

China Education Sector

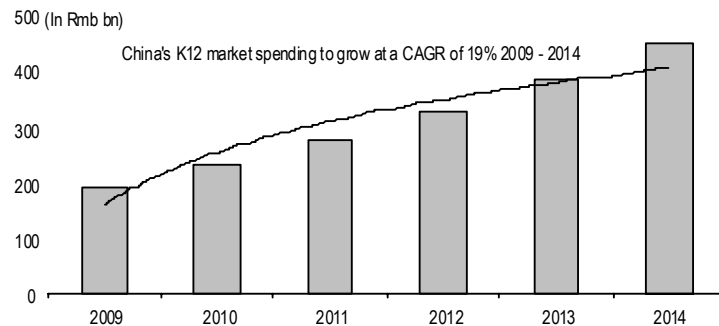
SECTOR REVIEW

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K12 after-school tutoring market: Finding the winners

Figure 1: China's K12 after-school tutoring a fragmented "blue ocean" market



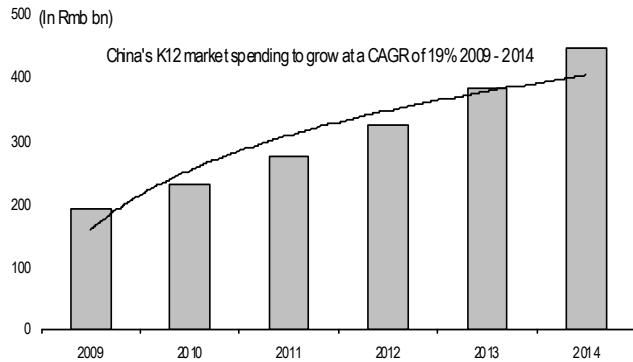
Source: Company data, Credit Suisse estimates

- **Still a city play, TAL is better positioned.** We believe that K12 after-school tutoring is still a city-by-city competition, and a national brand premium is limited given: (1) relationships with regulatory bodies, word of mouth, product R&D and highly regarded teachers are all local factors; and (2) proximity to home matters more for younger K12 students. TAL is a strong K12 player, in our view, because: (1) it has the largest number of primary school students which should lead to a longer customer lifetime; (2) its depth-driven expansion, strength in maths Olympics and online strategies are replicable in cities outside Beijing; and (3) ASP increases and the new business of Mobby (pre-K business) could be the two near-term catalysts.
- **EDU—a large K12 player, but not the strongest.** We initiate coverage on EDU with an OUTPERFORM (TP US\$33.88, 44% potential upside) based on: (1) its sophisticated products and a better pricing system, and (2) its efforts to become a high-end provider—MaxEn can create a new niche market. Our primary research and ASP study show that EDU is not the strongest player in K12 tutoring, but strategically positioned to avert market share losses in its strong segments. Moreover, EDU is trying to differentiate itself as a higher-end brand.
- **EDU and TAL cover the spectrum.** Investing in EDU alone will not be enough if investors want to position to enjoy the fast, inelastic and counter-cyclical growth of China education. Our target prices of US\$33.88 and US\$15.11 for EDU and TAL imply 25x and 31x FY13E ex cash non-GAAP P/E and 1.2x and 1.0x dil. non-GAAP PEG, respectively, which we believe are fair values. We believe current valuations of 17.6x and 20.7x non-GAAP 2013E P/Es are good entry points for investors. Key risks are: (1) competition, (2) sustaining margins, and (3) execution risks.

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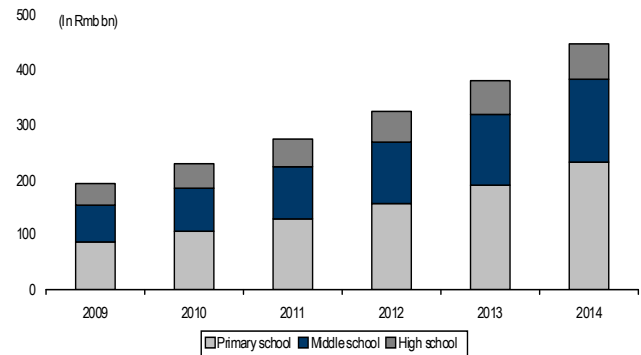
Focus charts

Figure 2: China's K12 market spending to see a 19% CAGR from 2009 through 2014E



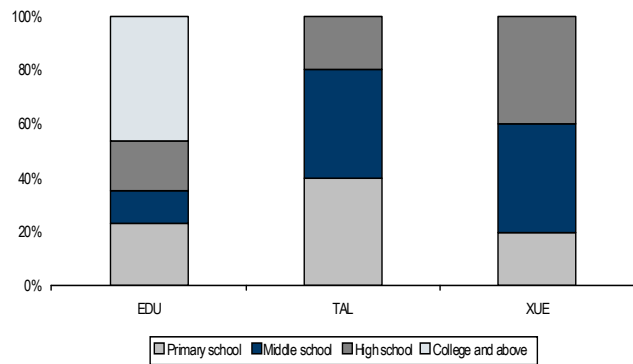
Source: Company data, Credit Suisse estimates

Figure 3: Primary school students make up half of the total addressable market



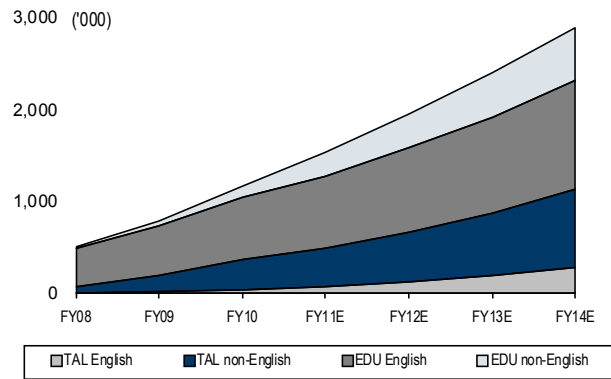
Source: Company data, Credit Suisse estimates

Figure 4: TAL has the largest percent of enrolments from primary schools, leading to a longer customer lifetime



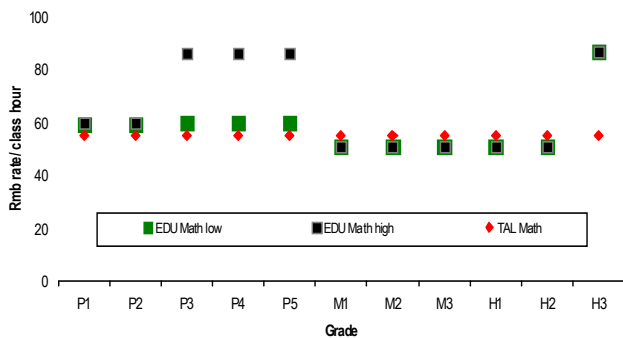
Source: Company data, Credit Suisse estimates

Figure 5: EDU and TAL each has an ace card, English and maths, the two largest niches in K12 (enrolment by subject)



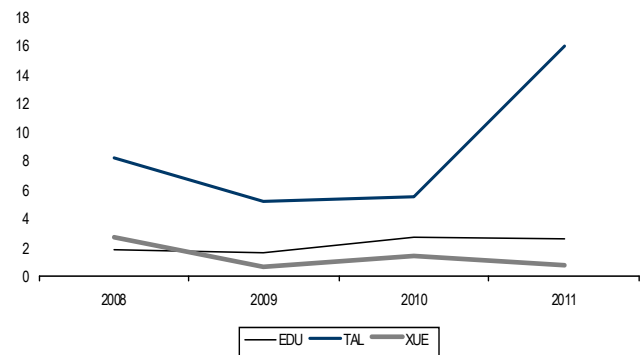
Source: Company data, Credit Suisse estimates

Figure 6: ASP study shows greater potential ASP upside for TAL in maths classes in Beijing



Source: Company data, Credit Suisse estimates

Figure 7: Number of learning centre adds per city



Source: Company data, Credit Suisse estimates

K12 after-school tutoring market: Finding the winners

Still a fragmented, city-by-city competition

China's K12 tutoring market spending could see a 19% CAGR from 2009 to 2014 when its size reaches Rmb450 bn, according to iResearch estimates. Being among the most inelastic, counter-cyclical sectors, K12 tutoring could be a bigger market than the overseas test prep market with its much bigger addressable market and lower penetration. We believe K12 after-school tutoring is still a much fragmented and city-by-city competition, and a national brand premium is limited given: (1) relationships with regulators, word of mouth, product R&D and well-regarded teachers are all local factors; and (2) proximity to home matters more for younger students. Beijing is home to many national market players, including listcos like EDU, TAL and XUE, and many private companies. Local private players have a bigger market share in key cities—Shanghai, Shenzhen and Guangzhou.

China's K12 tutoring market size could reach Rmb450 bn by 2014E, and K12 after-school tutoring is still a much fragmented, city-by-city competition

Segmentation in K12 tutoring

EDU dominates the overseas test prep market, a “red ocean”, while K12 tutoring is a “blue ocean”, still highly fragmented. Note, we have drawn on some terms from *Blue Ocean Strategy*, by W. Chan Kim and Renée Mauborgne. A “Blue Ocean” is an open market, a “Red Ocean”, a contested, “bloody” space. Listed companies have the capital and resources to garner more market shares. In terms of customer profile, maths and English are of top priority for primary schoolchildren while entrance exams prep is paramount for middle/high school students. We have also seen efforts to extend customer lifetime: EDU's Mobby and TAL's MaxEn target different segments in the pre-K market which have significant potential. By subject, EDU's and TAL's strengths lie in arts and sciences, respectively, for outperformers, while XUE's 'one-on-one' attracts underperforming students. Increasing price structure disparity should also drive segmentation.

Listed companies have the capital and resources to garner more market share

Seek the blue ocean winner(s)

Our analysis of formats among smaller classes, one-on-one and online, as well as key success factors for K12 tutoring, as per iResearch survey, show that word of mouth, backed by a strong track record and locally popular teachers, is the top factor considered by students and parents. TAL ranked first in the customer satisfaction survey, followed by XUE and EDU. EDU is strategically positioned to avert market share losses in its strong segment of overseas prep. Our primary ASP study on hourly rates of small classes in Beijing and a representative Tier 3 city shows that the market perception of EDU having a price premium over competitors is wrong. Admittedly, EDU's pricing structure is more sophisticated, with it being more professional in structuring prices and segmenting customers by prices, but we think TAL has great ASP upside potential.

Word of mouth, built by a strong track record and locally-popular teachers, is the top factor in the decision-making process of students and parents

Operating and financial matrix, and valuation

TAL is well positioned in the K12 market, in our view, because: (1) it has the largest number of primary schoolchildren which implies a longer customer lifetime; (2) its depth-driven expansion, strength in maths Olympics and online strategies are replicable in cities outside Beijing; and (3) ASP increases with the new business of Mobby (pre-K) could be a near-term catalyst. EDU is a solid player but not the best in K12. We initiate coverage on EDU with OUTPERFORM based on: (1) more sophisticated pricing system; (2) efforts to move up the value chain; and (3) the prospect that the MaxEn segment can create a new niche market. Our target prices of US\$33.88 and US\$15.11 for EDU and TAL imply 25x and 31x FY13E ex cash non-GAAP P/E and 1.2x and 1.0x dil. non-GAAP PEG, respectively, which we believe are fair values. We believe current valuations of 17.6x and 20.7x non-GAAP 2013E P/Es are good entry points for investors.

We initiate coverage on EDU with an OUTPERFORM

Sector valuation matrix

Figure 8: Valuation comparison table

Company	Ticker	CCY	Close		Target price	Upside/downside	Mkt cap (USD mn)	PER				ROE			Net margin			FCF yield				
			price	Rating				2010	2011	2012	2013	2011	2012	2013	2010	2011	2012	2013	2010	2011	2012	2013
China Education																						
New Oriental	EDU.N	USD	23.55	O	33.88	44%	3,686	38.8X	31.1X	23.2X	17.6X	18%	19%	20%	24%	21%	21%	22%	3%	4%	6%	7%
TAL	XRS.N	USD	10.01	O	15.11	51%	780	43.9X	23.3X	27.5X	20.7X	16%	11%	14%	21%	27%	16%	16%	4%	7%	1%	6%
Xueda	XUE.N	USD	3.75	NR	n.a.	n.a.	253	20.1X	29.2X	21.8X	8.6X	7%	9%	12%	6%	5%	5%	8%	n.a.	n.a.	n.a.	n.a.
Average							1,573	34.3X	27.8X	24.2X	15.6X	13%	13%	15%	17%	18%	14%	15%	3%	6%	4%	7%
Global Education																						
Apollo	APOL	USD	44.75	O	52.00	16%	5,844	8.4X	9.1X	13.2X	12.3X	54%	32%	30%	18%	16%	9%	9%	13%	11%	5%	7%
Devry	DV	USD	33.01	N	36.00	9%	2,221	8.5X	7.1X	8.5X	8.1X	26%	18%	15%	15%	15%	12%	11%	11%	12%	7%	9%
Itt	ESI	USD	51.52	N	55.00	7%	1,374	4.6X	4.9X	6.6X	7.3X	203%	116%	63%	23%	20%	15%	11%	31%	23%	8%	6%
Strayer	STRA	USD	88.07	N	92.00	4%	1,057	9.1X	10.0X	12.6X	11.5X	98%	129%	168%	21%	17%	13%	13%	10%	11%	8%	7%
Capella	CPLA	USD	31.96	N	40.00	25%	462	8.8X	9.1X	10.0X	9.5X	29%	26%	26%	14%	13%	8%	7%	12%	11%	10%	7%
Average							2,191	7.9X	8.0X	10.2X	9.7X	82%	64%	60%	18%	16%	11%	10%	15%	14%	8%	7%

