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PRESENTATION

Operator

Good evening, and thank you for standing by for New Oriental's Fourth Fiscal Quarter and Fiscal Year 2019 Earnings Conference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

I would like to turn the meeting over to your host for today's conference, Ms. Sisi Zhao. Thank you. Please go ahead.

Sisi Zhao - *New Oriental Education & Technology Group Inc. - IR Director*

Thank you. Yes, thank you. Hello, everyone, and welcome to New Oriental's Fourth Fiscal Quarter and Fiscal Year 2019 Earnings Conference Call. Our financial results for the period were released earlier today and are available on the company's website as well as on Newswire Services.

Today, you will hear from Stephen Yang, Chief Financial Officer. After his prepared remarks, Stephen will be available to answer your questions.

Before we continue, please note that the discussion 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 involve inherent risks and uncertainties. As such, our results may be materially different from the views expressed today. A number of potential risks and uncertainties are outlined in our public filings with the SEC. New Oriental does not undertake any obligation to update any forward-looking statements except as required under applicable law.

As a reminder, this conference is being recorded. In addition, a webcast of this conference call will be available on New Oriental's Investor Relations website at investor.neworiental.org.

I will now turn the call over to Mr. Yang. Stephen, please go ahead.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Thank you, Sisi. Hello, everyone, and thank you for joining us on the call.

We're very pleased to conclude fiscal year 2019 on a strong note with a robust growth in top line as well as improvement in operating margin. In fiscal year 2019, we reported a net revenue of $3,096.5 million, representing a 26.5% increase year-over-year or 31.4% if computed in RMB. Total student enrollments in academic subjects tutoring and test prep courses in fiscal year 2019 increased by 32.4% to approximately 8,382,700.

During fiscal year 2019, we added a total of 152 new facilities, which includes 141 new learning centers in existing cities, 9 off-line training facilities and 6 new cities and 2 dual-teacher model facilities in 2 low-tier cities. Altogether, our total square meters of classroom area by the end of the fiscal year has expanded by approximately 24% year-over-year.

We also continued to strategically deepen our investments into the dual-teacher model classes and new initiatives for K-12 tutoring in our pure education platform, koolearn.com. With innovative application of technology in our education services, we're well-placed to continue to capture new business opportunities in low-tier cities and remote areas.

In the fourth quarter, we continued to execute our well-proven Optimize the Market strategy and focused our efforts on improving utilization in facilities and controlling costs and expenses. This has enabled us to tap into tremendous market opportunities with our standardized online and off-line integrated education system. As we continue to expand our capacity, we remain focused on improving utilization rates, investing and enhancing teaching quality in line with our long-term strategy.

In the fourth quarter of 2019, we reported revenue of $842.9 million, representing a 20.2% increase year-over-year or 28.4% if computed in RMB. Net revenue from education programming and services for the fourth quarter were $717.0 million, representing a 25.1% increase year-over-year or 33.6% if computed in RMB. The growth was mainly driven by increase in student enrollments in K-12 after-school tutoring courses.

Total student enrollments in academic subjects, tutoring and test prep courses in the fourth quarter of 2019 increased by 33.9% year-over-year to approximately 2,756,000.

I will now turn to pricing. Per program-blended ASP, which is cash revenue divided by total student enrollments, decreased by about 18% year-over-year. Please note that the lower-than-normal blended ASP is primarily due to the change in tuition fees collection schedule for our K-12 after-school tutoring courses. We split the autumn semester into 2 parts similar to what we did in the spring semester. The total -- the number of the students recorded and the amount of the fee collected during the quarter only cover the first half of the autumn semester. This is different from the past where we historically collect the full sum of the tuition fee for autumn semester in the fourth quarter. The change in tuition collection schedule therefore means our blended ASP for the fourth quarter of 2019 appears to be lower. Hourly-blended ASP, which is cash revenue divided by total teaching hours, increased by approximately 10% year-over-year in RMB terms.

To provide a breakdown of the hourly-blended ASP. U-Can middle high and high school increased by 10%; POP Kids increased by 12%; and the overseas test prep program increased by 7%, all year-over-year in RMB terms. Our solid progress in fiscal year 2019 is in line with our expansion plan and our emphasis on improving our operational efficiency.

