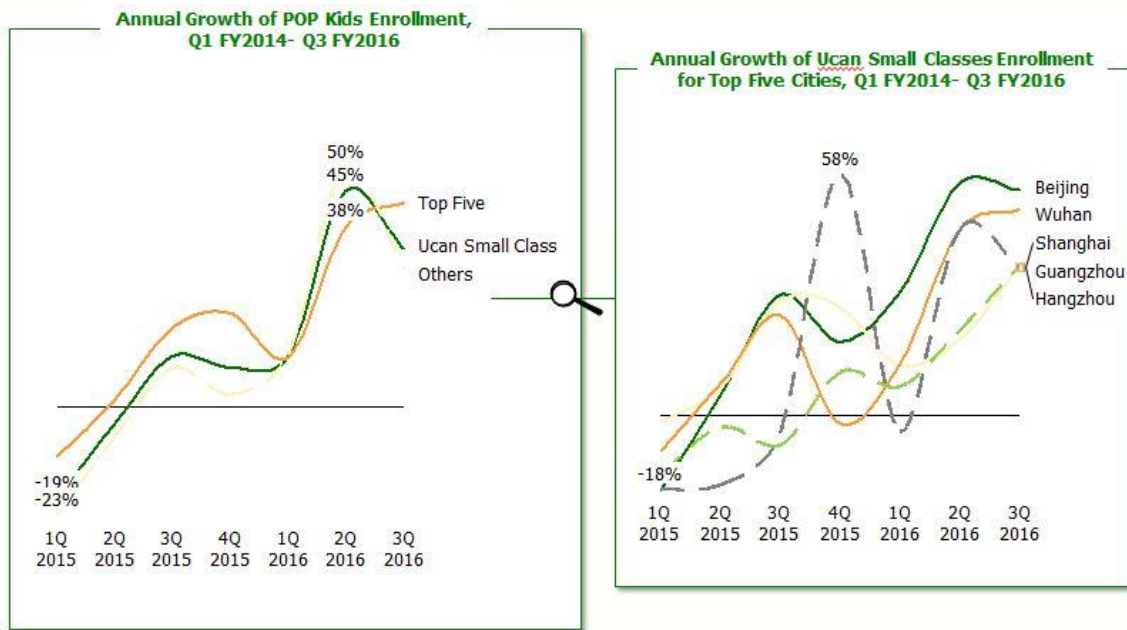


Source: BDA Analysis

- **POP Kids:** POP Kids has reaped a strong a growth since Q2 FY16. Its top five players show signs of continuing strong growth while other cities are sluggish.



Source: BDA Analysis

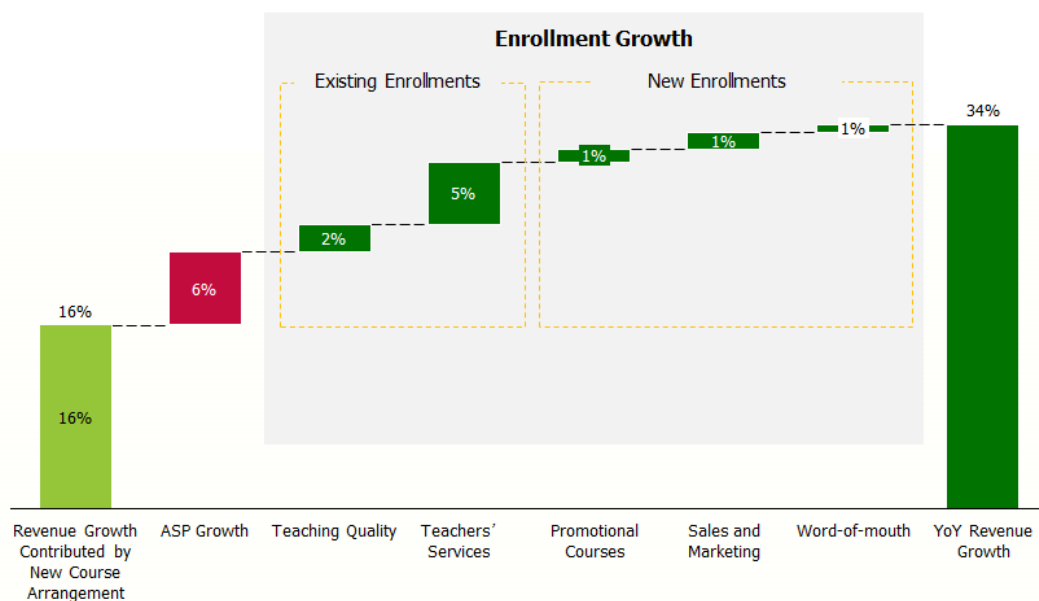


Source: BDA Analysis

2. Growth Driver of K12 Small-classes Segments

- Pop:** Nearly 50% of revenue growth of POP Kids is contributed by the new seasonal course arrangement, which is unlikely to be sustainable in the long run. Despite this one-off effect, revenue growth is driven by a 6% growth in ASP and 11% growth in enrollment. Improvement in teachers' services is the major contributor to exiting enrollment growth, while promotional courses and sales and marketing are main drivers for new enrollment growth.