Source: Company data, Credit Suisse estimates, XUE: consensus

Figure 9: Listed China education companies' K12 operating metrics

(As at 31 August 2011)	EDU	TAL	XUE
Founding year	1993	2003	2001
Motto	Language is power	Learning changes lives	
Year to enter the K12 segment	2008	2003	2004
- No. of non-teaching staff	11,100*	3,600	5,725
- No. of teachers	13,500*	3,100	8,402
- No. of enrolments (12 months by 31 Aug 2011)	1,132,000	570,150	77,451^
- No. of non-English enrolments (12 months by 31 Aug 2011)	311,000	456,120	n.a.
- No. of registered online users (12 months by 31 Aug 2011)	6,800,000*	200,000	n.a.
- No. of paid online users (12 months by 31 Aug 2011)	231,000*	80,000	n.a.
No. of cities under coverage	49	10	61
No. of learning centres			
- Beijing	72	138	26
- Shanghai	49	44	14
- Shenzhen	12	9	9
- Guangzhou	17	19	13
- Others	338	58	194
Total	488	268	256
Small classes price range (Rmb/hour)			
- Beijing	28-87	55	n/a
- Shanghai	n/a	50	n/a
- Shenzhen/Guangzhou	n/a	60	n/a
- Others	n/a	32-60	n/a
Range	n/a	32-60	n/a
1x1 price range (Rmb/hour)			
- Beijing	180-480	200-500	186 - 240
- Shanghai	150-350	150-260	191 - 219
- Shenzhen/Guangzhou	150-350	170-240	163 - 219
- Others	100-300	115-345	163 - 187
Range	100-480	150-500	129 - 248

Note: * group numbers (including other business segments); ^12 months as of 30 June 2011

Source: Company data, Credit Suisse estimates

Still a fragmented, city-by-city competition

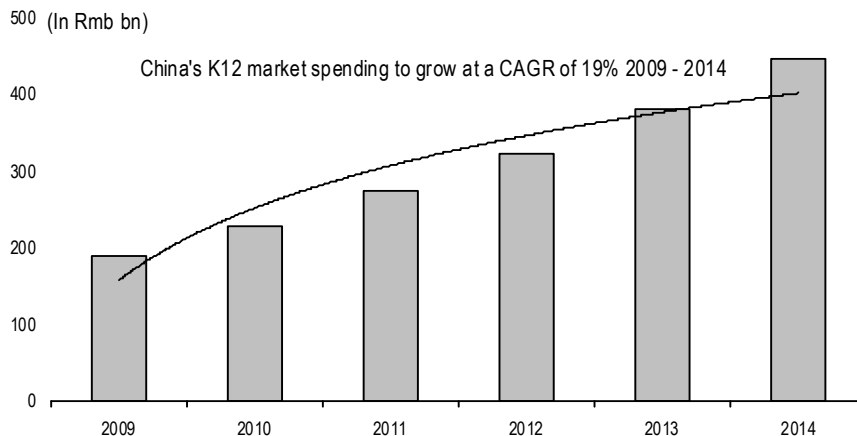
Sustainable 19% CAGR 2009-14E

The China education sector is one of the most counter-cyclical sectors in an economic downturn in the whole investing universe. According to iResearch, the K12 after-school tutoring market grew 26.4% YoY in 2009 while Chinese GDP growth dropped to 7.5% and the entire education sector's growth fell to 7%.

China's K12 tutoring market spending should see a 19% CAGR from 2009 through 2014E and its market size should Rmb450 bn, according to iResearch. We believe K12 tutoring is a blue ocean that is too fragmented with more than 100,000 players, with no-one having more than 1% market share. In this report, we discuss the competitive dynamics of the K12 tutoring business with a focus on New Oriental (EDU), Xueersi (TAL) and Xueda (XUE), and conclude that these companies are very strong in different niche markets of this blue ocean.

The China education sector is counter-cyclical

Figure 10: China's K12 tutoring market should see a 19% CAGR from 2009 to 2014E



Source: iResearch, Credit Suisse estimates

Key universities are limited resources and nurtures a big K12 tutoring market

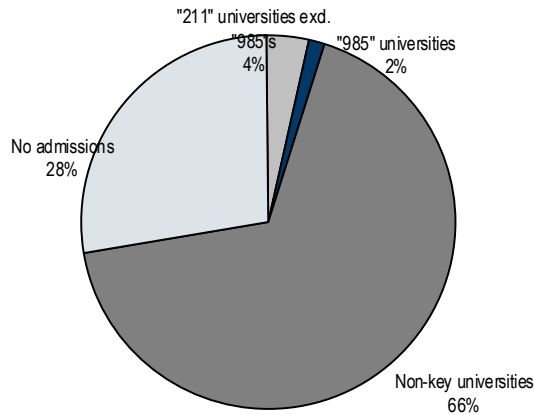
China has a limited number of key universities and mainly located in cities and provinces of Beijing, Shanghai, Jiangsu, Hubei, Shaanxi, Sichuan, etc. Among the 9.33 mn college entrance exam takers in 2011, only 5% won admission to one of the 116 project '211' universities. (211 工程, is a project of National Key Universities and colleges initiated in 1995 by the Ministry of Education of the People's Republic of China, with the intent of raising the research standards of high-level universities and cultivating strategies for socio-economic development. During the first phase of the project, from 1996 to 2000, approximately US\$2.2 bn was distributed.)

Among the project '211' universities, only 39 are the best project '985' universities, and only 2% of exam takers in China won admission here. (985 工程, is a project first announced by CPC General secretary and Chinese President Jiang Zemin at the 100th anniversary of Peking University on May 4, 1998 to promote the development and reputation of the Chinese higher education system. The project involves both the national and local governments allocating large amounts of funding to the best universities in order to build new research centers, improve facilities, hold international conferences, attract world-renowned faculty and visiting scholars, and help Chinese faculty attend conferences abroad).

We expect the competition to enter the best universities to remain fierce for Chinese students, and thus the K12 after-school tutoring market spending will continue to grow

According to Mr Guiren Yuan, Minister of Education Ministry of China, there will not be any new additions to project '211' or '985' universities after March 2011. Thus the number of universities in China is capped at the current 116.

Figure 11: Admission rates at the best (project '211' and '985') universities are extremely low



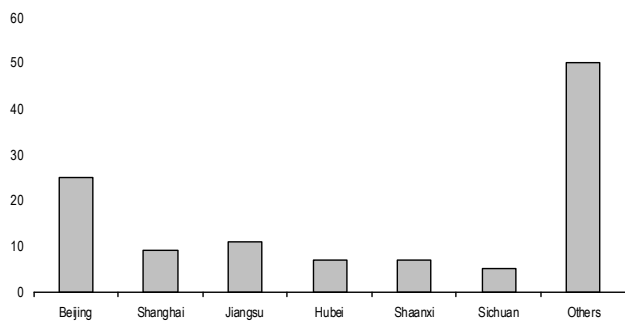
Source: Sina, Credit Suisse estimates

Based on the low admissions rate, we expect the competition to gain admission to the best universities to continue to be fierce for Chinese students, and thus K12 after-school tutoring market spending to continue to grow.

Tier-1 cities for education: Beijing, Yangtze river delta and Pearl river delta cities

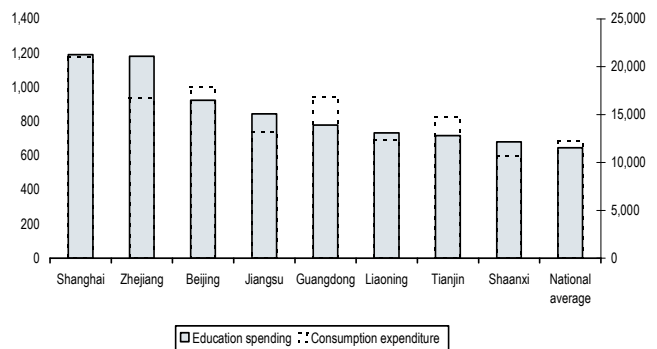
Though we believe education is one of the top priorities for parents across China due to the Chinese culture, we believe that Beijing, Yangtze river delta and Pearl river delta cities are the tier-1 cities for any K12 after-school tutoring providers who want to make a real impact.

Figure 12: No. of project '211' universities in China



Source: Education Ministry of China

Figure 13: Household consumption and education spending by cities, 2009 (in Rmb)



Source: National Bureau of Statistics of China,

(1) **Beijing:** Beijing has the most universities, including the key universities, in China. As a result, Beijing has the highest population of people with higher education and is the most competitive market for K12 tutoring with the largest number of providers, and the highest penetration, customer awareness and demand for K12 tutoring.

In Beijing, the fiercest competition is in the entrance to middle schools, wherein maths Olympics and English proficiency are the top two criteria for selection. For this reason,

in the more education-centric districts such as Haidian, more than 90% of primary school students enrol themselves for K12 after-school tutoring classes.

Beijing is home to many of the national market players, including public companies such as EDU, TAL and XUE, and private companies such as Longwen, Juren and Gaosi.

- (2) **Yangtze river delta cities led by Shanghai:** Shanghai is more economically developed than Beijing and has a competitive environment that is very close to that of Beijing. It is followed by cities such as Hangzhou (Zhejiang Province), Nanjing (Jiangsu Province) and others.

The Yangtze river delta is the richest region in China. The importance parents give to K12 tutoring and penetration is very high as well.

Local player 1Smart (private) has the largest market share in Shanghai, followed by national players like TAL and EDU.

- (3) **Pearl river delta cities led by Guangzhou and Shenzhen:** People’s priority for education is not as high as in Beijing and Yangtze river delta cities. However, because family dispensable incomes are high, parents’ investment in education is high, too.

Local players, such as BestStudy (private) and Bond (private) have an edge, especially in the southern cities, with good brand image and a larger user base than national players from Beijing.

There is some debate in the market as to who is the leader in China’s K12 tutoring space. Our view is that it is still early to crown a national champion of a K12 one-stop shop, as: (1) each player has its own challenges and opportunities, and (2) regional differences for K12 tutoring are quite wide. We believe it makes more sense to evaluate the market by niche at this stage.

K12—still a local play

K12 exams are more localised than standardised exams

There is a debate in the market as to whether national players have a brand premium than local players in K12 after-school tutoring. We believe the premium is very limited at this stage and in the near term. This is because unlike standardised exams such as overseas tests, each province has its own college entrance exams, and each district in every city has its own policies on selection and admission processes for high schools and primary schools. This makes K12 tutoring a much more difficult market for a provider to leverage on scale and network.

At this stage, localised products and guanxi (relationships with local key schools and regulators) still exert more importance than a national brand name.

K12 tutoring is a much more difficult market for a provider to leverage on scale and network

Figure 14: What makes K12 much tough to generate network effects?

	Standardised exams	K12 tutoring in China
# of sponsors	1 for each exam	National college entrance exam: 16 provinces (tier one and two): independent exam papers; 15 less developed provinces: national exam papers High school and primary school entrance: Hundreds of municipal education regulators

Source: Company data, Credit Suisse estimates

More relationships to manage at the local level rather than nationwide

- (1) **Key schools.** For example, in Beijing some top middle schools have their own training classes for primary school students, a.k.a, ‘Keng Ban’ (exclusively trained seed students classes). The most well-known golden ‘Keng Ban’ are Ren Hua school (for

the high school affiliated to Renmin University), Shui Mu Long Hua training school (for the high school affiliated to Tsinghua University), 101 Training Centre (for No. 101 Middle School) and online school of No. 4 Middle School (for No. 4 Middle School). However, there are soft caps on these training schools/classes; thus only few students can get into those exclusive classes.

To parents, the real life-changing exam is not the college entrance exam

Rather it is the middle school entrance exam, which in Beijing is based on many criteria. Except for those students who have influential parents/grandparents to make them 'Students with a Note' (Tiaozi Sheng, 条子生; the students who have strong recommendation from influential individuals) and 'Student to Build Together' (Gongjian Sheng, 共建生; students whose parents are employees of major ministries, commissions, regulators and SOEs), ordinary students have to pass tests in maths and English to get admission to a key high school. According to our channel checks, 8-10% of the graduating Grade VI students in Beijing are either 'Students with a Note' or 'Students to Build Together.'

8–10% of the graduating Grade VI students in Beijing are either 'Students with a Note' or 'Students to Build Together'

As an alternative, independent tutoring providers such as TAL emerged as the universal 'Keng Ban'

Such institutions usually have good, long-term relationships developed with some key middle schools. Thus classes by these universal 'Keng Ban' are tailored to gain entry into not just a particular key school but several of them. In the meantime, it trains the students on test preps on maths and English. In fact, TAL also conducts 'Xueersi Bei' tests on maths and English which, in our channel checks, serve as one of the criteria for the selection of prospective students by several key schools.

'Xueersi Bei' tests on maths and English serve as one of the criteria for selection of prospective students by several key schools

- (2) **Regulators.** Besides key schools, it is also important to develop close ties with local regulatory bodies to be on top of policy changes and align class offerings accordingly.
- (3) **Exam sponsors.** Some K12 tutoring providers are test preps as well. Close relationships with local exam sponsors help the providers to choose the best teaching material and generate best results. For example, English for Grade V students are taught based on New Concept English 2, and maths is taught based on maths Olympics learning points. After the training and classes, a graduating Grade VI student needs to pass FCE (First Certificate in English, Beijing English Test Level III, which equates to 5.5 points in IELTS test), instead of PET (Preliminary English Test, Beijing English Test Level II), to impress the admission committees of key high schools.

Word of mouth and products R&D are still local

Our channel checks suggest, in the K12 tutoring market, the decision-making process involves both the students themselves and the parents, especially for younger students, and the herd effect exists, too, but in a relatively small community of adjacent same-tier schools. When the top-10 students in a class go to a tutoring school, the rest of the class also wants to go to the same school, trying to catch up.

When the top-10 students in a class go to one tutoring school, the rest of the class wants a seat in that same school

Star teachers are local resources

Schools with a bigger scale face the challenge of finding and maintaining the best talent in each city that they have a presence. Schools like EDU may need to transfer talent from a more developed school to a school with a smaller size in less developed city as they expand. However, such internal transfers are limited to the school heads level and usually accompany with a promotion to incentivise the relocation. However, it is difficult for the schools to adopt the same strategy to transfer star teachers, in our view.

Proximity matters more for younger students

Unlike overseas standardised exams, in which customers are mostly grown-up students, K12 students are much younger and thus are constrained by the radius of their activity zones. Admittedly, many of the parents may have own cars that facilitate commuting

between home and the learning centre. According to our interviews, location is one of the most important factors in the decision-making process.

As a result, local players which have learning centres spread across the city are at an advantage to grab market shares than national brands which have presence in a lot of cities but are restrained from launching many centres as the local players do in a certain city.

In the long term, however, national brands should win with effective matrix

Talent are the most valuable assets for education service providers, and all K12 players targeting to be nationwide providers face the challenge of matrix management.

