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EDITED TRANSCRIPT

TAL - Q1 2019 TAL Education Group Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to TAL Education Group First Fiscal Quarter 2019 Earnings Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, Thursday, 26th of July 2018. I would like to hand the conference over to your first speaker today, Mr. (sic) [Ms.] Echo Yan. Thank you, please go ahead, sir (sic) [ma'am.]

Echo Yan

Thank you all for joining us today for TAL Education Group's First Fiscal Quarter 2019 Earnings Conference call.

The earnings release was distributed earlier today and you may find a copy on the company IR website or through the newswires. During this call, you will hear from Chief Financial Officer, Mr. Rong Luo. Following the prepared remarks, Mr. Luo will be available to answer your questions.

Before we continue, please note that the discussions today will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations. Potential risks and uncertainties include, but are not limited to, those outlined in public filings with the SEC. For more information about these risks and uncertainties, please refer to our filings with the SEC.

Also, our earnings release in this call includes discussions of certain non-GAAP financial measures. Please refer to our earnings release, which contains a reconciliation of the non-GAAP measures to the most directly comparable GAAP measures.

I would like now to turn the call over to Mr. Rong Luo.

Rong Luo - *TAL Education Group - CFO*

Thank you, Echo. Good evening and good morning to you all. Thank you for joining us today on this earnings call.

Our first quarter revenue growth was driven by a stable demand in the cities we currently cover and a contribution from our online courses. Revenue growth in the first quarter was 71.1% in U.S. dollars and to USD 550.6 million and 57.1% in RMB terms. Student enrollment increased by 88.7% year-over-year, mostly driven by the growth in the online enrollments as well as Peiyou small class.

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GAAP income from operations increased by 160.3% to USD 75 million in the first quarter. Non-GAAP income from operations grew by 127.8% to USD 90 million.

We will continue to maintain a certain level of investment in content development, technology and marketing activities especially for the ongoing improvement of our online product quality, geographical penetration and brand awareness. Looking ahead, we remain committed to a healthy and sustainable overall business development as always.

I will now turn the call over to Echo Yan, our IR Director. She will give you an update on our operational progress in the first quarter. After that, I will update you on our business strategy execution and discuss our business outlook.

Echo Yan

Thanks, Rong. The solid first quarter revenue growth was based on the performance of different business lines in the cities we currently cover.

Let me review the business by different revenue streams. Small class, which consists of Xueersi Peiyou small class, Firstleap, Mobby and some other educational programs and services accounted, for 80.7% of total net revenue, almost unchanged from the first quarter last year.

Xueersi Peiyou small class, which remains our core business, represented 71.4% of total revenue, almost unchanged from 71% in the same period of the prior year. Net revenue from Xueersi Peiyou small class was up by 72% in U.S. dollar terms and 58% in RMB terms, while enrollment increased by 87%. This growth rate reflects the healthy growth in both Peiyou off-line and online class.

By now, we offer Xueersi Peiyou online courses, most of which are tailored to off-line students' incremental needs in major cities of our network. Xueersi Peiyou online currently offers regular and short-term courses and other promotion courses.

Excluding contribution from Peiyou online, in both the first quarter of fiscal 2018 and 2019, the Peiyou off-line small class revenue increased by 66.7% in U.S. dollar terms and 53.1% in RMB terms, while enrollments increased by 34.4%.

In Q1 fiscal year 2019, Peiyou online accounted for 3.1% of total Xueersi Peiyou small class revenue and 28.1% of total shares to Peiyou small class enrollments.

Revenue and the enrollments from Peiyou online were minimal in Q1 fiscal year 2018. Xueersi Peiyou small class revenue from top 5 cities, Beijing, Shanghai, Guangzhou, Shenzhen, Nanjing, grew by 68.4% in U.S. dollar terms year-over-year and accounted for 60% of Xueersi Peiyou small class business. Revenue generated from cities other than the top 5 grew by 77.7% in U.S. dollar terms. And the other cities accounted for the remaining 40% of the Xueersi Peiyou small class business. The growth momentum is supported by market demand and the incremental ramp-up as expected of the enrollment from our earlier classroom expansion.

We make ongoing assets to diversify our course offerings. Chinese and English courses continue to grow at a solid pace. By the end of July 2018, we will offer Chinese classes in 15 cities and English classes in 24 cities. Furthermore, in our 10 Mobby centers, we have started to offer a wider variety of activities such as programming, science and others. Chinese, English and the subjects of Mobby and Firstleap are still in the early stage of development.