POP Kids Revenue Growth Analysis (Q1-Q3 FY15 – Q1-Q3 FY16)



Source: BDA interview and analysis

- New seasonal course arrangement:** The new course arrangement has elevated class density and increased average student enrollment from 2.5-3 times to 4 times, with same or slightly increased ASP, boosting revenue by 16%. However, this revenue contributor is likely to be one-off and is unsustainable in the long run.
 - The new course scheme has resulted in tightened class arrangements and increasing class consumptions.

Comparison of Previous and New Course Arrangements

Semester	Previous Arrangement	New Arrangement	Comments
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Spring	Mar-Jun	Mar-May	<ul style="list-style-type: none"> Previously courses were run on a rolling basis, beginning at different times in spring, summer or autumn and usually running till the next semester. Under the new scheme, courses usually start at the same time and must be completed within each quarter, and no overlap is allowed. In order to complete the course, class density has increased and students will consume more classes per year.
Summer	Jul-Aug	Jun-Aug	
Autumn	Sep-Jan	Sep-Nov	
Winter	Feb	Dec-Feb	<ul style="list-style-type: none"> In the past, winter semester was only 10 days after deducting Spring Festival, so only optional short term courses were provided. Currently, as course content was designed to be more consecutive. students have to sign up for main courses in winter. Some students may choose optional short-term courses simultaneously.

Source: BDA interview and analysis

"For instance, under the old scheme, a student signing up for a New Concept English (NCE) level 1 course will enroll for 3 semesters; each has 12 classes, so he will have 36 classes in a year. He may also choose an optional short term English Writing course in winter that has 10 classes. Under the new scheme, the same NCE level 1 course will run in four semesters, so he needs to enroll for 4 times and has 48 classes in total. The price per class remains the same. Also because he will have a normal course in winter, he is more likely to choose an additional short-term course as well."

--- Industry expert

"As teachers need to complete their courses by the end of each quarter, class density is increased. For instance, in Xi'an, students used to only have classes on Sunday, now they also need to have classes on Saturday or Wednesday night as well."

--- Industry expert

- It is estimated that changes in the course arrangement will bring a YoY growth rate of 16% in FY16 Q1-Q3 due to an increasing number of enrollments and slightly increased ASP.
 - i. Enrollment growth:

- a) Enrollment growth for lower tier cities is higher as their previous average enrollment was lower.
- b) As different cities started implementation at different times, we expect a 30% penetration rate of new course arrangements in total number of enrollments for both the top 5 as well as other cities.
- ii. ASP changes: we expect ASP to slightly increase by 3% due to normal price adjustments.

Revenue Contribution of the New Course Arrangement

	<i>Unit</i>	Q1-Q3 FY15	Q1-Q3 FY16 E	Revenue Growth
POP Kid's Total Revenue and Enrollment				
Total POP Kid's Revenue	<i>RMB MN</i>	744	999	34%
Top 5	<i>RMB MN</i>	343	469	
Other cities	<i>RMB MN</i>	400	530	
Total Enrollments	<i>K</i>	512	647	
Top 5 Cities	<i>K</i>	174	224	
Other Cities	<i>K</i>	338	423	
Revenue and Enrollment of New Scheme				
Enrollment affected by New Scheme	<i>K</i>	154	232	
Top 5	<i>K</i>	52	70	
Other cities	<i>K</i>	101	162	
ASP Changes	<i>RMB</i>	1,452	1,478	
Top 5	<i>RMB</i>	1,972	2,051	
Other cities	<i>RMB</i>	1,185	1,232	
Revenue of New Scheme	<i>RMB MN</i>	223	343	16%
Top 5	<i>RMB MN</i>	103	143	
Other cities	<i>RMB MN</i>	120	200	
Key Assumptions				
Enrollment growth from New Scheme				
Top 5	<i>%</i>	33%	3 enrollments on average previously, increased to 4, ~33% increase	
Other cities	<i>%</i>	60%	2.5 enrollments on average previously, increased to 4, ~60% increase	
Enrollment Penetration rate of New Scheme				
Top 5	<i>%</i>	30%	Among the top 5 cities, Beijing, Wuhan and Guangzhou have completed majority of course changes in FY15, so only a small portion of enrollments were affected in FY16. Shanghai and Hangzhou started the new scheme in FY16 so the majority of enrollments were affected. Blended, we assume that 30% of enrollments were affected	
Other cities	<i>%</i>	30%	Major tier-2 cities have started to change the course arrangement while major tier-3 cities haven't implemented the new scheme. Considering different cities' varying progress, we assume that 30% of enrollments in other cities are affected in FY16 Q1-Q3	