In the 1Q12 earnings call, EDU announced replacements of four school heads in Changchun, Shenyang, Dalian and Harbin. Enrollments at the four schools declined 18% YoY in 1Q12 due to bad management. The importance of school heads is gaining increasing attention of investors. In fact, after our primary channel checks, the challenge is not only limited to the four schools that have been disclosed, school heads left even at some larger schools like Nanjing and Guangzhou.

The market is concerned about EDU's 'feudal culture,' i.e., school heads overrule the headquarters when local interests conflict with that of the headquarters. EDU has been making great efforts in enforcing the matrix management system, symbolised by Mr. Xiangdong Chen taking the Executive President role in October 2010.

Figure 15: No. of school heads

	EDU	TAL	XUE
# of school heads	29	10	~40 subsidiary GM

Source: Company data, Credit Suisse estimates

We believe middle management is critical to the continued success of EDU. Admittedly, this will be a challenge for not only EDU, but all the other players as they expand to become truly nationwide companies. TAL recently announced that the company will expand into four to six cities in January, and the school heads will be developed internally. We like its organic growth structure, but it still takes time to see what incentives and matrix TAL endorses to not get itself in the dilemma that EDU is in today.

With more listed companies expanding nationwide, the national brands will make more sense for our analysis. Because, in our view, national K12 tutoring providers integrate R&D based on regional products offerings and leverage on teachers and management training programmes.

Some local names

Some private companies have already gained regional recognition in cities like Beijing, Shanghai, Guangzhou and Shenzhen. We believe they will more likely target to go public on their own, rather than becoming acquisition targets. In our view, M&A is challenging in the education sector due to differences in culture and system.

Shanghai-based 1Smart 精锐 (private)

1Smart created UPC studying methods (one-on-one tutoring, six-on-one service) to complement and reinforce the school teaching, and help the students to improve learning capability.

The company has set up 150 learning centres in 10 cities since its inception four years ago. In 2011, it has 10,916 enrollments for the fall semester.

Guangzhou-based BestStudy 卓越 (private)

Based in Guangzhou, BestStudy started operations in 1997 and has been the largest K12 tutoring provider of small classes and one-on-one tutoring in south China with almost

The importance of school heads is grabbing increasing attention

With more listed companies expanding nationwide, national brands will make more sense for our analysis

3,000 teachers. It has rolled out more than 80 learning centres in Guangzhou, Shanghai, Chengdu, Shenzhen, Zhuhai and Foshan. Annual enrolments are over 260,000.

In October 2007, BestStudy received Round A investment from a venture capitalist (VC), and in 2011 it has gotten a US\$10 mn Round B investment from a leading VC.

Beijing-based Gaosi 高思 (private)

Established in November 2009 by core members of Ren Hua School (one of the golden 'Keng Ban' in Beijing) and Juren, Gaosi is positioned as the elite K12 tutoring provider specialised in maths Olympics. It has grown fast in recent two years in Beijing.

Gaosi has expanded to eight learning centres with annual enrolments of 10,000 in 2011.

Beijing-based Longwen 龙文 (private)

Longwen School is based in Beijing, and like XUE it focuses on one-on-one tutoring from K12 to adult training. As of October 2011, Longwen had more than 1,000 branches across 52 cities including Shanghai, Chengdu, Tianjin, Guangzhou, Nanjing and Hangzhou.

In Beijing alone, Longwen has 170 learning centres with more than 500 senior teachers and 2,000 full-time teachers graduated from key universities.

Segmentation in K12 tutoring

EDU dominates the ‘red ocean’ of overseas test prep market, while K12 tutoring is a ‘blue ocean’ that is still highly fragmented. Hence, listed companies have the capital and resources to garner more market share.

Both TAL and XUE started as K12 after-school tutoring players, focusing on small classes and one-on-one model, respectively. EDU entered the market relatively late, but has been able to leverage on its nationwide school and learning centre network to accelerate its K12 business line with U-Can and POP Kids.

No winner takes it all, in the blue ocean

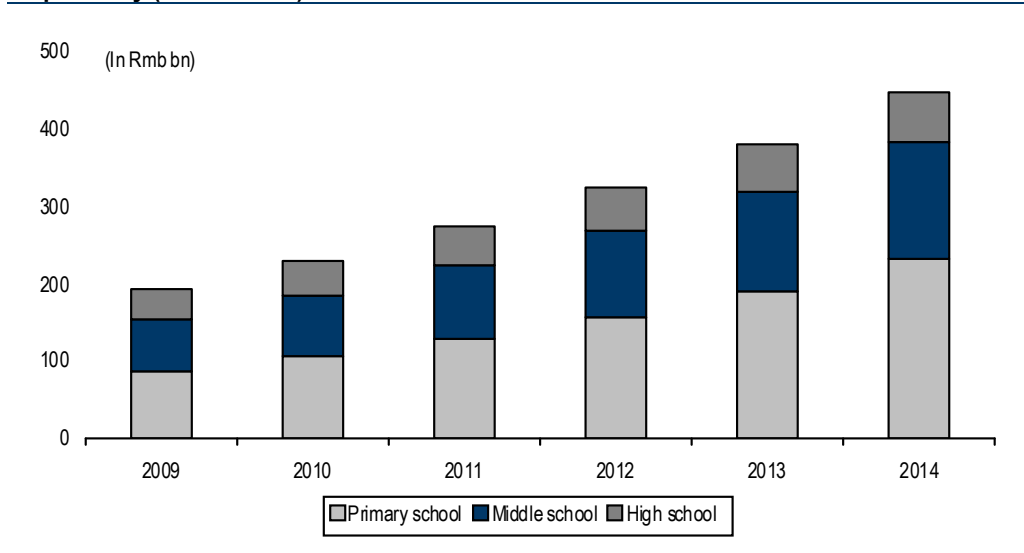
As self-explained by its motto, ‘language is power,’ EDU is still the top choice in the arts-related subjects, especially English, while on the other hand, TAL has gained an edge in science subjects, especially maths. XUE does not compete directly with EDU and TAL as its one-on-one approach addresses a different market segment, which we will discuss later.

Our research and SWOT analysis show that these companies have very different corporate cultures and organisation structures, which will drive them to grow in very different ways.

Ages: Maths and English for primary school kids; entrance exams for middle/high school students

We believe that penetration in the primary school tutoring is the highest and this segment should be able to achieve the fastest CAGR of 22% from 2009 to 2014E, while middle- and high-school tutoring markets should see a lower CAGR of 18% and 11%, respectively.

Figure 16: Primary, middle and high-school markets to see 22%, 18% and 11% CAGRs, respectively (Rmb100 mn) from 2009 to 2014E



Source: iResearch, Credit Suisse estimates

For primary students, most of after-school tutoring demand comes from maths Olympics and English.

There are some proposals to ban these classes and maths Olympics in certain cities, like Chengdu and Chongqing. However, nothing concrete has been enforced so far. In fact, Chinese parents crave for maths Olympics classes. Though 95% of the students in maths Olympics classes will not end up winning any awards or medals, parents believe the process of good training and practice inculcates a better way of thinking in their children.

EDU dominates the ‘red ocean’ overseas test prep market, while K12 tutoring is a ‘blue ocean’ market that is still highly fragmented

For primary students, after-school tutoring demand comes majorly from the maths Olympics and English

We believe the Chinese will continue their love affair with maths for a long time. Thus, no matter how each city designs its selection and enrolment process, the maths Olympics will remain an important class for many primary school students for a long time, in our view.

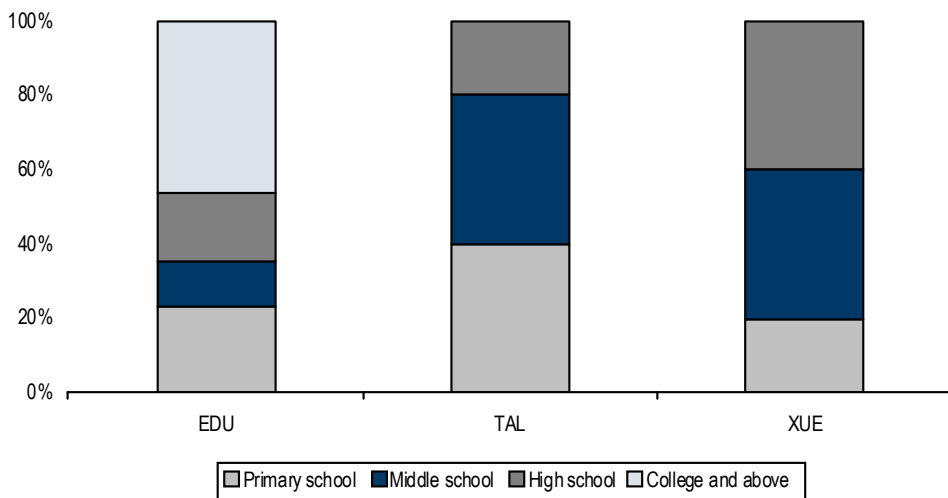
It is the same for English, which the Chinese parents believe plays an important role in shaping their children’s future. Courses like Cambridge Kid English, New Concept English and various English proficiency tests by municipal education authorities nurture the primary school students to master the second-largest after-school tutoring subject.

For middle and high school students, high school/college entrance exam prep is the main theme. K12 tutoring for these students is the lowest, and we expect a lower CAGR in these two segments as students are busy preparing for the ‘once-in-a-lifetime’ exams of high school and college entrance exams.

Efforts to expand customer lifetime—who has the most young customers?

About 40% of TAL’s enrolments are primary school students while those of EDU and XUE is around 20%. We believe it is easier for companies with the youngest customers to grow with their customers and expand into more business areas as their customers grow older.

Figure 17: TAL has the largest percentage of primary school student enrolments



Source: Company data, Credit Suisse estimates

Companies with older customers have to expand their product offerings down the age group to prevent losing customers in their original strong segments to the competitors who have younger customers and trying to retain these customers as they grow older.

EDU and TAL both announced to enter pre-K markets targeting at different niches

In October, both EDU and TAL announced new initiatives to enter the pre-K age groups, by offering MaxEn and Mobby, respectively. We can see that the two companies positioned themselves very differently. EDU’s MaxEn targets mainly the student group that aspires for overseas colleges while TAL’s Mobby targets the students who aim to enrol in domestic colleges.

- (1) **EDU’s MaxEn: Luxury overseas prep, at much younger age.** On 9 November 2011, EDU announced setting up a joint venture with McGraw-Hill Education to operate ‘MaxEn Centers,’ which leverage on EDU’s strength in overseas brand to provide content with soft-skill training, boasting the next-generation Global Citizens. Our channel checks show that MaxEn’s ASP is as high as ~ Rmb20,000 a year, 4x POP Kids, primary school K12 tutoring at EDU. It has 200+ enrolments in Beijing and another 200+ in Tianjin, Fuzhou and Chengdu.



For middle and high school students, high school/college entrance exam prep is the main theme

About 40% of TAL’s enrolments are primary school students while the same for EDU and XUE is around 20%

EDU’s MaxEn targets mainly the overseas college student group while TAL’s Mobby targets the domestic college students

We like the strategy and would like to see the class offerings and market reception to this concept.

Figure 18: MaxEn versus Mobby, first glance

	Logo	Age group	Subjects	Pricing	Current centres
MaxEn by EDU		4-17	English	~ Rmb 20,000/year	Beijing, Tianjin, Chengdu, Fuzhou
Mobiby TAL		3-6	Maths, English, Chinese	~ Rmb 10,000/year	Beijing

Source: Company data, Credit Suisse estimates

(2) **TAL's Mobby, on the other hand, is more driven by the Chinese education system.** Mobby tries to improve the thinking process in pre-K children through hard-core courses in maths, Chinese and English. If a student takes only one subject, prices are about Rmb10,000 a year. We believe the relative lower pricing of Mobby as compared to MaxEn is based on: (1) a larger addressable market that Mobby is targeting, and (2) in-line K12 prices as these students enrol themselves in primary school itself. We estimate Mobby has enrolments of ~300 students at its five Mobby centres in Beijing.

We believe Mobby and MaxEn are not direct competitors as they target different segments in the pre-K market, and both have huge market potential. MaxEn may be a more advanced and higher-end programme for parents than Mobby, but we believe EDU should be able to generate a meaningful revenue contribution from this business in the future.

Subjects: EDU in arts and TAL in science subjects; XUE's one-on-one attracts more underperforming students

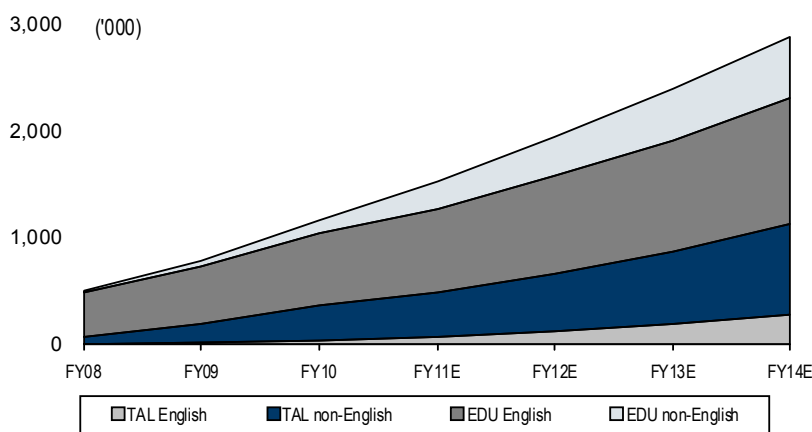
Though EDU and TAL vie more directly for the 'cream of the crop' students, each has its own strengths.

EDU has strong reputation in English standardised exams which is scalable into the English-related subjects in K12 tutoring. On the other hand, demand for non-English subjects at EDU is lesser, especially in cities where TAL has presence. According to students and parents we interviewed during our channel checks, EDU is the top choice for arts-related subjects, especially English, while TAL is the first choice for science-related subjects, particularly maths.

We believe Mobby and MaxEn are not direct competitors as they target different segments in the pre-K market, and both have huge market potential

EDU and TAL compete more directly for the 'cream of the crop' students, but each has its own strengths

Figure 19: EDU and TAL each has an unrivalled weapon, English and maths, the two largest niches in K12 tutoring



Source: Company data, Credit Suisse estimates

EDU's U-Can and POP Kid programmes providing package offerings to encourage their English students to take more non-English subjects at EDU, while TAL does the vice versa. As commuting is troublesome in tier-1 cities and proximity plays a role in students and

parents choosing their tutors, the package programmes work. Thus EDU gets some non-English students and TAL too increases its English subject enrolments.