We see a steady and healthy growth of all these varieties of subjects, and going forward, they will gradually contribute more to our overall business.

Looking ahead, we will continue to roll out more subjects in more cities and further diversify our course offerings.

Our one-on-one business, including the overseas consulting business, had a steady first quarter and achieved year-over-year revenue growth of 23.2% in U.S. dollar terms and 13.2% in RMB terms, mostly from regular price increases. One-on-one including the overseas consulting business accounted for 9.5% of total revenue compared to 13.2% in the first quarter of fiscal 2018.

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Turning to our capacity expansion. We added a net of 36 learning centers across a wide spectrum of cities in Q1 fiscal year 2019. We opened 46 new learning centers across 20 cities and closed down 10 learning centers, based on our standard operations and regulatory requirements.

During the quarter, we added 850 Peiyou small class classrooms. Most small class classrooms were added in Tianjin, Beijing, Xi'an, Shenzhen, Jinan, Wuhan, Hangzhou, Shanghai, Shijiazhuang and Guangzhou.

Meanwhile, we continue to enter new cities at pace. In the first quarter, we entered into 1 new city, Huizhou.

During the quarter, we added a net of 29 small class learning centers, 7 Firstleap small class learning centers and 1 Mobby center. We closed a net of 1 one-on-one learning center.

By the end of May, we had 630 learning centers in 43 cities across China, of which 455 were Peiyou small class, 10 were Mobby small class, 70 were Firstleap small class and the 95 were Zhikang one-on-one.

Looking to Q2, we expect to add 5 to 10 Peiyou small class learning centers. These estimates reflect our current expectation, which may vary due to the change of the demand.

Moving now to our online business. First quarter revenue from xueersi.com grew by 212.8% in U.S. dollar terms year-over-year and 187.9% in RMB terms, while the enrollments grew by 144.7% year-over-year. Online contributed 9% of total revenues and 23% of the total enrollments this quarter, compared to 4.9% of total revenue and 18% of total enrollments in the same period of the prior year, respectively.

Finally, other revenues are mostly from online advertising business. It represented 0.8% of total revenue versus 1.1% in the same period of last fiscal year 2018.

Let me now go through some other key financial points for the first quarter of fiscal year 2019.

In the quarter, small class ASP decreased by 5.3% in U.S. dollar terms and 13% in RMB terms year-over-year.

Xueersi Peiyou small class ASP decreased by 15.5% in RMB year-over-year. Excluding the impact from Xueersi Peiyou online, the Xueersi Peiyou off-line small classes ASP in RMB terms decreased by 13.9% -- excuse me, sorry, sorry. Excluding the impact of Xueersi Peiyou online, the Xueersi Peiyou off-line small classes ASP in RMB terms increased by 13.9%, that is, 1-3-point-9 percent.

Zhikang one-on-one ASP in U.S. dollar terms increased by 23.9% and 13.8% in RMB due to the gradual price increase in the comparable quarter.

Online course ASP increased by 27.9% in U.S. dollar terms and 17.4% in RMB in the first quarter, partially due to the online enrollment shift from the prerecording model to live broadcasting model.

Cost of revenues increased by 53.9% to USD 261.1 million from USD 169.6 million in the same quarter 1 year ago. The increase in cost of revenues were mainly due to an increase in rental costs and teacher compensation. Non-GAAP cost of revenues, which exclude share-based compensation expenses, increased by 53.9% to USD 260.9 million from USD 169.6 million in the same year ago period.

In the first fiscal quarter, gross profit was USD 289.6 million, up 90.1% year-over-year from USD 152.3 million in the same year ago period. Gross margin for the first quarter was 52.6% as compared to 47.3% for the same period of last year.

Sales and marketing expenses increased by 117.4% to USD 94.5 million from USD 43.5 million in the same period of last fiscal year. The increase was primarily a result of more marketing promotion activities to expand our customer base and brand enhancement, as well as a rise in the compensation to sales and marketing staff to support a greater number of programs and the service offerings compared to the same period in the prior year.

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Operating income increased by 160.3% to USD 75 million. Non-GAAP operating income increased by 127.8% year-over-year to USD 90 million.