We would like to highlight that we once again delivered another year-over-year operating margin expansion in this quarter. During the quarter, our non-GAAP operating income increased by 30.3% year-over-year to approximately $102.7 million. Our non-GAAP operating margin rose by 100 basis points to 12.2% from 11.2% a year ago.

As we enter fiscal year 2020, we will continue to leverage our online and off-line integrated education system across all business lines and improve efficiency using standardized, modularized and systemized operating processes. We're confident that we will be able to deliver continued margin expansion and generate sustainable long-term value for our customers and shareholders.

We would also like to take the chance to talk about our recent summer promotion strategy, which has delivered outstanding results. In consistence with the last few years, we launched the summer promotion this year to rapidly secure Grade 7 student customers before they started their first year of secondary school. We offered low-price experiential courses for multiple test subjects in total of about 43 cities. We're extremely pleased to see that even with increasing our promotion price from around RMB 200 to around RMB 400, the summer promotion remains very well received by the market.

In fact, the promotion enrollments we brought in before the start of the summer holiday in early July this year saw a 4% increase comparing the same period of last year, reaching 765,400 enrollments. Under this strategy, we are also able to better identify and retain customers with higher loyalty. And overall, we are pleased to see the higher positive outcome. Please note that these promotion enrollments are not reported in our reported enrollments.

Looking ahead, this year, we will become even more focused on efforts in retaining a larger portion of students following the promotion, which will boost the revenue and drive profitable growth throughout the fiscal year 2020. We do not foresee any negative impacts of the promotions on operating margins throughout the whole fiscal year. We are confident that the summer promotion will continue to be a sound and highly profitable strategy to rapid the interest and secure market share in the high-growth K-12 after-school tutoring market. As these students move from Grade 7 through to Grade 12, the continued improvement in retention rates and customer loyalty will drive revenue growth in the next 3 to 6 years.

Now let us move onto the fourth quarter performance across our individual business lines. Our key revenue driver, K-12 all-subjects after-school tutoring business, achieved year-over-year revenue growth of 29% in dollar terms or 37% in RMB terms. We should highlight that, as we have mentioned in the last quarter's earnings call, we moved 1 week of K-12 tutoring classes from March to June to ensure our teachers have enough time to complete the licensing procedures. Therefore, our K-12 tutoring revenue in this quarter saw a degree of impact from the arrangement. The revenue related to the adjustment will be recognized in the first quarter of fiscal year 2020.

Breaking it down, the U-Can middle school, high school all-subjects after-school tutoring business reported a revenue increase of 27% in dollar terms or 36% in RMB terms for the quarter. Pre-enrollment grew approximately 24% year-over-year for the quarter. The lower-than-normal enrollment growth is due to delayed registration for classes in certain cities, in compliance with the new industry regulation stating that the tuition fees should not be collected more than 3 months before the class start.

Our POP Kids program continues to produce outstanding results with revenue up by about 31% in dollar terms or 40% in RMB terms for the quarter. Enrollment was up about 56% for the quarter.

The overseas test prep business recorded a revenue increase of 13% in dollar terms or 21% in RMB terms for the quarter.

The consulting business recorded a revenue growth of about 2% in dollar terms or 9% in RMB terms year-over-year for the quarter. As we mentioned in the last quarter's earnings call, the adoption of the new accounting standards has led to a greater portion of the revenue from the overseas consulting business being recognized in Q3 instead of Q4, which is peak season for the business line.

Finally, VIP personalized class business recorded a cash revenue growth of about 14% year-over-year in dollar terms or 21% in RMB terms year-over-year for the quarter.

Next, I will provide some updates on the progress we're making with our Optimize the Market strategy. In consistence with our long-term plan, we have been focusing on expanding our capacity by investing in the buildout of our online and off-line integrated education system, and this continues to produce very promising result.

We will start with our off-line business. In the fourth quarter of fiscal year 2019, we added a net of 65 learning centers in existing cities and opened 3 off-line training schools and 1 learning center in the cities of Baotou, Changshu and Yuci. All together, this increased the total square meters of classroom area by approximately 24% year-over-year and 9% quarter-over-quarter by the end of the quarter.