However, our primary research shows that EDU and TAL are well known for English and maths, respectively. We thus believe neither will be able to grab more shares in the others' strong markets in the near future.

Though there are good students going to XUE with some star teachers achieving better academic results, the majority of XUE's students are below-average academic performers. XUE's one-on-one programme provides the parents with dedicated teachers to oversee the students' studies in terms of doing homework and clarifying doubts.

Seek the blue ocean winner(s)

Small classes, one-on-one or online—which is most preferred?

Figure 20: Sub-brands of the three players

Format	Providers
Small classes	TAL (Pei You 培优), EDU (U-Can 优能), XUE (Elite Class 菁英学堂)
1 on 1	XUE (1 on 1), TAL (Zhi Kang 1 on 1), EDU (VIP 个性化)
Online	TAL (eduu.com and etc.), EDU (koolearn.com)

Source: Company data

Small class model has higher entry barriers

As of 2009, small classes had a market share twice that of one-on-one. According to our primary channel checks and iResearch data, we believe that market sizes of small classes and one-on-one are similar. However, R&D and teachers' skill requirements for small classes are higher than those for one-on-ones. We thus expect the one-on-one market to be more fragmented with smaller localised players, while the small class market to consolidate with large, listed companies having more opportunities to leverage on scale and network.

We believe that market sizes of small classes and one-on-one are similar

Figure 21: Comparison of the three types of classes

	Pros	Cons
Small classes	(1) More interaction with peer students (2) Sufficient teacher attention to each student (3) Cheaper than one-on-one classes	1) Not enough individualised teaching as compared to one-on-one (2) Medium priced
One-on-one	(1) Fully devoted teacher and individualised teaching plan (2) Better cash flows for business operations	(1) Most expensive, if the student goes for a famous teacher (2) Difficult to scale up
Online	(1) Cheap (2) No time and location constraints, most convenient	(1) Not personalised and interactive

Source: Company data, Credit Suisse estimates

There is no particular student segmentation for a certain type of class, in our view. Students and their parents make their class type decision based on (1) word of mouth (what other students in their class are taking), (2) convenience to commute, (3) start teachers' availability, and (4) consultant advice. Thus, in our observation, many students take a package of two or even three formats.

Many students take a package of two or even three formats

One-on-one has higher barriers to scale up

The one-on-one market is a more competitive one compared to small classes and even online, because (1) it is more of localised and individualised, (2) R&D is hard to synchronise, and in fact R&D is not a key driver of growth currently, and (3) it is easier to set up a small mom-and-pop shop by a star teacher and thus increases local competition.

The one-on-one market is a more competitive one

We have talked with managements of some private one-on-one companies like 1Smart, and believe that the one-on-one business has very high barriers to scale up as (1) product innovation is relatively light for one-on-one classes at the current stage, (2) different markets have different tastes for personalised services—a company that thrives in Beijing may not get the customers in Shanghai, and (3) the more teachers a franchise has, the harder to manage and maintain the standards.

Online is insignificant in revenue contributions in the near term, but of strategic importance

We believe the market has been overlooking the importance of online strategy, due to its relatively low percentage of contribution to the topline. Online is important, in our view, as (1) it helps to build the network of potential customers and spread the word of mouth at little cost, (2) it allows the company to gauge a new market before the entry and customise offerings, and (3) it will be supplementary to the company’s offline offerings and uncovered cities.

Online helps to build the network of potential customers and spread the word of mouth at lower cost

Figure 22: TAL is a leader in online offerings

	Website ranking	Daily average page views	Daily average IPs
EDU - K12	1,268	334,304	99,200
TAL	548	1,105,584	148,800
XUE	9,852	37,696	12,160

Source: Alexa websites rankings 2010, iResearch

EDU changed its online strategy from multiple localised websites managed by regions to an integrated one website on 15 April 2011, and changed official website from *neworiental.org* to *xdf.cn*. This was due to (1) resources consolidation and (2) better Chinese user experience.

TAL hosts a full suite of discussion boards based on different topics, i.e. *zuowen.com* (writing), *aushu.com* (maths Olympics), *zhongkao.com* (high school entrance exams) and *gaokao.com* (college entrance exams). Thus the brand name is secondary to the subject matter, and we believe it is a viable strategy as TAL is still not as strong a brand as EDU nationwide and is still trying to expand.

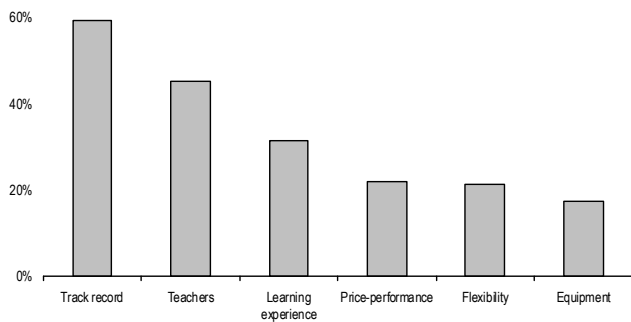
TAL has online discussion board coverage of 40 cities

Like EDU, XUE has an integrated website *21edu.com* and a corporate website *xueda.com*. There is no superior or inferior strategy as to whether to integrate or diversify the traffic online, in our view. However, we believe that TAL has been putting in more efforts in ramping up the online segment so far and has done things differently, too.

Success factors—word of mouth comes first

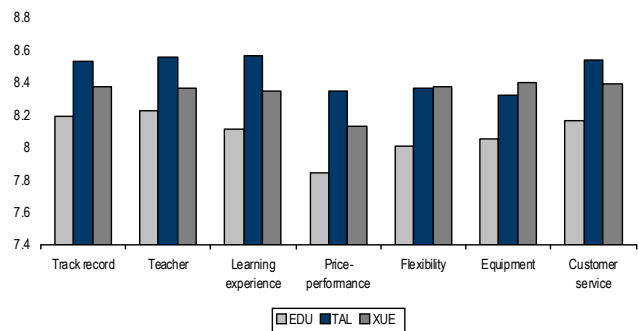
We believe the key success factors for K12 after-school tutoring are (1) word of mouth (track record and teachers), (2) class offerings (learning experience and pricing), and (3) service (flexibility and equipment).

Figure 23: Success factors for K12 tutoring



Source: iResearch 2010 survey, Credit Suisse estimates

Figure 24: Satisfaction ratings on each success factor



Source: iResearch 2010 survey, Credit Suisse estimates

The iResearch survey on key success factors for K12 after-school tutoring shows that word of mouth built by a strong track record and teachers are the top factors that influence decision making by students and parents. TAL ranked first in the customer satisfaction survey, followed by XUE and EDU.

EDU is not a strong player in K12 tutoring, but it is strategically positioned in the market to avert market share losses to competitors in its strong segment of overseas prep.

An ASP study—EDU moving luxury; TAL has ASP upside

We did an hourly rate ‘apples-to-apples’ comparison between K12 after-school small class offerings by EDU and TAL in a tier-one city (Beijing) and a representative tier-three city. We have five very interesting findings.

We believe the main difference is TAL sets prices at its headquarters while at EDU, each school head decides the prices at his/her school, making their price offerings more flexible.

- EDU’s pricing structure is more sophisticated than that of TAL**, which prices at an identical hour rate in a given city. EDU’s pricing is more complicated as (1) each school decides its own prices allowing it to change prices more frequently, while TAL’s prices are set at its headquarters, and (2) there are a lot of different types of English classes offered at EDU. For example, in Beijing, EDU’s English class prices range from Rmb500 to Rmb2,500, with an average hour rate ranging from Rmb28 to Rmb55.
- In Beijing, EDU priced maths class hour rates higher than those for English class for its POP classes and English class hour rates at a discount to those of TAL.** On average EDU’s hour rate for English classes is Rmb40, while it is Rmb60-86 for maths classes. In comparison, TAL charges an Rmb55 flat hourly rate for both English and maths classes in Beijing. This fact seems to contradict with our belief that TAL’s maths classes are in higher demand in the market and EDU’s English classes are its area of strength. We believe this is because (1) the number of EDU’s maths class offerings is much less than its English classes and it tries to differentiate and test the market’s sensitivity to prices and (2) EDU tries to lower prices of its strong classes of English to increase enrolments and to roll out non-English classes through packages.

EDU’s English classes are priced at a wider range

Figure 25: English subject hourly rates in Beijing

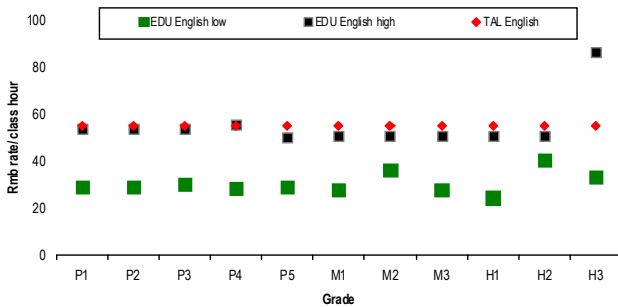
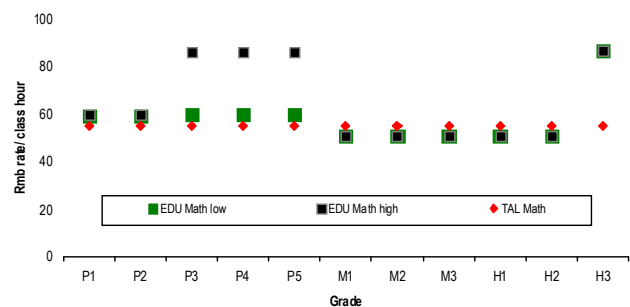


Figure 26: Maths subject hourly rates in Beijing

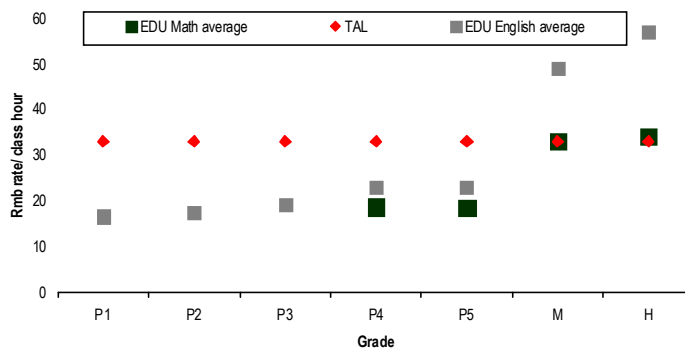


Notes: Low and high refers to the lowest and highest hourly rate; P1: Primary school Grade 1, M1: Middle school Grade 1, H1: High school Grade 1

Source: Company data, Credit Suisse estimates

- In tier-3 cities, the pricing structure reflects the strength of each company more accurately.** Though EDU has a more complicated pricing system than TAL’s, we have seen a much narrower range for class rates of the same grade at less developed cities for EDU. We believe this is due to the fewer number of classes that are offered at these cities.
- As students enter high school, EDU’s pricing power on its English classes increases significantly.** This is in line with our analysis that EDU’s English class customers are older students.

Figure 27: Tier-3 city small class price per hour comparison



Source: Company data, Credit Suisse estimates; P1: Primary school Grade 1, M: Middle school, H: High school

EDU moving to luxury brand; TAL has great ASP upside potential

We believe this ASP study would be very helpful for investors to understand the sophistication of strategies at both the companies. In addition, we see great ASP upside for TAL.

(1) EDU is more professional at pricing and segmenting the customers

While we can say that TAL’s pricing structure is very simple and straight forward like in the small-scale peasant economy days when prices were written by hand on the blackboards, EDU is already a sophisticated player that provides the customers with more choices to address different segments of the market.

Also, though EDU has far less maths class offerings, it is probing the market by pricing higher and tries to attract the less price-sensitive clientele. We believe EDU should be able to get to the desirable customer segments through trial and error with maths class prices.

(2) TAL has great ASP upside potential.

We expect TAL to upgrade its pricing structure by offering more options of classes, and raise ASP significantly in its strong subjects, maths, in tier-one cities like Beijing. Though the company still has the policy of twice-a-year price raise, we think EDU has turned out to be the master of price raises without attracting many customer complaints.

EDU is probing the market by pricing higher in new classes like maths and tries to attract less price-sensitive clientele

Success paths for EDU

From college to middle and primary school customers

EDU traditionally has a strong brand image among college students, as it has unparalleled strength in overseas test prep. However, as the ages of students going abroad are decreasing, EDU’s customers have been moving down the age groups, to high schools and then primary schools.

Absolute leader in English, but not in non-English

Starting from 2008, EDU has rolled out the U-Can programme for middle school kids in K12 tutoring, and in 2009, it started POP Kid for primary schoolchildren. Though U-Can and POP Kids have been key drivers of enrolment growth in recent two years, K12 non-English subject enrolments were only around 259,000, which accounted for less than 15% of total enrolments of EDU for FY11. In contrast, TAL has about 378,000 enrolments, 80%+ of which come from non-English subjects.

80% of TAL’s enrolments are in non-English subjects

We believe the market for English language training and overseas test prep that EDU was competing in the second half of the last decade was a blue ocean and it would gradually

grow into a red ocean as the market matures. EDU has achieved a six-year 17% CAGR in enrolment growth.

Figure 28: SWOT analysis on EDU

EDU			
Strengths		Opportunities	
#	No. 1 brand and dominant market share in English language training	#	K12 tutoring has much larger addressable markets with far less penetration, than its traditional core businesses
#	Nationwide network of 487 schools and learning centres covering 47 cities	#	MaxEn helps EDU to go down its customer age groups and increase customer lifetime, may also create a new niche market for EDU
#	Strong brand in overseas test exam training with strong relationships with standardized test organizations		
Weaknesses		Threats	
#	Not as strong in non- English subjects, especially science-related subjects	#	Increasing portion of VIP business, more sensitive to macro economics and depress margins
#	Only 2% of total enrolments are non- English for primary school students	#	28% of total enrolments are primary school students, backward customer acquisition is difficult
#	Management divisions on pre-K, primary school and middle/high school and MaxEn may constrain synergy	#	Strong competitors in overseas test preps with global players such as Pearson, and many smaller local ones in Kids English

Source: Company data, Credit Suisse estimates

Capable school heads drive penetration across the country

EDU's success has been achieved by a team of young people with entrepreneurial skills.