Other income was USD 8.7 million for the first quarter of fiscal year 2019, mainly related to the fair value changes of equity securities in accordance with the update of accounting standards update 2016-01 and accounting standards update 2018-03 to the accounting standard of Accounting Standards Codification 321 adopted on March 1, 2018.

Income tax expense was USD 17.3 million in the first quarter of fiscal year 2019 compared to USD 8.4 million same year ago period.

Basic and diluted net income per ADS were USD 0.12 and USD 0.11, respectively, in the first quarter of fiscal year 2019. Non-GAAP basic and the diluted net income per ADS, which excluded share-based compensation expenses, were both USD 0.14.

From the balance sheet as of May 31, 2018, we had a total of USD 1,929.2 million in cash, cash equivalents and short-term investments compared to USD 1,498.9 million as of February 28, 2018.

Capital expenditures for the fiscal -- for the first fiscal quarter were USD 28.7 million, representing a decrease of USD 0.9 million from USD 29.6 million in the same year ago period.

As of May 31, 2018, USD 90.8 million was reclassified from a deferred revenue to accrued expenses and other current liabilities upon adoption of revenue from customers with -- of revenue from contracts with customers, the Topic 606, on March 1, 2018. It mainly represented estimated amounts of tuition collected that may be refunded in the future if students withdraw from a course for any remaining classes. I would like to refer you to the note in the earnings release that provides further detailed explanation of this reclassification.

The company's deferred revenue balance after the reclassification was USD 1,328.5 million compared to USD 959.4 million as of May 31, 2017, representing a year-over-year increase of 38.5%.

Deferred revenue primarily consisted of the tuition collected in advance for the summer and fall semesters of Xueersi small classes.

Now I will hand the call back to Mr. Luo to briefly help you on our strategy execution and provide the business outlook of the next quarter. Rong, please.

Rong Luo - *TAL Education Group - CFO*

Thank you, Echo. As you have seen our strategy and mission for years, we continue to make efforts to advance education through science and technology.

We continue to pursue a healthy growth in Peiyou small class and other off-line tutoring services and further expand our learning centers networks at pace. As you know, our strategy focus in the coming years is online business development and increasing market penetration.

In fiscal year 2019, we will continue to invest in technology operating models, marketing and personnel for online market share gains, so that we can turn opportunity into TAL's overall business.

Let me know move to outlook for the next quarter. Based on our current estimates, total net revenues for the second quarter of fiscal year 2019 are expected to be between USD 647.2 million and USD 660.8 million, representing an increase of 42% to 45% on a year-over-year basis. If not including the impact from a recent depreciation of RMB against U.S. dollar, the projected revenue growth rate is expected to be in the range of 40% to 43% for the second quarter of fiscal year 2019. These estimates reflect our current expectations, which is subject to change.

So that concludes my prepared remarks. Operator, we are now ready to take questions.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Tallan Zhou from Deutsche Bank.

Tallan Zhou - *Deutsche Bank AG, Research Division - Research Analyst*

I want to ask you about the revenue guidance for the second quarter. It seems like growth slows down a bit. Any particular reason that you can elaborate like mix of online, off-line in the second quarter? And how does the margin look like in the second quarter? On top of that, if I may also ask about your full year guidance [on the revenue and] the margin as well?