Since July 2016, we started to pilot a new dual-teacher model class in select cities. By the end of the fourth quarter of fiscal year 2019, the new offering has been tested in the POP Kids program in 37 existing cities and U-Can middle school, high school program in 29 cities and in both POP Kids and U-Can K-12 business in 9 new low-tier cities. We're encouraged to see increased market penetration in those markets we have tapped into as a result of the offering. We also saw maintained customer retention rates and improved scalability generated by the model. We will continue to execute this strategy in the coming new fiscal year given these proven results.

Moving onto the online parts. We invested $31.5 million in the quarter to improve and maintain our [online to off-line] (corrected by company after the call) integrated education ecosystem and a total of $103.1 million for the full fiscal year 2019. Most of the investments were recorded under G&A expenses.

Now I will walk you through some updates on the online and off-line two-way interactive education system. Since the launching of the U-Can Visible Progress Teaching System in September 2014, the interactive education system has been used in all existing cities. We have launched the newly revamped POP Kids English program, Shuang You, in most of the cities by end of the Q4 '19 -- fiscal year '19. Also, the interactive education system has been gradually used in more and more cities. The interactive education system for overseas test prep program including IELTS, TOEFL and SAT courses, was rolled out and tested in most of major cities by end of Q4 fiscal year '19. At the same time, we also standardized our product offerings across 14 major cities.

We also made strides in the koolearn.com business line and our other supplementary online education products.

With the goal of tapping into the huge market opportunity in the online education space, we continue to deepen our investments of resources into executing new initiatives in our online K-12 after-school tutoring business during the fiscal year 2019. This includes investments into content development, teachers recruiting and training, sales and marketing, R&D and other costs and expenses necessary to drive the growth of the new online programs. These programs have enabled us to cover more students in both low-tier new cities and higher-tier cities covered by our off-line business in an interactive and scalable approach through these programs. We're confident that this will help koolearn.com gain new market share in the online education market and drive our top line growth.

Now let me walk you through the other key financial details for the fourth quarter. Operating costs and expenses for the quarter were $765.9 million, representing an 18.9% increase year-over-year. Non-GAAP operating costs and expenses for the quarter, which exclude share-based compensation expenses, were $740.2 million, representing a 19.0% increase year-over-year.

Cost of revenue increased by 24% year-over-year to $371.2 million, primarily due to increase in teachers' compensation for more teaching hours and the rental costs for the increased number of schools and learning centers in operation.

Selling and marketing expenses increased by 4.8% year-over-year to $105.9 million.

General and administrative expenses for the quarter increased by 18.4% year-over-year to $288.8 million. Non-GAAP general and administrative expenses, which exclude share-based compensation expenses, were $264.4 million, representing a 19.2% increase year-over-year. This increase was primarily due to the increased headcount as the company grew its network of schools and learning centers as well as the increase in R&D expenses and human resource expenses related to the development of the company's online and off-line integrated education system.

Total share-based compensation expenses, which were allocated to related operating cost and expenses, increased by 15.9% to $25.7 million in the fourth quarter of fiscal year 2019.

Operating income was $77 million, a 36.0% increase from $56.6 million in the same period of the prior fiscal year. Non-GAAP operating income for the quarter was $102.7 million, a 30.3% increase from $78.8 million in the same period of prior fiscal year.

Operating margin for the quarter was 9.1% compared to 8.1% in the same period of prior fiscal year. Non-GAAP operating margin, which excludes share-based compensation expenses and the changes from fair value change of the long-term investments for the quarter, was 12.2% compared to 11.2% in the same period of the prior fiscal year. That means our margin expansion was 100 bps up in this quarter.

Net income attributable to the New Oriental for the quarter was $43.2 million, representing a 33.5% decrease from the same period of prior fiscal year. Basic and diluted earnings per ADS attributable to New Oriental were $0.27 and $0.27, respectively. Non-GAAP net income attributable to New Oriental for the quarter was $95.1 million, representing an 8.9% increase from the same period of last year. Non-GAAP basic and diluted earnings per ADS attributable to New Oriental were $0.60 and $0.60, respectively.

Net operating cash flow for the fourth quarter of 2019 was approximately $326.9 million. Capital expenditures for the quarter were [$80 million] (corrected by company after the call), which were primarily due to the opening of 104 learning centers and renovations at our existing learning centers.