No. 1 in overseas test prep

We believe EDU's success in English and overseas test prep is acknowledged by the market. As we mainly focus on the K12 market in this report, we skip this part of business in our analysis.

Success paths for TAL

From zero to No. 1 in Beijing, and steady city expansion

Some investors regard TAL as the regional, smaller scale competitor to EDU. However, we believe TAL's competitive advantage and market position are underestimated.

Beijing is the most competitive market for K12 after-school tutoring with the largest addressable market and many players. We believe Beijing serves as a leading indicator to the rest of the country as to where the competition is headed. TAL's success in Beijing as a late mover is replicable in other cities, in our view.

TAL's competitor, Juren Education Group, was founded in 1994, almost 10 years earlier than TAL, and has grown into a comprehensive education institute. Juren has more than 70 learning centres in the city and set up 11 schools across the country as of 2011.

Like TAL, Juren's small class model contribution outweighs that of one-on-ones, representing about almost 60% of total revenue. However as of 2009, Juren, with a 1.9% market share, lost its leading position to TAL, which has a 5% market share or so in 2011, in Beijing's K12 tutoring market.

We believe TAL has achieved the success in Beijing due to:

- (1) **its right cut into the most promising niche.** TAL entered the market focusing on maths Olympics, the area with the largest addressable niche market and at the highest sustainable growth rate.
- (2) **Juren's strategy missteps and core member departures.** In the meantime, Juren has turned into a education provider with a product line catering to all age groups, providing tutoring in subjects including Cambridge English, adult English, maths

TAL's success in Beijing as a late mover is replicable in other cities, in our view.

competitions, abacus, memorising techniques, essay writing and kids computer, and offers multiple arts education courses including singing and music, calligraphy and painting, and dancing and sports. As a result, it does everything but has no ‘killing edge.’

Easier to achieve longer customer lifetime for TAL

TAL has 40% of its total enrolments from primary school students which makes it easier for the company to accompany the students as they grow up and achieve a longer customer lifetime. In comparison, EDU’s POP Kid (primary school students) enrolments account for only 23% of total.

Figure 29: SWOT analysis on TAL

TAL			
Strengths		Opportunities	
#	Strong track record in science subjects in K12 tutoring, especially in Math Olympian competition training	#	K12 tutoring is more counter-cyclical than overseas test prep with far less penetration
#	Largest market share in Beijing with strong word-of-mouth and reputation	#	Successfully gaining market share in Tianjin, Guangzhou and Shenzhen
#	A full suite of K12 e-learning websites with 8.6 mn unique visitors in Sep 2011*	#	40% of enrolments are primary school students, easier to achieve longer customer lifetime
#	Small class model and online marketing through its own e-learning websites support higher margins than peers	#	Can leverage expertise in science subjects and expand into pre-school age groups
		#	Mobby helps TAL to reach very young student base, increasing customer lifetime
Weaknesses		Threats	
#	60% of learning centres are in Beijing, which contributes 80%+ total revenue	#	K12 exams differ by provinces, thus it is hard to standardise training material
#	Not a well-known brand outside of Beijing and Shanghai, only has presence in 10 cities	#	Execution of expansion into new markets and segments pose uncertainties

Source: Company data, Credit Suisse estimates

Viable online strategy—higher margins and more visible expansion

Though TAL has learning centres only in 10 cities, we particularly like its online strategy which we believe is a viable and unique one to steadily expand its footprint. TAL currently has entered 26 cities with its Olympics forum, *aoshu.com*, and 40 cities with its general discussion board, *eduu.com*, for K12 after-school tutoring. It helps TAL to gauge the market before it makes a decision on entry, and nurtures word of mouth for free.

Figure 30: TAL's subject-based online empire

Websites based on subjects	Discussion boards
 Youjiao.com 幼教网 : Pre-K	 eduü.com e度网
 Aoshu.com 奥数网 : Maths Olympics	 BBS.eduü.com e度论坛
 Zhongkao.com 中考网 : High school entrance exam	 eduü.com e度访谈 fanglan.eduü.com
 Gaokao.com 高考网 : College entrance exam	 eduü.com e度字典 zidian.eduü.com
 Yingyu.com 英语网 English	 eduü.com e度成语 chenovv.eduü.com
 Zuowen.com 作文网 Writing	 eduü.com e度网 订阅中心
 LIUXUE.com 留学网 Going abroad prep	

xueersi 学而思网校

Source: Company data, Credit Suisse estimates

TAL has a full suite of online discussion boards, such as *zuowen.com* (writing), *aoshu.com* (maths Olympics) and *eduu.com* (general discussion board on study). According to Google AdPlanner data, these discussion boards generate 8.6 mn unique visitors per month. Our channel checks also confirm the impact these boards have on students and parents. Comparatively speaking, EDU and XUE attach less importance to this strategy and their online impact is limited despite their much broader city coverage.

Even though the online segment revenue would not be meaningful in the near term, we believe that online influence is of strategic importance and like TAL's online strategy.

Success paths for XUE

'Enclosure strategy' for market share gain in the one-on-one business

Xueda started to quickly expand its physical presence in 2007 across the country, when it received a US\$20 mn capital injection from a VC, despite profitability pressures. As a result, Xueda could cover 61 cities as of 30 June 2011 and has achieved a larger share in the one-on-one business of K12 after-school tutoring. Due to wider city coverage, Xueda has a more diversified revenue breakdown in terms of cities than TAL.

XUE's one-on-one model is more tailored to academically poor students

XUE's one-on-one addresses students with poor academic record

While EDU and TAL compete for the 'cream of the crop' students, XUE's one-on-one model is more tailored to academically poor students.

The good and bad of faster expansion

We believe the 'enclosure strategy' has benefited Xueda in gaining market shares and positioning itself as a more nationwide competitor. However, we are concerned about the management and execution challenges that along with growing numbers of cities and learning centres.

Figure 31: SWOT analysis on XUE**XUE**

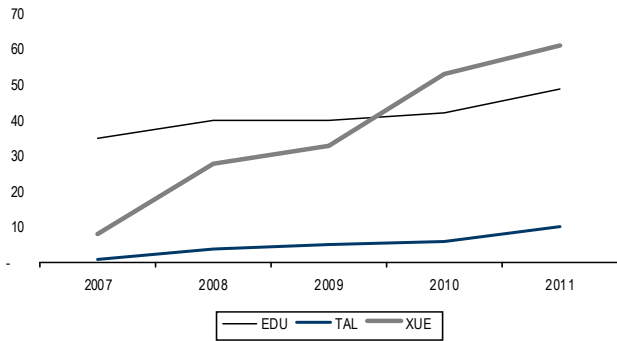
Strengths		Opportunities	
#	Largest nationwide 1 on 1 K12 tutoring provider	#	Small class trial in 22 L/Cs to compliment its 1 on 1 classes going forward
#	First mover advantage in many cities	#	Only listed 1 on 1 company - can leverage on building the platform to scale up
Weaknesses		Threats	
#	Lower margins than small classes model	#	Many local 1 on 1 players
		#	Effective and systematic matrix management with the fast expansion

Source: Company data, Credit Suisse estimates

Operating and financial matrix, and valuation

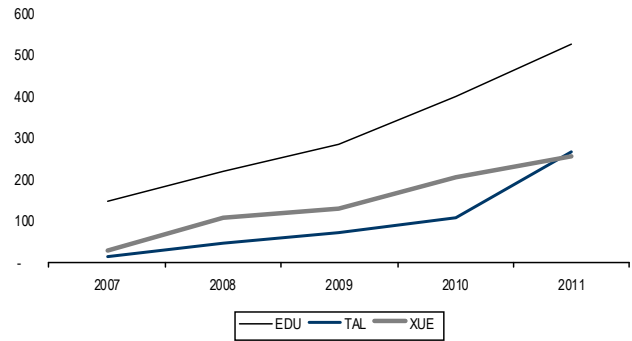
Operating matrix comparison

Figure 32: Number of cities covered



Source: Company data, Credit Suisse estimates, as of 31 August

Figure 33: Total learning centres

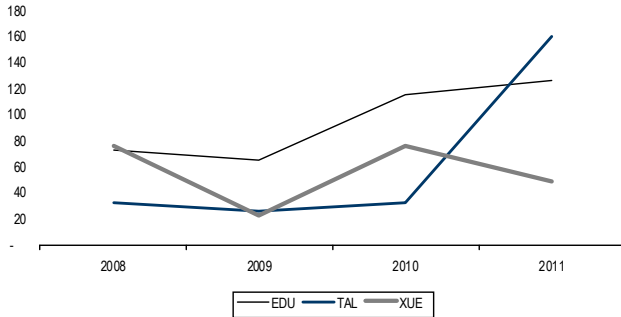


Source: Company data, Credit Suisse estimates, as of 31 August

XUE more focused on national coverage

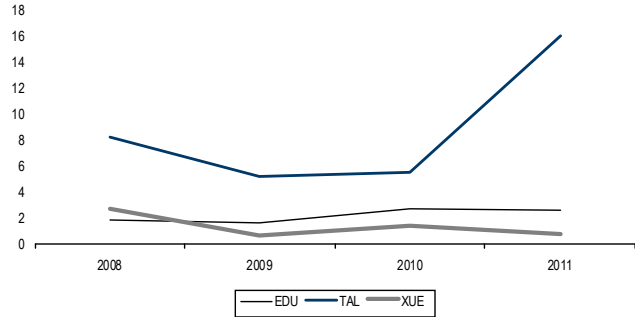
While TAL and EDU are more conservative, XUE has the most aggressive city expansion strategy. In terms of learning centres, TAL focuses most on the depth of each city it has presence in.

Figure 34: Net adds of learning centres



Source: Company data, Credit Suisse estimates, as of 31 August

Figure 35: Number of learning centre adds per city

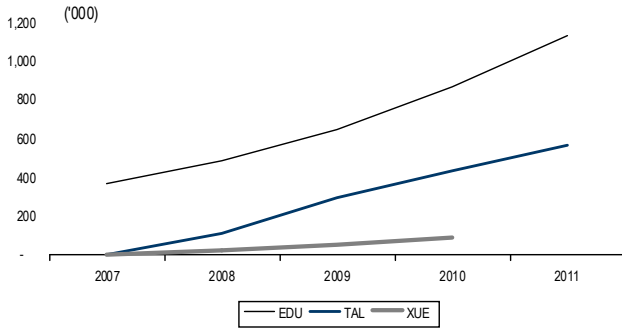


Source: Company data, Credit Suisse estimates, as of 31 August

TAL most focused on the depth of each city, followed by EDU

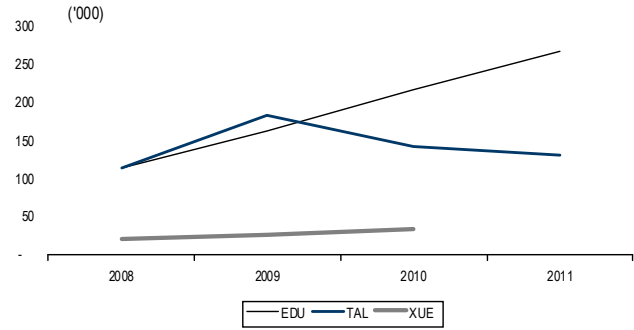
The average number of learning centre adds per city is calculated by learning centre adds divided by the number of cities covered. We believe this incremental number shows the expansion strategy divergence in 2011 as TAL more than doubled its learning centres in Beijing from 59 in August 2010 to 138 by August 2011.

Figure 36: Total enrolments



Source: EDU's Ucan+PoP enrolments; Company data, Credit Suisse estimates, 12 months as of 31 August

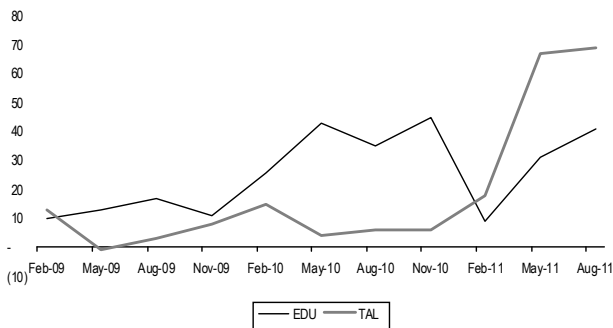
Figure 37: Net adds of enrolments



Source: EDU's Ucan+PoP enrolments; Company data, Credit Suisse estimates, 12 months as of 31 August

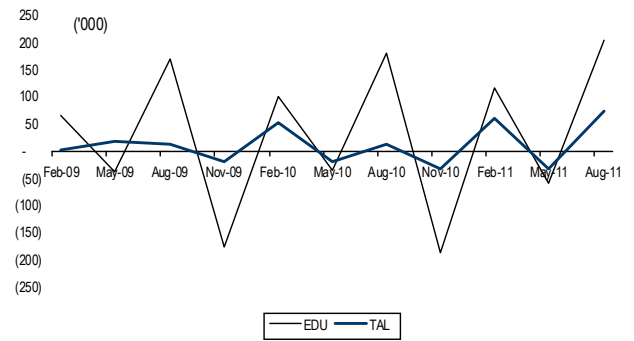
TAL's enrolment adds slowed in 2010 and 2011 due to its conservative city and learning centre expansion in 2009 and 2010, as we believe enrolment growth lags that of expansion.

Figure 38: Net adds of learning centres (quarterly)



Source: Company data, Credit Suisse estimates

Figure 39: Net adds of enrolments (quarterly)

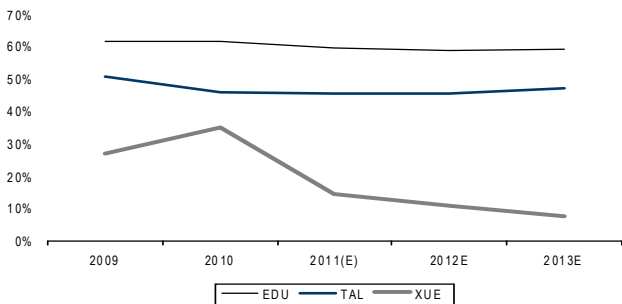


Source: Company data, Credit Suisse estimates

K12 tutoring is a seasonal business and the strongest quarters for enrolments are summer, followed by winter when students have the summer and winter breaks. EDU's seasonality is stronger than TAL's, mainly due to a larger enrolment base.