Source: BDA interview and estimate

- **ASP growth:** ASP is expected to grow by 6% thanks to 1) normal price hike, and 2) higher enrollment contribution cities with higher ASP.

- **Enrollment growth:** It is estimated that new enrollments normally account for 30% of total enrollments and 70% of total enrollment is contributed by exiting enrollments. Existing enrollments are mainly maintained by teachers’ improved services with teaching quality enhancement not that significant currently. New enrollments, on the other hand, are mainly driven by promotional courses and marketing endeavors, while the contribution of word-of-mouth is smaller.
 - i. **New enrollments:** Promotional courses are likely to contribute ~35% of new enrollment, also partially driving subject extension. Marketing efforts are expected to contribute ~45% of new enrollment while only ~20% of students are referred by word-of-mouth.
 - a) **Promotional courses:** Entry grades, including grade 1 to grade 3, normally contribute over 50% of total new enrollments; therefore, major cities have launched promotional courses to attract entry grades students. These promotional courses have contributed ~35% of total new enrollments. However, retention rate for these promotional courses are relatively low at only 30-40%.
 - b) **Subject extension:** The average number of subjects per student has increased from ~1.3 in FY 15 to ~1.5 in FY16E. However, subject extension is still mainly contributed by promotional courses or other heavy promotions.
 - c) **Marketing efforts:** The sales and marketing team has been restructured to improve sales efficiency. In the past, sales and marketing managers are mainly experienced teachers who also need to monitor student retention rate. After the restructuring, only people with sales and marketing background can be elected as sales managers, and their KPI is solely based on the number of new enrollments, which has improved sales and marketing efficiency.
 - d) **Word-of-mouth and branding powers:** Currently word-of-mouth contributes only ~20% of total new enrollments.
 - ii. **Existing enrollments:** Student retention rate has been maintained at high levels for major cities and has witnessed improvement in certain cities. Teachers’ improving services contributed the most to the high retention rate.

Student Retention Rate for Major Cities

City	FY 15	FY 16E	Improvement
Beijing	70-75%	~80%	5-10%
Shanghai	~75%	~80%	~5%
Guangzhou	~82%	~85%	~3%
Nanjing	80~85%	~90%	5-10%

Source: BDA interview and estimate

- a) **Teachers' services:** Teachers' services have been improving over the past 2 years thanks to teachers' compensation reform and rigid requirements on teachers' out-of-class services.
- i. Teachers' compensation reform: After the reform, class retention reward as percentage of teachers' total compensation has significantly increased to motivate teachers to improve their class retention rate.

"In the past, for example in Beijing, teachers have a base salary and the majority of their income is class hour income. They can earn a fixed amount of class retention reward (RMB 1,000~2,000 per class per quarter), which only accounts for 10-20% of their total income. After the reform, they no longer have a base salary, but the percentage of class retention reward has significantly increased. Some teachers could earn over RMB 10,000 or as high as RMB 50,000 of class retention reward in a quarter, and on average class retention reward now accounts for 30-50% of their total income."

--- Industry expert

- ii. Improvement in teachers' services: In order to quickly improve the class retention rate, POP Kids focuses on improvement of teachers' after-class services to strengthen the relationship with parents.

"Previously there was no requirement on teachers' out-of-class services. After the reform, the company has emphasized the importance of teachers' services and set up many requirements. For instance, teachers need to actively participate in Weixin group to answer students' questions and bond with parents. Teachers also need to remind parents to enroll for future courses. Overall teachers' services have improved significantly in the recent two years, and I believe this is the most important reason for the improvement of class retention rate."

--- Industry expert

- b) **Teaching quality:** POP Kids has improved their teaching quality over the past years, including the R&D of unified textbook and teaching materials and emphasize more on teacher training. However, the improvement progress is relatively slow compared with that of Ucan and plays a small role in sustaining and improving class retention rate.
- i. Currently most cities have fully or partially adopted a unified textbook developed by headquarters for English courses. But for Math and Chinese courses, most cities still rely on local textbooks and teaching materials.

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