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MAGAZINE

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# International Investing

## Private Education in China

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Of the 142 companies that headed to New York's stock exchanges for initial public offerings in 2010, several were from China, including four hailing from an increasingly crowded, but fast-growing niche — private education and career enhancement services. What Ambow Education, TAL Education, Global Education & Technology Group and Xueda — as well as a bevy of other providers — are betting on is that pent-up demand among Chinese consumers will fuel their growth.

**W**ith a national school system that is struggling to keep pace with the country's burgeoning economic success, private education companies are filling a void on several fronts. For some that means providing primary and secondary schools or supplementing government-run teaching with after-school tutorials. Demand is also growing for workshops preparing teenagers for admission exams for universities at home and abroad, as well as for English and other foreign language courses for customers of all ages.

But the private education business is in many respects a microcosm of the struggles many young sectors in Corporate China face. Industry observers cite low barriers to entry, unclear and inconsistently enforced regulations, and a lack of industry standards as reasons why the niche has faced — and will continue to face — a host of challenges that can throw their growth strategies off course. With increasing urgency, private education players are jostling for market share in an overcrowded market, and survival in the years ahead will require far larger, more honed investment models than were previously needed.

They'll also need novel strategies to develop greater brand awareness and a larger array of programs to attract increasingly discerning consumers beyond their



traditional urban bases. That's a far cry from the free-for-all that has been encouraging thousands of providers — of variable quality and reputations — to pile into private education in China.

### Roll Call

Education in China overall is facing a number of pressures. School systems have had to cope with far different parameters than they did, say, a generation ago when the country had yet to be opened to globalization and a young, increasingly urban generation is preparing for international careers. China's government has yet to catch up. While state spending is increasing — from 3.6 percent of gross domestic product in 2009 to an expected 4 percent by 2012 — it lags other countries. In 2008, average government spending on education in developing countries was 4.8 percent of GDP and 5.5 percent among developed economies. That's a potential boon for China's private educators.



One of the trailblazers is New Oriental. Founded in 1993 and listed on the New York Stock Exchange in 2006, it's a veteran in the sector and now claims to be the country's largest provider of private education services in terms of the number of programs offered, total student enrollments and geographic reach. It provides foreign language training (including a new high-end Elite English course for affluent families); test preparation courses for major admissions and assessment tests in the U.S., China and British Commonwealth countries; primary and secondary school education, development and online education. It's also broken the mold in another respect: Since its inception, New Oriental allows students, if unhappy with the teaching they receive, to "expel" their teachers from the classroom.

The firm teaches nearly two million students annually, a number that has been growing 20 percent year on year. Net income last year was \$386 million.

Another veteran provider is English First. Part of the world's largest private education company that was founded in the 1960s, EF launched its adult education business, EF Professional, in China in 2004. Back then, the venture "was like a startup which had little brand recognition, no students, no training centers and basically no staff," says Peter Winn, president of EF in China. That's changed. In 2010, EF Professional enrolled more than 40,000 students, paying annual fees ranging from between \$2,000 and \$6,000.

But in the spotlight now are the newly listed specialist providers, including Xueda and TAL Education Group's Xueersi. Mainly focusing on test preparation and after-school tutoring to primary and secondary school students, both firms have grown with capital from private equity investors in recent years. Net revenue at Xueda — with 157 learning center in 44 cities — doubled year on year to \$77.9 million in the six months ended June 30, 2010. It