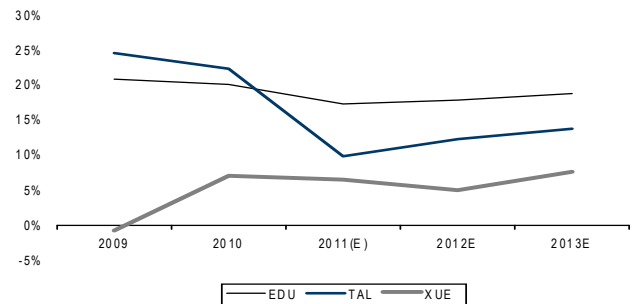
Financial matrix comparison

Figure 40: GAAP gross margins



Source: Company data, Credit Suisse estimates, EDU FYE: 31 May, TAL FYE: 28 February, XUE FYE: 31 December; 2011E, 2012E, 2013E Bloomberg consensus for XUE

Figure 41: GAAP operating margins



The financial matrix is not apples-to-apples comparable for the three companies, as EDU has a mix of overseas test prep, U-Can (middle and high school K12), POP Kids and domestic English test prep, and other language training (ASPs in the order of descending), TAL has a mix of small class and one-on-one models, while XUE has mostly one-on-one.

New Oriental Education

(EDU.N / EDU US)

Rating	OUTPERFORM*
Price (28 Nov 11, US\$)	23.55
Target price (US\$)	33.88 ¹
Chg to TP (%)	43.9
Market cap. (US\$ mn)	3,617
Enterprise value (US\$ mn)	2,910
Number of shares (mn)	153.58
Free float (%)	41.8
52-week price range	33.70 - 21.37

*Stock ratings are relative to the relevant country benchmark.
¹Target price is for 12 months.

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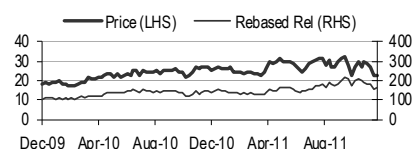
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INITIATION

Not the strongest in K12, but visible growth

- **Initiate with OUTPERFORM with a target price of US\$33.88.** EDU has the oldest customers in the K12 business, with about 20% of K12 enrolments being from primary school students while the same is 40% for TAL. EDU does not focused on the depth of each city as much as TAL does, and has not been successful in its M&A. EDU has a more sophisticated management system with a much more complicated pricing structure than TAL's.
- **EDU is strategically positioned in K12 competition.** (1) If not doing so, competitors who grow with younger customers can threaten EDU's core business of overseas prep. (2) EDU can also differentiate itself as a more luxurious brand, for example, by providing MaxEn to the high-end POP Kids customers and going down to even younger customers in the pre-K segment.
- **Market concerns overdone.** EDU's shares have seen a market sell-off after its 1Q12 results (share prices went down 10%+ since 17 October) due to the failure of Newwave acquiring in Shanghai and higher-than-expected G&A expenses (excluding SBC) at 18.2% of revenues that dragged down operating margins and raised market concerns about margin pressure. We believe the concerns are overdone as (1) its overseas test prep provides stable growth, and (2) MaxEn could be a catalyst that creates a new niche market.
- **Valuation.** Our DCF model derives a target price of US\$33.88, implying 25x FY13E ex cash non-GAAP P/E and 1.2x non-GAAP FY13 PEG. We believe is a fair value for EDU. We also believe the current valuation of 17.6x non-GAAP 2013E P/E is a good entry point for long-term investors. Key risks are (1) competition, (2) sustaining margin and (3) execution risks.

Share price performance



The price relative chart measures performance against the MSCI China Free index which closed at 51.88 on 28/11/11. On 28/11/11 the spot exchange rate was US\$1./US\$1

Performance Over	1M	3M	12M
Absolute (%)	-21.7	-13.0	-12.8
Relative (%)	-13.9	-5.9	12.3

Financial and valuation metrics

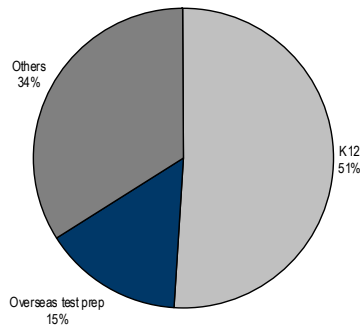
Year	5/11A	5/12E	5/13E	5/14E
Revenue (US\$ mn)	557.9	756.3	977.4	1,152.9
EBITDA (US\$ mn)	112.0	155.3	213.4	265.1
EBIT (US\$ mn)	95.5	130.3	185.2	234.5
Net income (US\$ mn)	101.8	137.9	192.9	237.9
EPS (CS adj.) (US\$)	0.65	0.88	1.20	1.48
Change from previous EPS (%)	n.a.	-74.9		
Consensus EPS (US\$)	n.a.	0.94	1.22	1.67
EPS growth (%)	29.8	34.6	37.1	22.6
P/E (x)	36.1	26.8	19.6	16.0
Dividend yield (%)	0	0	0	0
EV/EBITDA (x)	29.5	18.7	12.2	8.1
P/B (x)	7.0	5.4	4.2	3.3
ROE (%)	21.8	22.7	24.3	23.1
Net debt/equity (%)	net cash	net cash	net cash	net cash

Source: Company data, Thomson Reuters, Credit Suisse estimates.

Not the strongest in K12, but dominates overseas prep

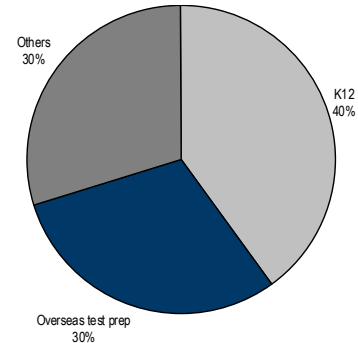
■ EDU's K12 play is unique

Figure 42: Enrolment breakdown, FY11



Source: Company data, Credit Suisse estimates

Figure 43: Revenue breakdown, FY11



Source: Company data, Credit Suisse estimates

Based on our sector analysis above, we believe that EDU is not the strongest player in K12 after-school tutoring. Its core competency is still overseas prep—only 15% of total enrolments come from overseas test prep, but its revenue contribution twice that of others.

- (1) EDU has the oldest customers in the K12 business, with about 20% of K12 enrolments being from primary school students while the same for TAL is 40%.
- (2) EDU does not focus on covering the depth of each city as much as TAL does.
- (3) EDU has a more sophisticated management system with a much more complicated pricing structure than TAL's.

■ EDU is strategically positioned in K12 competition

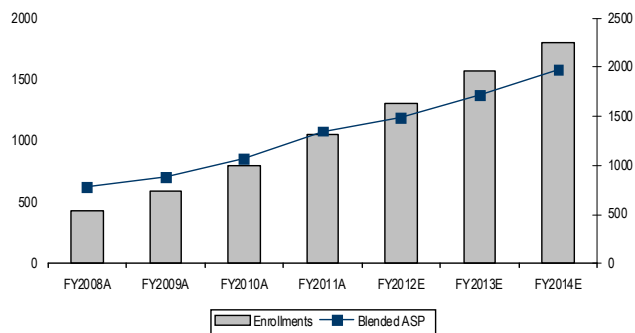
- (1) If not, competitors who grow with younger customers can threaten EDU's core business of overseas prep.
- (2) EDU can differentiate itself as a more luxurious brand, for example, by providing MaxEn.

■ Initiate with OUTPERFORM, as (1) its overseas test prep provides stable growth, and (2) MaxEn could be a catalyst that creates a new niche market.

EDU suffered a market sell-off after its 1Q12 results (share prices went down 10% from 17 October to 11 November) due to the failure of Newave acquiring in Shanghai, and higher-than-expected G&A expenses (excluding SBC) at 18.2% of revenues that dragged down operating margins and raised market concerns about margin pressure.

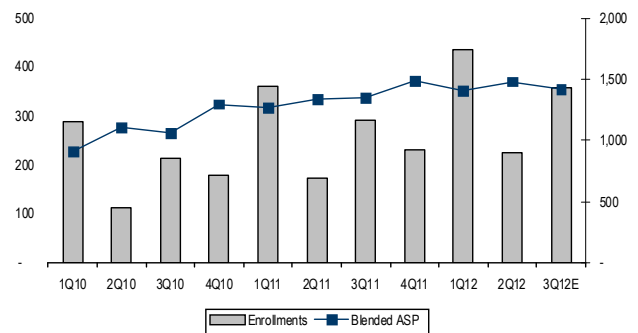
We believe the concerns are overdone because (1) though EDU is not the strongest K12 market player, its strength in overseas prep and English ensures the enrolment growth and ASP pricing power in VIP segments, and (2) MaxEn could be a next twelve months catalyst as EDU would create a new niche market of the younger students determined to go abroad for high school/college education and that is not the same K12 market that we are discussing here.

Figure 44: Annual enrolments and ASP in K12 segments (U-Can and POP Kids combined)



Source: Company data, Credit Suisse estimates

Figure 45: Quarterly enrolments and ASP in K12 segments (U-Can and POP Kids combined)



Source: Company data, Credit Suisse estimates

Figure 46: CS forecasts

FY end May (US\$ mn)	1Q12	2Q12E	3Q12E	4Q12E	FY12E	FY13E
Total revenue	272.0	128.8	175.3	180.2	756.3	977.4
Guidance	255.8 to 265.4	124.4 to 129.1				
Consensus		129.0	177.1	178.4	758.2	980.0
Gross profit	179.3	68.1	100.8	102.5	450.6	583.6
Gross profit (non-GAAP)	179.5	68.3	101.0	102.7	451.4	584.5
Operating profit	94.8	(3.9)	28.5	10.8	130.3	185.2
Operating profit (non-GAAP)	101.6	0.6	31.9	17.7	151.8	206.7
Net profit	90.7	1.6	30.3	15.3	137.9	192.9
Net profit (non-GAAP)	97.5	6.1	33.7	22.1	159.4	214.4
EPS (d) (US\$)	0.58	0.01	0.19	0.10	0.88	1.20
Consensus		0.02	0.19	0.11	0.94	1.21
EPS (d) (non-GAAP) (US\$)	0.62	0.04	0.21	0.14	1.01	1.34
Consensus		0.04	0.22	0.14	1.00	1.30
Gross margin (%)	65.9%	52.8%	57.5%	56.9%	59.6%	59.7%
Operating margin (%)	34.8%	-3.0%	16.3%	6.0%	17.2%	19.0%
Net margin (%)	33.4%	1.2%	17.3%	8.5%	18.2%	19.7%

Source: Company data, Credit Suisse estimates

Financial summary

Figure 47: EDU—income statement

YE Feb (US\$m)	FY 2009	FY 2010	FY 2011	FY 2012E	FY 2013E	FY 2014E
Net revenue	292.6	386.3	557.9	756.3	977.4	1152.9
% growth	46%	32%	44%	36%	29%	18%
Gross profit	180.9	239.7	336.1	451.4	584.5	691.7
% gross margin	62%	62%	60%	60%	60%	60%
Opex	120.0	162.4	240.6	321.1	399.3	457.3
G&A	64.5	87.9	141.3	194.7	242.4	276.7
S&M	38.7	58.3	82.8	105.0	135.4	159.1
EBIT (GAAP)	60.9	77.3	95.5	130.3	185.2	234.5
% EBIT margin	21%	20%	17%	17%	19%	20%
EBIT (non-GAAP)	77.7	93.5	112.1	151.8	206.7	255.9
% EBIT margin	27%	24%	20%	20%	21%	22%
Other income/(loss)	7.2	6.2	14.3	23.3	31.5	39.0
Interest income	6.6	6.5	13.0	18.1	31.5	39.0
Interest expense	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	68.1	83.5	109.8	153.6	216.7	273.5
Income tax	(7.3)	(6.0)	(8.2)	(15.7)	(23.8)	(35.6)
Net profit (GAAP)	61.0	77.8	101.8	137.9	192.9	237.9
% net margin	21%	20%	18%	18%	20%	21%
Net profit (non-GAAP)	77.8	94.0	118.4	159.4	214.4	259.4
% net margin	27%	24%	21%	21%	22%	23%
GAAP EPS (US\$)						
Basic	1.859	2.061	2.656	0.892	1.195	1.508
Diluted	1.588	2.010	2.608	0.878	1.204	1.475
non-GAAP EPS (US\$)						
Basic	2.369	2.490	3.089	1.031	1.359	1.644
Diluted	2.023	2.428	3.033	1.015	1.338	1.609

Source: Company data, Credit Suisse estimates

Figure 48: EDU—balance sheet

YE Feb (US\$m)	FY 2009	FY 2010	FY 2011	FY 2012E	FY 2013E	FY 2014E
Cash and cash equivalents	254.8	281.1	317.3	706.8	1008.6	1471.7
Short-term investments	0.0	0.0	143.7	0.0	0.0	0.0
Restricted cash	0.5	0.6	3.4	3.4	3.4	3.4
Term deposits	59.8	137.9	152.7	152.7	152.7	152.7
Accounts receivable, net of allowance	1.5	1.9	1.7	6.5	8.4	9.9
Inventory	15.2	17.2	18.0	37.3	39.2	45.6
Deferred tax assets	1.6	3.0	5.3	5.3	5.3	5.3
Current assets of discontinued operations	14.2	22.2	33.2	50.1	71.3	82.7
Total current assets	347.7	463.8	675.3	962.0	1288.9	1771.2
PP&E, net	109.8	118.1	160.4	173.3	174.6	167.1
Land use right, net	3.5	3.4	3.5	3.5	3.5	3.5
Deferred tax assets	1.1	1.6	1.0	1.7	1.7	1.7
Long-term prepaid rent	1.3	1.9	2.8	2.8	2.8	2.8
Trademark	0.9	0.8	5.0	5.0	5.0	5.0
Goodwill	2.7	2.8	7.6	7.6	7.6	7.6
Long-term investment	0.0	3.7	7.8	3.9	3.9	4.0
Total non-current assets	121.7	132.6	188.1	197.7	199.0	191.6
Total assets	469.4	596.4	863.4	1159.8	1487.9	1962.8
Accounts payable - trade	9.3	11.0	9.5	22.3	28.2	32.7
Accrued expenses and other current liabilities	29.9	44.8	77.0	112.7	142.6	165.3
Income tax payable	3.7	5.8	7.2	11.4	17.6	26.6
Deferred revenue	74.8	107.1	194.3	278.6	350.3	529.6
Total current liabilities	117.8	168.7	288.0	424.9	538.7	754.2
Deferred tax liabilities	0.2	0.1	1.1	1.1	1.1	1.1
Total liabilities	118.2	168.9	289.1	426.1	539.9	755.4
Total shareholders' equity	351.2	427.6	574.2	733.7	948.0	1207.4