Rong Luo - *TAL Education Group - CFO*

Thank you, Tallan. Specifically, in the second quarter, I will try to give aspirations in online and off-line, 2 perspectives. For Peiyou class -- for Peiyou small class, our off-line business, actually I think in the past few quarters, in every investor conference we have made it clear and we want to draw your attention again on the positive -- on the policy uncertainty. In the past few quarters, we have seen the government has released more policies to regulate this tutoring market. All the policies cover the whole industry, and I think this will not only [sure to impair] the off-line business maybe in the future -- in the future several quarters. Because of the uncertainty of the policies, maybe we're going to have some -- maybe even bigger impacts in the long run. So even we said that before, today we still want to draw your attention a little bit. That is something, we need to care about that. And we, as a company, we fully understand now it's a very important timing that it's -- we are in midst of the ongoing educational reforms and [recommendations .] All of these policies are aimed at further improving the overall standards and the ecosystem of the whole industry, so we are fully cooperating with the government directions, and where needed, make adjustments to our business operations accordingly. The reform policy that is -- will, in the overall, be very positive for the quality and diversity of off-line school tutoring services. So, but in a short-term perspective, maybe in the long-term perspective, again, we would like to draw investor attention on this, we need to care about that. So we proactively follow the government regulations and do the adjustments ourselves. So are off-line growth will be slowed down a little bit. And on the other side, we need to point out actually our off-line is getting bigger and bigger. So to grow at a higher pace, we need to be -- also control the right pace to be more healthy. Specific on online, you'll probably know we make some progress in the online. For example, in Chaoyang, we grew our online by around 200 -- over 200% revenue growth and in Q2, we're also running some promotions to get more market share. And I think the key for the online actually will be by the end of Q2, that is the time all our new enrollments are coming to our systems through the promotions, they will show the retention rates, how much, how many, what's the percentage of them. They usually attend from summer to fall. I think that is a very important indicator we need to pay attention to. By the end of today, because the summer class is just beginning, so we still lack all of the data to say what kind of percentage and commercial rate that will be because it's the first year for us to be running this large scale of promotions in online marketing, so we probably can give you more colors by the end of Q2 and please stay tuned for this. So in the profit perspective for off-line, I think when we start Q2, it can show a little bit, the slow down a little bit in the top line perspective, including the expansion pace. We can see some leverage coming in the margin perspective. I think Q1 we probably can see that average GPM have increased by more than 5 points. So the key principle for off-line, actually slow down a little bit in top line, [be prepared to see] increase the margin a little bit. And for online margin, actually Q1, we have started to spend the online marketing dollars to do some promotions, while the more investment will happen actually in the second quarter, which is the peak season for the whole year.

So specific for Q2 for online will be a loss-making [position.] Even though the whole company in Q2 will be in loss-making position. The gross margin -- sorry, the non-GAAP operating margins for second quarter will decline compared to the same quarter last year. And specific for the whole year, actually today, we are still maintaining our full year top line revenue guidance in the range of 30% to 50%. One thing I need to draw your attention is because there is policy uncertainty and we're also seeing a lot of new dynamics from a technology perspective in this industry so we also will be very cautious to -- about giving the outlook of our business. So by the end of this year, we will give our outlook for the next year. The year-over-year outlook will be more accurate than before. So that's my answers. Thank you, Tallan.

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Operator

Your next question comes from the line of Thomas Chong from Crédit Suisse.

Yiu Hung Chong - *Crédit Suisse AG, Research Division - Regional Head of Internet*

I have 2 questions. My first question is about our online enrollment and target and revenue for Peiyou online. Can you share about what's your KPI for this year and over the next couple of years? And my second question is about the summer promotion program. What's your KPI in terms of the retention rate and the number of enrollments, if any?

Rong Luo - *TAL Education Group - CFO*

Thank you, Thomas. For the Peiyou online enrollments, actually Peiyou online is one part of our Peiyou small class business. Our key focus we'll try to provide some online offerings to our off-line students, which is quite different from the Xueersi online school. Xueersi online school is a separate department who is providing the online services to their students all over the country and most of them are not our off-line students. And our key KPI to measure the Peiyou online, I think is still the quality we can deliver to their students and the retention rate for the students who enroll in Peiyou online this semester to next semesters. Peiyou online actually, I think will start to roll out this program started from the last year, which is the fiscal year 2018. But Q1, the number is very minimal, immaterial. Starting from Q2, the numbers has been a little bit bigger than before and this number is fast growing in the past few quarters. But again, I think Peiyou online, even for the Peiyou off-line students, they still need some time to get adapted to this kind of new offerings. We are making a little bit progress, but compared to -- when we look into visceral business, I think the key for us is now looking into their enrollments or revenues. So the key is whether we can really provide values and services to the students who enroll in this program and they feel that's valuable to them. So by the end of Q1, we have also made clear Peiyou online revenue is only 3.1% of total Peiyou small class revenue, which is below 5% threshold. And looking forward, we will continue to focus on the quality we can deliver and we will focus on how satisfied the parents and students are. And your second question about the KPI for the summer promotions, I think for summer promotions, we will mention actually we have -- there are off-line summer promotions, which is lower and less than what we have last year while the online promotions, that's really the first year we tried to introduce our online marketing to get more market share. And the key KPI for this promotion, I think it's what I mentioned just now, is the retention rate of the students who we can retain from the summer to fall. I think that is very important indicator in targets. Because the high retention rate means our offerings is well adapted by the consumers and the students. And the lower retention rate means our offerings are not good. So based on information we have today, we see we are pretty much on track in this program, but since it's only the beginning of the summer class, so we still have several more terms to go. I think stay tuned. By the end of Q2 I will give you more colors about that. So the retention rate is the key KPI for us to -- when we properly evaluate the online summer promotions effect. Thank you, Thomas.