Private Education Companies in China: Study Resources					
Company	Ticker	BetterInvesting Data	Value Line Report	Morningstar Analysis	No. of Analysts
Ambow Education	AMBO	2007	None	No	4
ATA	ATAI	2003	HTML	No	3
Chinacast Education	CAST	2004	HTML	No	3
China Distance Education	DL	2005	None	No	3
ChinaEdu	CEDU	2004	HTML	No	1
China Education Alliance	CEU	2003	HTML	No	N.A.
China Interactive Education	CIVN*	None	None	No	N.A.
China Ivy School	CIVS*	None	None	No	N.A.
CIBT Education	MBA	2001	HTML	No	N.A.
Global Education & Technology	GEDU	2008	None	No	3
New Oriental Education & Technology	EDU	2001	Yes	Yes	16
TAL Education	XRS	2008	None	No	4
Xueda	XUE	2008	None	No	3
* Pink Sheet/OTC stock					
<b>Explanation of table:</b> This table lists companies providing private education services in China that have stocks traded in the United States. The BetterInvesting Data column details the first year fundamental data is provided for these companies. Sometimes this data is incomplete. For many of the companies historical stock prices and price-earnings ratios go back only two or three years. The Value Line Report column indicates whether the service provides a report in the Standard Edition or Small & Mid-Cap Edition; the HTML designation means Value Line provides data only in the HTML format at its website. In the Morningstar Analysis column, New Oriental Education & Technology is the only stock covered by an analyst. (Standard & Poor's provides no coverage of these companies.) The final column lists how many analysts currently cover the companies, according to Yahoo! Finance. For more information, go to the sites listed in the Websites of Interest section at the end of this article.					

raised about \$127 million from its initial public offering in November.

TAL is larger, having enrolled more than 380,000 students in the 12 months ended February 28 last year, a fivefold increase over the last two years. It has 109 learning centers, 87 service centers and online programs. For this fiscal year's first half, TAL reported revenue of \$53 million. Its IPO in October raised about \$120 million.

"It's a huge market. K-12 tutoring in 2010 was about a \$34 billion market and we expect it to be a \$66 billion market by 2014," TAL's chief financial officer, Joseph Kauffman, stated in an interview with Reuters following the firm's IPO. He said TAL plans to add more learning centers in the large cities where it already has a presence, including Beijing, Shanghai and Shenzhen.

Ambow, whose IPO was in August, has five kindergarten-to-12th-grade

schools, 96 tutoring centers, two colleges and 16 career enhancement centers, and sells products and services in 30 of the 31 provinces and autonomous regions in China. The company's net revenue grew 47.6 percent, to 260.3 million Renminbis (\$39.5 million) in the three months ended March 31, 2010, while net income fell 81.8 percent to under RMB 3 million in the same period. Like the others, Ambow's executives say they want to use the \$117.4 million of funds to tap the higher disposable incomes of the Chinese and help local and foreign firms address the seemingly chronic skills shortage.

### Age of Uncertainty

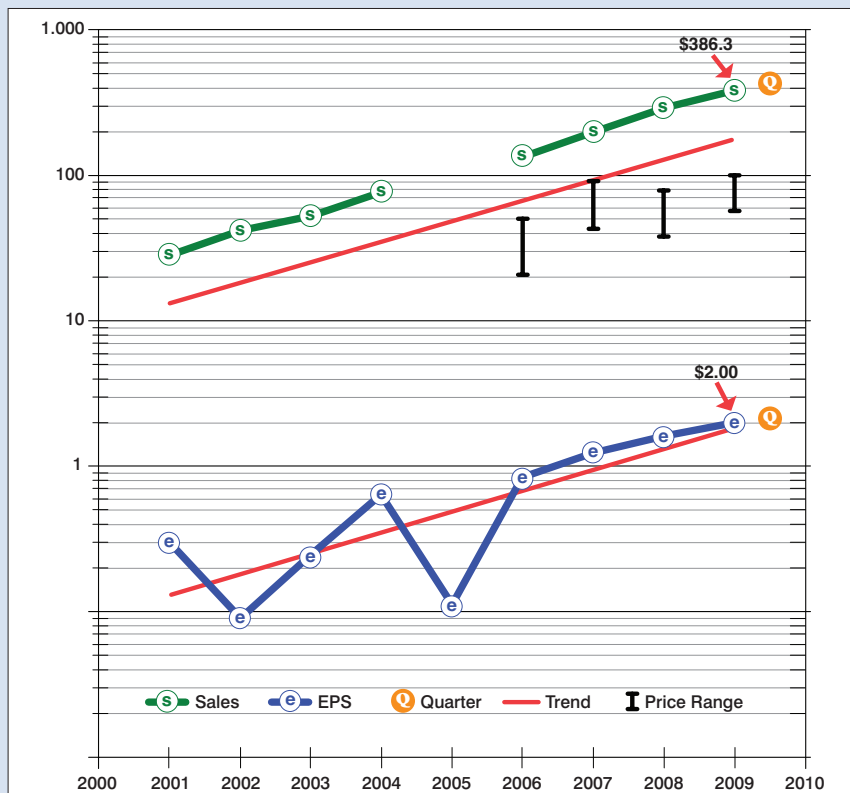
What these and the hundreds, if not thousands, of other private educators have found is that although their companies have been growing at a robust pace, they've had little in the way of infrastructure for support. For