Turning to the balance sheet. As of May 31, 2019, New Oriental had cash and cash equivalents of $1,157.1 million compared to $983.3 million as of May 31, 2018. In addition, the company has $365.7 million in term deposits and $1,668.7 million in short-term investments.

New Oriental's deferred revenue balance, which is cash collected from the registered students for courses and recognized proportionally as revenue as the instructions are delivered, at the end of the fourth quarter of fiscal year 2019 was $1,301.1 million, an increase of 2.4% from $1,270.2 million at the end of the fourth quarter of fiscal year 2018.

Due to the company's adoption of the new accounting standard starting June 1 of 2018, as of the end of the fourth quarter of fiscal year 2019, $76.1 million of deferred revenue was reclassified to the accrued expenses and other current liabilities, representing the estimated amount of the tuition collected that may be refunded in future if students withdraw from a course before completing all classes. In addition, the lower-than-usual increase was due to the change of tuition fee collection schedule in compliance with the latest regulatory requirements.

Heading into the new fiscal year, we will continue to execute the Optimize the Market strategy. The approach has consistently supported us to achieve success in the last several years, and we are well placed to capture a wider range of the market opportunities.

To give you more specifics on our areas of focus for fiscal year 2020. First, we will continue to expand our off-line business. We aim to add around 20% capacity, including new learning centers and expanding classroom areas of some existing learning centers for K-12 business in existing cities. In addition, we will continue to roll out our dual-teacher model schools to a number of new low-tier cities in certain provinces throughout the year.

Second, we will continue to leverage our investments in the online and off-line integrated standardized teaching system for our off-line business, especially for our K-12 tutoring and overseas test prep business. We will continue to make investments, and we believe that the total spending in absolute dollar terms in fiscal year 2020 will increase moderately compared with last fiscal year. Furthermore, we will continue to invest in and execute the initiatives, including product content development, teachers recruiting and training, R&D as well as sales marketing in pure online K-12 after-school tutoring business on koolearn.com.

Third, our top priority will remain as the focus on optimizing utilization of facilities and controlling costs expenses across the business to drive continued margin expansion and increase operational efficiency. We have solid confidence to deliver a continued non-GAAP operating margin expansion and enhanced operational efficiency for the coming fiscal year. As new facilities built in fiscal year 2018 and 2019 continue to be ramped up and utilized efficiently. The improved utilization will cover the margin pressure resulting from our investments in the koolearn.com as well as the other pure online education products. In short, we expect our overall non-GAAP operating margin to expand year-over-year in the first quarter of fiscal year 2020 and for the whole fiscal year.

With the newly introduced policy related to the after-school tutoring institutions being implemented on city-by-city basis, we continue to comply with the regulatory requirement closely and cooperatively. Administrative costs that incurred as a result of the new policy have been in line with our expectation and have been [digested] within fiscal year 2019. As such, we do not currently see a material impact on the business. As the leading education service provider in China, we're firmly supportive of these reforms, which will improve market standards and foster healthy growth of the industry. We're committed to provide high-quality education service and contributing in creation of the sustainable markets.

Finally, the recent RMB depreciation against the U.S. dollar will also impact our earnings in dollar terms for the first quarter of 2020.

Finally, I would like to emphasize that we have great confidence in the fundamentals of our business, which is set to remain strong. As we continue our Optimize the Market strategy, we're certain that New Oriental will continue to capture sustainable growth opportunities in the market and deliver long-term value for our customers and shareholders.

Looking at the near term and our expectations for the next quarter. We expect total revenue to be in the range of $1,050.5 million to $1,075.5 million, representing a year-over-year growth in the range of 22% to 25%. If not taking into consideration the impact of the potential change in the exchange rates between RMB and U.S. dollar, the projected revenue growth rates is expected to be in the range of 26% to 29% for the first quarter of fiscal year 2020.

The estimated exchange rate used to calculate the expected revenue for the quarter of fiscal year 2020 -- for the first quarter of fiscal year 2020 is 6.8851. The historical exchange rates used to calculate the revenue for the first quarter of fiscal year 2019 was 6.6757. This forecast has taken into account the factor that traditionally, our overseas test prep business has relatively large contribution to the overall business in the first quarter compared to the rest of the year. Thus, the overall year-over-year growth rate in the first quarter tends to be slowest when compared to the other quarters. With this, we anticipate an upward trend to emerge throughout the year. I must mention that these expectations reflect New Oriental's current and preliminary view, which is subject to change.