Operator

Our next question comes from the line of Natalie Wu from CICC.

Yue Wu - *China International Capital Corporation Limited, Research Division - Analyst*

First of all, can management update us about the capacity expansion plans for off-line small classes in this fiscal year? And what's the pace we should be expecting? And secondly, if I remember correctly, like 2 quarters ago you said that a late Chinese New Year issue sort of like impact your fourth quarter revenue. And I thought a major part of the last courses in the fourth quarter would be realized in the August quarter. So can management update us the percentage of the impact that would be like realized in August quarter?

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Rong Luo - *TAL Education Group - CFO*

Thank you, Natalie. I think for the capacity, in the first quarter, we added 36 -- net of 36 learning centers, which for the Xueersi Peiyou small class is more than 800 classrooms compared to their Q1 fiscal year 2018, the number is much lower. And in Q2, currently, based on what we can see today, we will add around 5 to 10 -- net of 5 to 10 new learning centers. And how much we will add in the coming Q3 and Q4, I think we need some time to evaluate the policy uncertainties. Insofar, I can't give exact numbers, but all I can say is Q1 actually we -- a majority of their classrooms we want to add in the first half and the second half, we will evaluate the policy uncertainties, the new conditions or maybe new regulation policy may happen in -- across different cities and they will make decisions to go. I think [as there comes some point,] when their policies have some uncertainties right over there, we don't want to rush out for top line revenue growth and then continue to adding so many classrooms. I think that's now the right strategy to go. So we want to be more cautious and focus on our execution today, improving the fulfillment rate and all the KPIs of our classrooms to make our overall business more healthy, I think that's something we want to drive. And yes, second question, there's several -- the class' delayed impact has been considered in our Q2 guidance. And again, for the Q2 guidance, we're considering all of the impacts, especially we're considering about policy uncertainties and we practically made changes to make sure we can slow down a little bit in top line, but hold our company still in healthy growth. Our guidance, over 43% to 45%, I think that is based on what we can see today. Thank you, Natalie.

Yue Wu - *China International Capital Corporation Limited, Research Division - Analyst*

Actually I have a very quick follow-up, if I may, about the 5 to 10 learning centers you are planning to add in the second quarter, is that -- we can translate that to 100 to 200 classrooms. Is that right?

Rong Luo - *TAL Education Group - CFO*

I think around 200 classrooms because our learning centers is getting bigger and bigger than before, and so in general, around 200 classrooms.

Operator

Our next question come from the line of John (sic) [Wendy] Huang from Macquarie.

Wendy Huang - *Macquarie Research - Head of Asian Internet and Media*

This is Wendy Huang from Macquarie. Firstly, I just want to clarify your previous comment on the capacity expansion because you first mentioned that for the second quarter you will only add 5 to 10 new learning centers and also you are actually evaluating how many you are going to add for the second half. But on the other hand, you were saying that you will maintain your 35% to 40% capacity expansion target for this year. But if you are maintaining this 35% to 40% capacity target for full year, that means you really need to add, I think, at least 800 classrooms this quarter for the second half. That seems a lot. So I first one to reconcile this comment.

Rong Luo - *TAL Education Group - CFO*

Thank you, Wendy. That's a very good question. Let me recap a little bit of our business model. So actually, every time we add a new learning center, it doesn't mean the learning center we're planning trying to use right away because we need some time to do some renovations and we need some time to ask the government for the license to open the school. When you want to get a license, you need to pass a lot of checks, for example, like the fire security check and some other conditions, which follow the regulations. And considering the China parents today care more and more about the environmental protection, so even when you finish your renovations, you need to leave some time for them to do air cleaning. And even when all operation is done over there, so we can't fill our classrooms through right away. We need some time, several quarters, to bring some of the classes and try to increase their fulfillment rates, same as our learning centers in third quarter's time. So actually what we added, the classrooms, what we added this year, I think most of which will contribute -- are mainly for contributions next year. So if we talk about the revenue guidance of this year, actually we need to go back to see the capacity was added last year. And let me recap a little bit, 2 years ago we added their capacity

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a lot and last year we added capacity around 30%. And this year, by the end of Q1, we added around 18%, 1-8. So we're still running the company in a healthy pace and we still need to wait for it to see what will happen, especially the policy uncertainties, to decide how much we will add in the second half. So that's the general answers to your questions.