**New Oriental (EDU) Fundamentals**

	FY2006	FY2007	FY2008	FY2009
<b>Sales (millions)</b>	\$136.4	\$201.0	\$292.6	\$386.3
<b>EPS</b>	\$0.84	\$1.24	\$1.60	\$2.00
<b>Pre-tax profit</b>	23.0%	24.4%	23.3%	21.6%
<b>ROE</b>	12.9%	15.6%	17.3%	18.7%
<b>High price</b>	\$50.20	\$92.20	\$78.90	\$100.60
<b>Low price</b>	\$20.60	\$42.90	\$38.00	\$56.50
<b>High P/E</b>	60.0	74.3	49.3	50.3
<b>Low P/E</b>	24.6	34.6	23.8	28.3

Note: Fiscal year ends May 31.

Source: BetterInvesting Data Service



example, because private education is relatively new to China, the government has yet to set many guidelines. An accreditation system is also lacking. “In the private education industry, you don’t get any support from the government,” says Sun Ji Jun, a former New Oriental principal, who is now starting his own private equity firm. “Private companies need to figure out everything by themselves.”

“Traditionally in China, education has been firmly in the domain of the state. It’s been only very recently that private service providers have emerged and that vocational and language training, test preparation, supplemental tutoring and other

forms of education have transformed into a business sector,” says Winn of EF. “That means consumer awareness, industry practices and regulatory standards are still developing.”

In July, the central government announced a general 2010-2020 national plan for education reform. But because it has yet to release information about what the plan’s implementation will entail, education providers are none the wiser. Adding to potential missteps, regulations across provinces and cities can be even more opaque, and vary widely. “There is very little consistent regulation even among different districts in a city such as Beijing,” laments

a senior executive from Xueda. “We need to be very careful (and not) assume the same rules can be applied (from one school to another).”

According to the prospectus of TAL Education, 26 of its 109 centers are subject to possible penalties if authorities decide that the scope of their business falls outside what various local rules permit.

Companies with big investment plans such as New Oriental and EF are hankering for change. “If an effective system of standards and quality assurance were implemented by the government, the education and training market could be strengthened and more private capital is more likely to be invested in the sector,” says Sun.

But many of the startups have learned to turn disadvantages into advantages. As the Xueda executive notes, “Though we don’t get incentives from the government like other industries do, (the government has) demonstrated generosity to private schools by allowing us to have room to grow, rather than setting many constraints.” And he’s encouraged by the government’s new five-year plan that begins this year. From what he’s been able to read into various government statements about the new plan, “there are two key messages: One is to encourage and support the development of private schools, another one is to manage the development in a ‘more regulated’ manner.”

**Standing Out From the Crowd**

Up until now, the lack of standards and regulations — combined with the sector’s enticing growth prospects — have encouraged all kinds of companies to hop on the private-education bandwagon. And in a sense, their services have been an easy sell, especially when compared to the overcrowded classes and rigid curricula found in government schools. Private schools have more flexibility than government-run schools to adapt coursework and teaching to the needs of students. Schools such as EF, for instance, have developed online offerings, which students can access

around the clock to reinforce what they've learned in the classroom.

Courses can also be tailored to individuals, a big attraction for parents such as Xiao Min, whose 11-year-old son is taking classes at Xueda in Shanghai. "One-on-one tutoring is tailored to my child to ensure he gets enough attention," he says. "My boy is much more focused and less pressured in this small study environment."

And like other parents, Xiao hopes the extra after-school tutoring translates into exam results that will help his son get into a top university, at home or abroad. Clearly, Xiao isn't the only parent with such hopes.