Source: Company data, Credit Suisse estimates

Figure 49: EDU—cash flow statement

YE Feb (US\$m)	FY 2009	FY 2010	FY 2011	FY 2012E	FY 2013E	FY 2014E
Operating activities						
Net income	60.9	77.6	101.5	137.9	192.9	237.9
Depreciation and amortization	10.4	12.2	16.4	24.9	28.1	30.6
Share-based comp expense	16.8	16.2	15.0	21.5	21.5	21.5
Deferred income taxes	(1.1)	(1.9)	(1.2)	(0.7)	(0.0)	(0.0)
Changes in working capital:						
Accounts receivable, net	(0.7)	(0.4)	0.3	(4.9)	(1.9)	(1.5)
Inventory	(4.3)	(2.0)	0.1	(19.3)	(1.9)	(6.3)
Prepaid expenses and other current assets	(0.4)	(8.0)	(10.0)	(16.8)	(21.2)	(11.4)
Accounts payable - trade	2.1	1.7	(2.1)	12.8	5.9	4.5
Accrued expenses and other current liabilities	1.1	13.9	19.7	35.7	29.9	22.7
Income tax payable	0.9	2.0	0.9	4.2	6.2	9.0
Deferred revenue	14.6	32.3	76.6	84.2	71.7	179.3
Long-term deposit	(2.0)	(1.6)	(3.9)	-	-	-
Long-term prepaid rent	(1.3)	(0.5)	(0.8)	-	-	-
Net operating cash flow	97.2	141.9	215.8	279.7	331.1	486.2
Investing activities						
Restricted cash	(0.0)	(0.0)	(2.7)	-	-	-
Term deposits	(6.0)	(78.1)	(7.1)	-	-	-
Purchase of trademark and intangibles	(0.5)	-	(0.4)	-	-	-
Purchase of subsidiaries	-	(0.5)	(1.9)	-	-	-
Purchase of PP&E	(16.0)	(19.6)	(49.1)	(37.8)	(29.3)	(23.1)
Proceeds from disposal of PP&E	0.2	0.3	1.7	-	-	-
Proceeds from a disposal of discontinued operations	-	-	1.3	-	-	-
Purchase of investments	-	-	(139.9)	147.6	(0.0)	(0.0)
Net investing cash flow	(16.3)	(19.8)	(191.1)	109.8	(29.4)	(23.1)
Financing activities						
Term deposits	(6.0)	(78.1)	(7.1)	-	-	-
Proceeds from issuance of common shares	5.3	12.4	6.4	-	-	-
Cash paid for shares repurchase	(35.5)	(30.0)	-	-	-	-
Net financing cash flow	(36.1)	(95.7)	(0.7)	-	-	-
Effects of exchange rate changes	1.5	(0.1)	12.1	-	-	-
Net change in cash and equivalents	46.3	26.3	36.2	389.5	301.8	463.1

Source: Company data, Credit Suisse estimates

Valuation

Our DCF model derives a target price of US\$33.88, implying 25x FY13E ex cash non-GAAP P/E and 1.2x non-GAAP FY13 PEG. We believe this is a fair value for EDU. We also believe the current valuation of 17.6x non-GAAP 2013E P/E is a good entry point for long-term investors.

Figure 50: EDU—DCF model

Free cash flow (usd mn)	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012E	FY 2013E	FY 2014E	FY 2015E	FY 2016E	FY 2017E	FY 2018E
NOPAT	5.3	12.8	5.8	25.0	42.9	54.7	72.3	89.2	117.4	166.1	204.8	258.8	313.1	371.3	419.8
D&A	2.2	3.0	5.1	6.8	7.7	10.4	12.2	16.4	24.9	28.1	30.6	33.7	37.4	41.9	47.3
SBC	2.0	-	7.9	4.6	8.7	16.8	16.2	15.0	21.5	21.5	21.5	21.5	23.2	25.1	27.1
Chg in WC	3.1	(2.9)	6.0	17.7	11.2	10.1	37.3	80.9	96.0	88.7	196.3	208.5	233.8	273.6	315.4
CapEx	(29.1)	(43.0)	(11.6)	(7.9)	(11.4)	(16.0)	(19.6)	(49.1)	(37.8)	(29.3)	(23.1)	(28.8)	(34.9)	(41.6)	(50.2)
FCF to the firm	(16.5)	(30.2)	13.2	46.2	59.2	75.8	118.5	152.5	221.9	275.1	430.0	493.6	572.6	670.2	759.4
Terminal value															8,233.4
Total FCF	(16.5)	(30.2)	13.2	46.2	59.2	75.8	118.5	152.5	221.9	275.1	430.0	493.6	572.6	670.2	8,992.8

WACC assumptions	
RFR	4.50%
Market premium	8%
β	1
Cost of equity	12.5%
Cost of debt	5%
Tax rate	15%
Debt to capital ratio	
WACC	12.5%
Terminal g	3%

Firm value	\$5,616.1
Net debt	(\$313.9)
EV	\$5,302.3
ADS outstanding	156.5
EV per ADS	\$33.88
Current price	23.55
% potential upside	44%

Source: Company data, Credit Suisse estimates

Figure 51: Valuations

Multiples	FY09	FY10	FY11	FY12E	FY13E	FY14E
P/E (non-GAAP)	46.6X	38.8X	31.1X	23.2X	17.6X	14.6X
P/E (GAAP)	59.3X	46.9X	36.1X	26.8X	19.6X	16.0X
P/E ex cash non GAAP	41.8X	34.0X	28.2X	21.1X	16.3X	13.5X
Dil PEG (x) (Non-GAAP)	1.7X	1.2X	1.0X	.9X	.8X	.7X
EV/EBITDA	41.7X	33.2X	26.6X	19.2X	13.9X	11.2X
EV/FCF	39.2X	25.1X	19.5X	13.4X	10.8X	6.9X
P/B	10.3X	8.5X	6.4X	5.0X	4.0X	3.1X
ROE	17%	18%	18%	19%	20%	20%

Source: Company data, Credit Suisse estimates

Risks

- (1) **Competition risks.** Though EDU dominates the overseas test prep market, there are increasing competition in this space, especially after Pearson's acquisition of Global Education. In other business lines, EDU is not the strongest player and faces a more fragmented market and competition. If MaxEn is unable to create the younger "to-be-going abroad" students a new niche market for EDU as we expect, there would be greater challenge for EDU to grow its POP Kinds business line,
- (2) **Margin risks.** As VIP and K12 business lines grow, there will be increasing margin pressure. If EDU cannot balance growth and product mix, prices may squeeze and margins will be under pressure.
- (3) **Execution risks.** Management matrix and the right incentives to retain the best talents and school heads are essential for the business to thrive. However, this is becoming increasingly challenging. Especially after EDU disclosed the departure of four school heads in 1Q12, we would like to see more effective measures taken by EDU to prevent its losing key talent.

TAL Education Group

(XRS.N / XRS US)

Rating	OUTPERFORM
Price (28 Nov 11, US\$)	10.01
Target price (US\$)	(from 16.70) 15.10*
Chg to TP (%)	50.8
Market cap. (US\$ mn)	746
Enterprise value (US\$ mn)	557.65
Number of shares (mn)	74.50
Free float (%)	45.6
52-week price range	16.72 - 8.61

*Stock ratings are relative to the relevant country benchmark.
*Target price is for 12 months.

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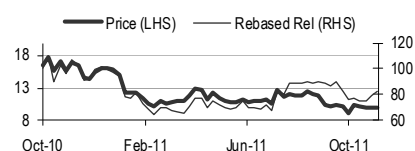
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COMPANY UPDATE

A young K12 leader running fast

- Beijing's success replicable.** TAL has achieved success in Beijing despite being a late mover due to: (1) the right cut into the niche market where TAL has competitive advantage, i.e., maths Olympics, and (2) viable online strategy. We believe this strategy is replicable in other cities, too, because: (1) maths Olympics is a test well-received in many cities across the country; (2) TAL's *aoshu.com* (maths Olympics website) has already reached 26 cities and its discussion boards covered 40 cities as of August 2011; and (3) TAL efficiently manages each school from its headquarters.
- Depth-focused expansion.** We believe the market mistook TAL for a one-city player and a much smaller player that can be overtaken by EDU. In fact, TAL's expansion is depth-driven. It had steadily expanded to 10 cities as of August 2011 and will be adding four to six more cities in January 2012. We like its investments in online and consulting as this strategy helps it build word-of-mouth publicity for free and test waters before taking more informed market entry decisions.
- Stock price has been down 35%+ YTD; two catalysts to boost share price in the next 12 months.** We believe TAL's aggressive expansion strategy in 2011–12 is appropriate because: (1) large K12 players focus more on profitability than growth, (2) it is difficult to raise new funding under a negative capital market environment, and (3) the company has enough cash funding to sustain aggressive expansion. TAL has two potential catalysts: (1) ASP increases in small classes and a better pricing structure to enhance customer value, and (2) the pre-K segment Mobby to enrich the product line.
- Maintain OUTPERFORM.** Our DCF model derives a target price of US\$15.10 (earlier US\$16.70), implying 31X FY13E ex cash non-GAAP P/E and 1.0X FY13E non-GAAP PEG, which we believe is a fair value for TAL. The company's FCF will return to 6% in FY13E. We believe the current valuation of 20.7x non-GAAP 2013E P/E is a good entry point for investors who want to share the growth of China's domestic K12 market growth.

Share price performance



The price relative chart measures performance against the MSCI CHINA F IDX which closed at 5297.45 on 28/11/11. On 28/11/11 the spot exchange rate was US\$1/US\$1

Performance Over	1M	3M	12M
Absolute (%)	-2.3	-17.2	-40.7
Relative (%)	6.7	-6.3	-18.5

Financial and valuation metrics

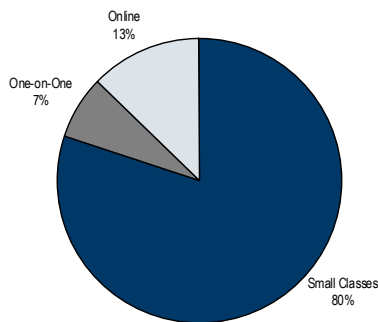
Year	2/11A	2/12E	2/13E	2/14E
Revenue (US\$ mn)	110.6	172.5	230.5	307.5
EBITDA (US\$ mn)	29.0	20.9	34.5	55.7
EBIT (US\$ mn)	25.6	17.1	26.5	45.1
Net income (US\$ mn)	24.0	20.2	29.8	45.0
EPS (CS adj.) (US\$)	0.35	0.26	0.38	0.57
Change from previous EPS (%)	n.a.	-26.0	-24.0	-21.0
Consensus EPS (US\$)	n.a.	0.35	0.47	0.66
EPS growth (%)	54.6	-26.6	47.5	49.7
P/E (x)	28.4	38.7	26.2	17.5
Dividend yield (%)	0	0	0	0
EV/EBITDA (x)	19.7	26.6	14.5	6.7
P/B (x)	4.3	4.2	3.5	2.8
ROE (%)	27.8	12.0	14.9	18.0
Net debt/equity (%)		net cash	net cash	net cash

Source: Company data, Thomson Reuters, Credit Suisse estimates.

Depth-focused expansion; Beijing's success replicable in other cities

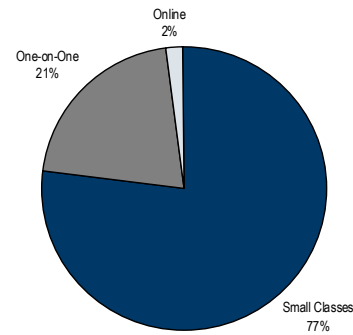
- Beijing's success replicable.** TAL has achieved success in Beijing despite being a late mover due to (1) the right cut into the niche market where TAL has competitive advantage, i.e., maths Olympics, and (2) viable online strategy. We believe this strategy is replicable in other cities, too, because (1) maths Olympics is a test well-received in many cities across the country; (2) TAL's aoshu.com (maths Olympics website) has already reached 26 cities and its discussion boards covered 40 cities as of August 2011; and (3) TAL efficiently manages each school from its headquarters.

Figure 52: Segment enrolment breakdown 2Q12



Source: Company data, Credit Suisse estimates

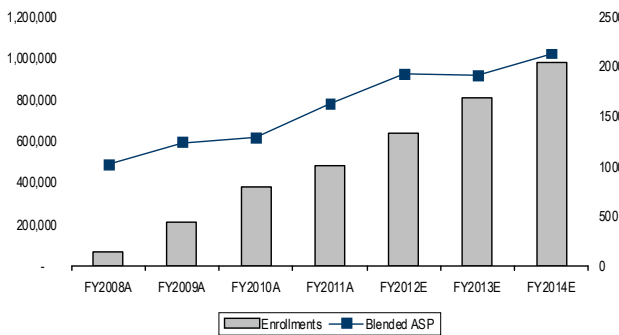
Figure 53: Segment revenue breakdown 2Q12



Source: Company data, Credit Suisse estimates

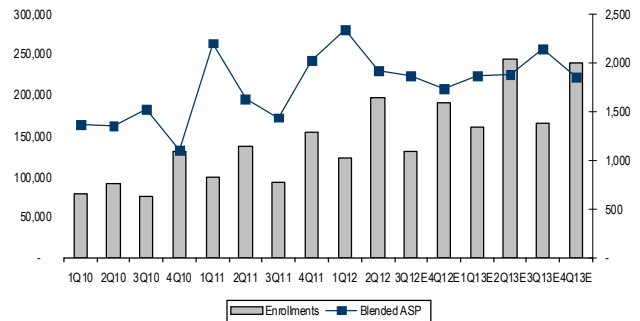
- Depth-focused expansion.** We believe the market mistook TAL for a one-city player and a much smaller player that can be overtaken by EDU. In fact, TAL's expansion is depth-driven. It had steadily expanded to 10 cities as of August 2011 and will be adding four to six more cities in January 2012. We like its investments in online and consulting as this strategy helps it build word-of-mouth publicity for free and test waters before taking more informed market entry decisions.