Wendy Huang - *Macquarie Research - Head of Asian Internet and Media*

Sure. And also regarding the 10 learning centers that you closed down this quarter, you mentioned some of them were due to the regulatory issue. Was that due to the government approval license issues? And if this is the overhang, how many learning centers in your existing operations right now that potentially you actually see the similar issue and will be closed down in the future?

Rong Luo - *TAL Education Group - CFO*

Thank you so much. I think we closed 10 learning centers this year, only one of them because of the regulations. That is because we're renting from a military-related company and I think based on a China policy few quarters ago, China doesn't allow any military services to provide this kind of commercials. So we follow their risk policies. We proactively looked for the new centers we can rent and will move -- or shift from that centers to the other one. So again, I think today, we are under -- we are doing a lot of self-check about all the learning centers that we can rent and if some of them, they don't meet the requirement of regulations, we will proactively look for the alternative locations and to move to the new place. So far, I think, it's still a small number of -- small percentage of numbers we have these issues. Will let you guys know every quarters when we report how much we will close, but we don't expect the numbers to -- we don't expect there will be number. And the others, the other night actually we solved things because the contract expired. So we moved to the other bigger place because of the new contract because today we have more than -- today we have more than 630 learning centers now, so 10 of them, that's maybe a very small number. And continually -- we will continue to running our standard operation guidelines to make sure all of our places can meet requirement of the governments. And if some learning centers they fail to meet that, we will proactively look for alternative learning centers to move for.

Wendy Huang - *Macquarie Research - Head of Asian Internet and Media*

Sure. And one final housekeeping, what's the online revenue forecast implied in your second quarter guidance? And also, do you have any online enrollment target for the upcoming summer promotion? That's all.

Rong Luo - *TAL Education Group - CFO*

Thank you, Wendy. The online revenue, in Q1, we grew more than 200%, which is 9% of the revenue now. And in Q2, we foresee the online growth will continue to perform and deliver some good contributions to the overall business. And we don't have a specific target to say how many enrollments we need to hit, but compared to the volume numbers, actually we care more is the retention numbers -- retention rate. We care more is whether when we provide services and product to the students and their families, a relative, maybe they study for a few weeks, they feel happy about us. They want to stay with us. So the retention rate, I think that's something we need to do very carefully. And on the other side is, again I need to draw attention on online. Online actually, that is where if you -- being small [is a way it can help us] to be more scalable all over the country in the longer term. But frankly speaking, we are not a company good at marketing in the past. So this summer is the first time for us to running the large-scale online marketing and online promotion activities. So we, as a team, is running our office in a very cautious way so we will give more color by the end of Q2. But thank you so much for your questions.

Operator

Your next question comes from the line of Lucy Yu from Bank of America Merrill Lynch.

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Lucy Yu - *BofA Merrill Lynch, Research Division - Research Analyst*

I've got 2 questions, one is on the Peiyou online. You have seen students off-line adapting to the online education, but once they have adapted to such format and online becomes a more prevailing study format for them, would that any cannibalization to our off-line enrollment? And what is your expectation on off-line enrollment in the rest of 2019 and maybe in the medium term? Secondly is on the margins. The first quarter margin is very good, which is up 4%, driven by the ASP hike and utilization rate improvement. So for the rest of the year, will such off-line margin expansion to be continued? Of course, in the next quarter it will be impacted by summer promotion. But assuming -- stripping off that summer promotion impact, that 4% margin improvement, is it a likely margin expansion for the rest of the quarter in terms of off-line business?