And that explains why the sector is increasingly overcrowded. As TAL's Kauffman noted in the Reuters interview, "it's a fragmented market, so even with a 4.5 percent share in Beijing we are the leading player."

The big challenge for firms such as his now is finding ways to stand out from the crowd, especially in a market without accreditation to help discerning consumers benchmark the quality of schools. But consumers are finding their own way around that challenge, thanks in large part to the country's love affair with social media.

According to Winn of EF, "Immediately after classes — and sometimes even in the middle of class — students are using micro-blogging and SMS to share comments about the learning environment and lecturers. So we need to deliver the best possible customer experience from the very beginning."

The digital revolution is happening at a time when the buying power of their target consumers is changing rapidly. A study by Boston Consulting Group found that in 2010, China had 247 cities with populations of 100,000 and where annual salaries were RMB 60,000 (\$9,100) or higher; by 2015, that will increase to 576 cities. That means providers are adapting their programs accordingly. Amid growing demand from parents, for example, New Oriental launched Pop Kids English in 2004 to boost the English proficiency of

children in kindergarten through grade six. According to the company, 434,000 children have taken part in the course thus far, paying fees ranging from RMB 100 to RMB 1,000.

### Adult Ed

At the other end of the spectrum are the programs for adults wanting to give their careers a boost. "We not only teach (adult students) English, but also coach them on skills necessary to succeed in the workplace such as business negotiation and presentation," says Winn, who says EF's adult students tend to be professionals between the ages of 22 and 35.

But brand building across this entire client spectrum is expensive. Xueda claims that the average cost of acquiring a student was approximately RMB 1,100 in 2010, or 11 percent of average revenue generated by each enrollment.

In 2010, New Oriental spent more than \$58 million on advertising and promotion — the equivalent of some 15 percent of its revenue, up from 12.7 percent in 2008. Typical marketing campaigns now need to include digital, outdoor and mobile media as well as the social networking websites that are popular among 15- to 35-year-olds, such as Xiaonei.com and Kaixin001.com.

Geographic expansion also requires more than hefty capital infusions for marketing. Currently, for example, Xueersi generates 97 percent of its profit from Beijing and Shanghai. New cities mean new regulations and real-estate needs, and pools of employees with potentially different recruitment requirements.

Sun from New Oriental says, "The education business is labor-intensive as you need to recruit and retain enough teachers who can deliver the service with consistent quality." Adding uncertainty to an already complex situation are the schools' hiring practices being put under regulatory scrutiny. Many private schools use teachers from public schools on a contractual basis, something regulators often frown upon: Public school

teachers are prohibited from moonlighting as paid tutors in a number of major cities, but can in others.

But competition for investment will shake up the sector, say experts. Smaller firms will fall by the wayside or be acquired, while larger firms with strong brands and easy-to-replicate business models will gain more market share, they predict.

From the vantage point of investors, the stable cash flow and countercyclicality of private education can outweigh the downsides. "In education, [many] companies collect prepayment, which secures the cash flow. Also the gross profit can be as high as 40 percent to 50 percent," Tseng Kwong Yu, managing director of Baring Private Equity Asia, said at a recent investment forum.

Winn believes the key is to stay focused on the fundamentals, such as providing good service and internal operating efficiency. Do all that, he says, and the sector "will pay dividends over time." **B**

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### Websites of Interest

#### Ambow Education

[www.ambow.com/en/index.shtml](http://www.ambow.com/en/index.shtml)

#### ATA

<http://www.ata.net.cn/english/>

#### China Distance Education

[www.cdeledu.com/versions/investor\\_en.html](http://www.cdeledu.com/versions/investor_en.html)

#### Chinacast Education

<http://ir.chinacast.com.cn/>

#### CIBT Education

[www.cibt.net/](http://www.cibt.net/)

#### Global Education & Technology

[www.globaleducation.cn/english/](http://www.globaleducation.cn/english/)

#### New Oriental Education & Technology

<http://english.neworiental.org/publish/portal59/>

#### TAL Education

<http://en.xueersi.org/>

#### Xueda

[www.xueda.com/english/index.shtml](http://www.xueda.com/english/index.shtml)