Figure 54: Annual enrolments and ASPs



Source: Company data, Credit Suisse estimates

Figure 55: Quarterly enrolments and ASPs



Source: Company data, Credit Suisse estimates

- Stock price has been down 35%+ YTD; two catalysts to boost share price in the next 12 months.** We believe TAL's aggressive expansion strategy in 2011-12 is appropriate because (1) large K12 players focus more on profitability than growth, (2) it is difficult to raise new funding under a negative capital market environment, and (3) the company has enough cash funding to sustain aggressive expansion. TAL has two potential catalysts: (1) ASP increases in small classes and a better pricing structure to enhance customer value, and (2) the pre-K segment Mobby to enrich the product line.

Figure 56: CS forecasts

FY end Feb (US\$ mn)	1Q12	2Q12	3Q12E	4Q12E	FY12E	FY13E
Total revenue	33.2	51.4	37.3	50.5	172.5	230.5
Guidance	29.0 to 30.5	46.1 to 47.7	36.1 to 37.3			
Consensus		47.0	37.7	47.9	170.5	229.5
Gross profit	15.1	26.2	14.93	22.74	78.9	105.7
Operating profit	3.4	10.1	(1.05)	4.82	17.1	26.5
Operating profit (non-GAAP)	5.9	12.6	0.45	6.32	25.3	34.5
Net profit	4.6	10.7	0.02	5.08	20.4	29.8
Net profit (non-GAAP)	7.1	13.2	1.52	6.58	28.4	37.8
EPS (d) (US\$)	0.06	0.14	0.00	0.07	0.26	0.38
Consensus			-	0.07	0.29	0.42
EPS (d) (non-GAAP) (US\$)	0.09	0.17	0.02	0.08	0.36	0.48
Consensus			-	0.10	0.32	0.45
Gross margin (%)	45%	51%	40%	45%	46%	46%
Operating margin (%)	10%	20%	-3%	10%	10%	12%
Net margin (%)	14%	21%	0%	10%	12%	13%

Source: Company data, Credit Suisse estimates

Financial summary

Figure 57: TAL—income statement

YE Feb (US\$mn)	FY09A	FY10A	FY11A	FY12E	FY13E	FY14E
Net revenue	37.2	69.3	110.6	172.5	230.5	307.5
% growth	315.0%	86.1%	59.6%	56.0%	33.6%	33.4%
Gross profit	19.0	31.9	54.4	78.9	105.7	144.8
% gross margin	51.0%	46.0%	49.2%	45.7%	45.8%	47.1%
Opex						
G&A	(5.9)	(10.9)	(19.1)	(36.7)	(46.7)	(58.6)
S&M	(2.3)	(5.6)	(9.9)	(25.0)	(32.4)	(41.1)
impairment charge	(1.6)	0.0	0.0	(0.1)	0.0	0.0
EBIT (GAAP)	9.1	15.4	25.4	17.1	26.5	45.1
% EBIT margin	24.6%	22.2%	23.0%	9.9%	11.5%	14.7%
EBIT (non-GAAP)	9.1	15.4	30.7	25.1	34.5	53.1
% EBIT margin	24.6%	22.2%	27.8%	14.6%	15.0%	17.3%
Other income/(loss)						
Interest income	0.1	0.3	1.3	4.1	5.6	6.2
Interest expense	(0.0)	(0.0)	(0.1)	0.0	0.0	0.0
Others	0.2	(0.1)	0.3	3.1	2.9	2.9
Profit before tax	9.5	15.6	27.0	24.3	35.1	54.2
Income tax	(2.0)	(1.4)	(2.6)	(3.9)	(5.3)	(9.2)
Net profit (GAAP)	7.3	14.2	24.0	20.4	29.8	53.0
% growth	354.5%	95.7%	68.8%	-15.2%	46.2%	77.8%
% net margin	19.6%	20.6%	21.7%	11.8%	12.9%	17.2%
Net profit (non-GAAP)	7.3	14.2	29.3	28.4	37.8	53.0
% growth	354.5%	95.7%	106.0%	-3.2%	33.1%	40.2%
% net margin	19.6%	20.6%	26.5%	16.5%	16.4%	17.2%
GAAP EPS (US\$)						
Basic	\$0.12	\$0.24	\$0.36	\$0.27	\$0.39	\$0.58
Diluted	\$0.12	\$0.23	\$0.35	\$0.26	\$0.38	\$0.57
non-GAAP EPS (US\$)						
Basic	\$0.12	\$0.24	\$0.44	\$0.37	\$0.49	\$0.68
Diluted	\$0.12	\$0.23	\$0.43	\$0.36	\$0.48	\$0.67

Source: Company data, Credit Suisse estimates

Figure 58: TAL—balance sheet

YE Feb (US\$m)	FY09A	FY10A	FY11A	FY12E	FY13E	FY14E
Cash and cash equivalents	30	51	173	188	244	373
Available-for-sale securities	0	2	0	0	0	0
Deferred tax assets-current	0	1	1	1	1	1
Prepaid expenses and other current assets	1	2	5	7	10	13
Total current assets	32	56	205	197	255	388
Property and equipment, net	2	5	8	72	76	82
Deferred tax assets-non-current	0	0	1	1	1	1
Rental deposit	1	2	3	5	6	2
Intangible assets, net	2	1	1	0	0	0
Goodwill	1	1	1	1	1	1
Total assets	39	66	218	276	339	473
Accounts payable	0	1	1	2	2	3
Deferred revenue	18	29	51	76	97	163
Accrued expenses and other current liabilities	4	7	8	14	18	23
Income tax payable	3	1	3	3	3	3
Total current liabilities	26	38	63	94	119	192
Convertible loan	0	1	0	0	0	0
Total liabilities	26	39	63	94	120	192
Series A convertible redeemable preferred shares	9	9	0	0	0	0
Additional paid-in capital	1	1	112	120	128	136
Statutory reserve	3	5	8	7	9	16
Retained earnings	0	12	33	54	82	128
Accumulated other comprehensive gain	0	0	2	0	0	0
Total Equity	3	18	155	182	219	280

Source: Company data, Credit Suisse estimates

Figure 59: TAL—cash flow statement

YE Feb (US\$m)	FY09A	FY10A	FY11A	FY12E	FY13E	FY14E
Cash flows from operating activities						
Net income	7	14	24	20	30	53
Depreciation of property and equipment	0	1	3	4	8	11
Amortization of intangible assets	1	1	1	1	0	0
Gain on extinguishment of liabilities	(1)	0	(0)	0	0	0
Share-based compensation	0	0	5	8	8	8
Changes in working capital	14	11	21	52	22	74
CFO	23	27	54	86	68	146
Cash flows from investing activities						
Purchase of property and equipment	(2)	(4)	(5)	(69)	(12)	(16)
Purchase / Sales of available-for-sale securities	0	(1)	2	0	0	0
Acquisitions of subsidiaries	(2)	0	0	0	0	0
CFI	(5)	(5)	(4)	(69)	(12)	(16)
Cash flows from financing activities						
Proceeds from issuance of preferred shares	5	0	0	0	0	0
Proceeds from IPO	0	0	129	0	0	0
Payment of issuance cost of IPO	0	0	(2)	0	0	0
Distribution to shareholders	0	(1)	(30)	0	0	0
Convertible loan	0	1	(1)	0	0	0
CFF	5	(1)	71	0	0	0
FX gain/(loss) and others	0	0	2	(2)	0	0
Net increase in cash and cash equivalents	24	21	122	15	56	129

Source: Company data, Credit Suisse estimates

Valuation

Maintain OUTPERFORM. Our DCF model derives a target price of US\$15.10, implying 31x FY13E ex cash non-GAAP P/E and 1.0X FY13E non-GAAP PEG, which we believe is a fair value for TAL. The company's FCF will return to 6% in FY13E. We believe the current valuation of 20.7x non-GAAP 2013E P/E is a good entry point for investors who want to share the growth of China's domestic K12 market growth.

Figure 60: Valuation

Multiples	FY09	FY10	FY11	FY12E	FY13E	FY14E
P/E (non-GAAP)	82.5X	43.9X	23.3X	27.5X	20.7X	14.9X
P/E (GAAP)	82.5X	43.9X	28.4X	38.3X	26.2X	17.5X
P/E ex cash non GAAP	82.7X	42.5X	21.2X	24.4X	18.4X	12.7X
Dil PEG (x) (Non-GAAP)	1.4X	1.1X	1.1X	.8X	.7X	.6X
EV/EBITDA	58.3X	33.8X	17.3X	20.5X	13.9X	9.3X
EV/FCF	29.8X	25.6X	12.5X	70X	12.6X	5.3X
P/B	179.0X	34.9X	4.4X	4.3X	3.6X	2.8X
ROE	217%	79%	16%	11%	14%	16%

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 28 Nov 11)

Apollo Group Inc. (APOL, \$45.82, OUTPERFORM, TP \$52.00)
 Capella Education Company (CPLA, \$32.59, NEUTRAL [V], TP \$40.00)
 DeVry Inc. (DV, \$33.61, NEUTRAL [V], TP \$36.00)
 ITT Educational Services, Inc. (ESI, \$53.91, NEUTRAL [V], TP \$55.00)
 New Oriental Education (EDU.N, \$23.55, OUTPERFORM, TP \$33.88)
 Strayer Education, Inc. (STRA, \$90.91, NEUTRAL [V], TP \$92.00)
 TAL Education Group (XRS.N, \$10.01, OUTPERFORM, TP \$15.10)

Disclosure Appendix

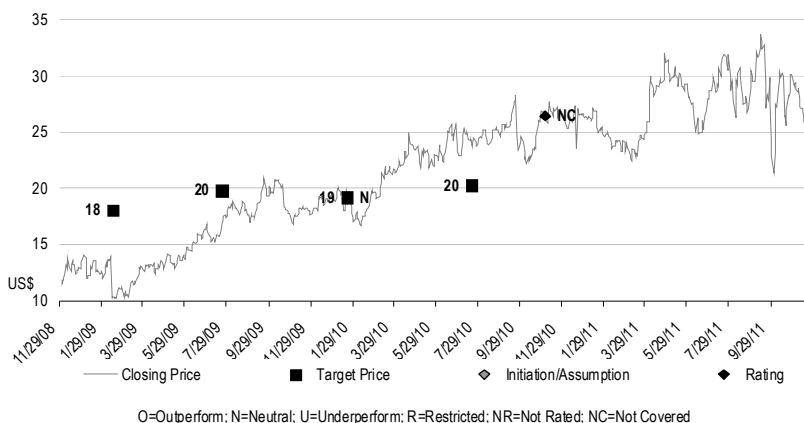
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See the Companies Mentioned section for full company names.

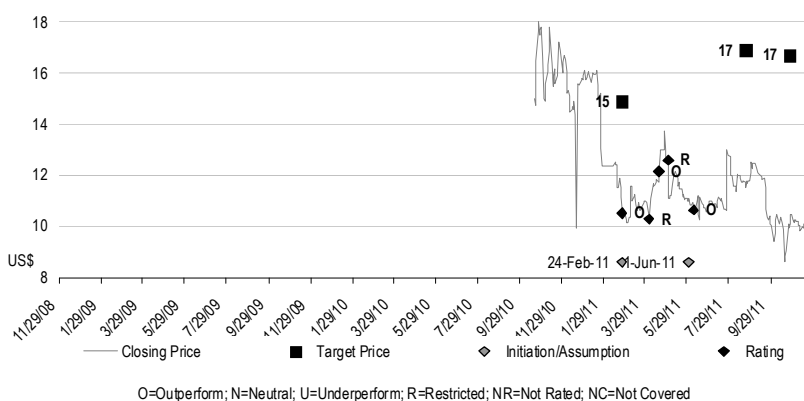
3-Year Price, Target Price and Rating Change History Chart for EDU.N

EDU.N	Closing Price	Target Price	Initiation/
Date	(US\$)	(US\$)	Rating Assumption
2/13/09	10.285	18.05	
7/22/09	16.818	19.83	
1/20/10	19.11	19.2	N
7/20/10	24.378	20.25	
11/4/10	26.465		NC



3-Year Price, Target Price and Rating Change History Chart for XRS.N

XRS.N	Closing Price	Target Price	Initiation/
Date	(US\$)	(US\$)	Rating Assumption
2/24/11	10.53	14.9	O X
4/4/11	10.29		R
4/19/11	12.15		O
5/2/11	12.6		R
6/1/11			X
6/8/11	10.65		O
8/23/11	11.54	16.9	
10/26/11	10.11	16.7	



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*Relevant benchmark by region: As of 29th May 2009, Australia, New Zealand, U.S. and Canadian ratings are based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe**, with Outperforms representing the most attractive, Neutrals the less attractive, and Underperforms the least attractive investment opportunities.

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Neutral/Hold*	40%	(57% banking clients)
Underperform/Sell*	10%	(54% banking clients)
Restricted	3%	

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Price Target: (12 months) for (EDU.N)

Method: Our DCF-based target price of US\$33.88 implies FY13E non GAAP ex cash P/E of 11.6x and FY13 non GAAP PEG of 1.2x and a 20% ROE. Our primary valuation methodology is DCF. In arriving at our DCF value for EDU, we estimate seven-year explicit earnings and cash flows through FY18E. We apply a weighted average cost of capital (WACC) of 12.5%. In arriving at our WACC, we assume no debt going forward. In addition, we assume a terminal growth rate of 3% and an exit FCF multiple of 10.0x.

Risks: Key risks to our target price of \$33.88 for EDU include: (1) MaxEn cannot create the younger "to-be-going abroad" students new niche market, (2) overseas test prep market competition increases and EDU loses its competitive advantage, (3) margin erosion due to VIP business, and (4) departure of key management and key school heads.

Price Target: (12 months) for (XRS.N)

Method: Our DCF-based target price of US\$15.10 implies FY13E non GAAP ex cash P/E of 18.9x and FY13 non GAAP PEG of 1.0x and a 17% ROE. Our primary valuation methodology is DCF. In arriving at our DCF value for XRS, we estimate nine-year explicit earnings and cash flows through FY18E. We apply a weighted average cost of capital (WACC) of 12.5%. In arriving at our WACC, we assume no debt going forward. In addition, we assume a terminal growth rate of 3% and an exit FCF multiple of 10.0x.

Risks: Key risks to our target price of \$15.10 for XRS include: (1) execution challenges while carrying out expansion, (2) low brand awareness outside its key markets of Beijing, (3) margin erosion due to expansion, (4) departure of key management and (5) revenue concentration in key markets.

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