Rong Luo - *TAL Education Group - CFO*

Thank you, Lucy. For the Peiyou online, actually today is we give this Peiyou online offerings, especially the shortened class to the off-line students to let them get into use with new type of services. And so far we did not see maybe a material number of students who are moving from off-line to online. So based on what we can see today is online and off-line, there is a 1-plus-1 kind of the mapping. So what we are is seeing more and more off-line students, they adapt to the Peiyou online offering. Because for off-line, every week we only have 1 session for the students. So -- but one we have 7 days. So some students they choose to take Peiyou online at home during the weekdays. And on other side, since we have introduced the ICS and IPS system, the Intelligent Practice System into our off-line classrooms, so we have some way to collect the data, especially the learning process data of the students during the sessions, not only in our classrooms. But also before the class, they do some prestudy; after class they do some homework. We also decided to roll out this kind of IPS to more cities in the future. So when we have all of this data in our minds, our Peiyou off-line shortened class can be more specific and tailor-made to help the off-line students to finish some of their [notch] points [if] they have difficulty. So far we did not see that much of material cannibalization. Secondly, about the margin in Q1, I need to give more colors about that. Q1 margin, yes, we are making some progress in off-line because we slowed down there little bit in the off-line growth. So which you can see in our [Q2] margin perspective, we are over 5 points higher and for the OpEx because we start to invest in online marketing a little bit, but peak time for that will be in the second quarter. So in Q1, we still can see we have a very positive margin leverage in Q1. But same as what we told The Street before is Q2 is the peak season for us to do the investment in online marketing, so the Q2 margin is going down. I think the full year perspective for off-line, because we control the pace of their capacity expansions and we control the pace of the off-line business, so you probably can see in the whole year off-line can continue to deliver their positive margin expansions. But that's depending on we don't see any further policy uncertainties. And secondly, it's for the online, this last year, online is profitable. This year, online starting to -- will be loss-making [provisions,] which we will -- will even drop down a little bit after overall company's margin. So for the full year, we still guide our margin for the full year, OP margin for the full year will be slightly declining a little bit. Thank you, Lucy.

Operator

Our next question comes from the line of Sheng Zhong from Morgan Stanley.

Sheng Zhong - *Morgan Stanley, Research Division - Associate*

I have a follow-up question about the regulation. So we still see the strong growth in first quarter and we add the 36 learning centers in the first quarter and -- but in the second quarter, it turns to more conservative. So just want to understand what the key change happened on the regulation impact did the management see? And do you think that there will be some regulation on the online business as well?

Rong Luo - *TAL Education Group - CFO*

Thank you for the question. I think for the regulations today, we see some changes or maybe impact in 2 perspectives. The first one is with the regulation policies being more and more strict, so actually which gives us more challenges in the operation -- in continue to expanding the networks. And we even don't know what future policy will be, but the trend after the policy is definitely very obvious the government will release more and more policies and more and more detailed policies to regulate the whole market. Compared to a few years ago, actually, there are more strict -- the stricter regulation in staff industry will create some challenges in operation perspective for all industry and also including us. Secondly is we

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are also seeing in some of the cities, the new policies has also somehow impact the parents' willingness to sending their kids to the tutoring companies. We can say that it is a worry majority phenomenon today, but we have seen that happens in several cities. So we, as a company, we don't want to overpromise or maybe too optimistic about the market we are facing today. So we would like to fully disclose the potential risk we have seen driven by the policy uncertainty and we also want to make sure our company can be fully prepared for the worst cases. Secondly, I think the regulations for the online, in the first place, we don't see any very material regulation policies how to regulate the online in the whole country perspective. But we also were already seeing some of the discussions is ongoing and you probably can also see that from the news channels in China as some policies under discussions, for example, they are thinking about whether they need to give license for the online educations or -- I think all of these online regulations is still under the discussions and we are only a company in this industry. We are not all, so we cannot estimate what the government will do. But the direction is -- the regulations will help the online education to be more healthy. The regulations can help online players, online education players to be more disciplined. So we, as a company, is just follow their -- and we are going to follow the government regulation requirements if they have in the future. And even before that, we, as a company, also we are operating our own business in a very disciplined way. And again, I think the policies now are shortened issue to say one quarter they will be done. That's not the right case, I think they will not only impair the one specific quarter, but will also impact the future set of quarters. So I think that is some kind of the potential risks driven by the policy uncertainty, we need to disclose to The Street and to all investors from a company perspective. Thank you.

Operator

There are no further questions at this time. I would like to hand the conference back to today's presenters. Please continue.

Rong Luo - *TAL Education Group - CFO*

Okay. Thank you so much, guys, to join our earnings calls. We, as a company, our mission still is to advance education through science and technology, so we will maintain our level of investments in this area. And we, as a company, also thank you so much for your support and attention on our company. We will continue to give you guys more colors and more informations by the end of Q2 about the promotions, which you have asked just now. So please stay tuned. Thank you so much, guys. Thank you.

Operator

Ladies and gentlemen, that does conclude the conference for today. Thank you for participating. You may all disconnect.

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