At this point, I will take your questions. Operator, please open the call, please. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Alex Xie from Crédit Suisse.

Alex Xie - *Crédit Suisse AG, Research Division - Analyst*

Congratulations on very strong results. So I'd like to ask for management's expectations about FY '20 in terms of both revenue growth and margins after delivering a strong Q4. Have we become more optimistic about FY '20 than before?

And secondly, I think for this quarter, the revenue growth of overseas and test prep and consulting business, I think, exceeded expectations. And what was the reason behind such outperformance? And these are my 2 questions, first.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. Okay. Thanks, Alex. This quarter, the revenue growth was 28.4% in RMB terms year-over-year. So it was a very strong quarter and even though we have been lower usual K-12 revenue because we moved 1-week of revenue from March to June. So that means we recorded the 1 week more revenue in the coming Q1 rather than this quarter. And some of our overseas consulting revenue, we'll -- that means we'll report the -- based on the accounting change -- the accounting policy change, we report some revenue of the overseas consulting revenue in Q3 rather than this quarter. But we still get the very strong quarter.

So in fiscal year '20, I think we -- as we guided before, we guided with our topline growth in RMB terms year-over-year. In fiscal year '20, we'll be over 30%. So this is our official guidance for the fiscal year '20 topline growth. I think that is because of the 3 reasons: number 1 is we are seeing higher student retention rates; and number 2 is -- you saw we expanded 24% new square meters classroom area in fiscal year '20, and we plan to open another 20% new classroom area in the fiscal year '20; and number 3, we will get very strong performance from the summer promotion enrollment.

And yes, as for the margin, yes, your going to see another strong quarter of the margin expansion. And in the Q -- in the Q1 fiscal year '20 and the whole year, as I've said before, we guided the -- you've got the margin expansion in the Q1 fiscal year '20 and for the whole year because we have more leverage -- operating leverage from the operation. And so this is my answer to your first question.

Second question, overseas test prep. Yes. This quarter, our overseas test prep business recorded revenue growth of about 13% in dollar terms or 21% in RMB terms. I think this is much better than we did in last 3 quarters of fiscal year '19. I think this is a result of our product reform for overseas test prep classes because we have -- we are seeing more and more young students to take our TOEFL, SAT courses. And so we're rolling out a new online and off-line integrated product as we did in the K-12 for -- business for the overseas test prep. So I think going forward, our overseas test prep business will achieve a positive result in fiscal year '20. Okay? Thank you.

Sisi Zhao - *New Oriental Education & Technology Group Inc. - IR Director*

Actually, please note that the revenue guidance for next fiscal year is in the RMB terms, okay?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes, RMB terms. Over 30% year-over-year. Okay?

Alex Xie - *Crédit Suisse AG, Research Division - Analyst*

Okay. May I just have a follow-up about our summer promotion? Because I think our expectations for FY '20 is actually quite strong, but I think for the -- in terms of number of summer promotion enrollments, it seemed that the absolute balance of increase in the number of enrollments is not that high as before. So what are our expectations for the retention rate? Or have we changed the strategy to grow our business in this year?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes. Consistent with the last few years, we launched the summer promotion this year. And even we raised the price from RMB 200 last year to RMB 400 this year, we're still seeing the strong enrollments from the summer promotion. So far, we brought the enrollment from the summer promotion of about 765,000, which is a 4% increase compared to last year. And so this year, I think the strategy change we made of the summer promotion is to -- for us, we are able to better identify and -- identify who are the real customers and retain the customers -- more customers after the summer promotion. So we believe the retention rates after summer promotion this year will be better, higher than last year, definitely, okay?

Operator

Your next question comes from the line of Tian Hou from T.H. Capital.

Tianxiao Hou - *T.H. Capital, LLC - Founder, CEO & Senior Analyst*

Congratulations on a good quarter. I also have 2 questions. One is related to online education. We see the competition of the online education in China sort of heated up, and we saw a lot of advertising, off-line advertising, online advertising. And so EDU is also one of the online education vendors. I wonder what is the strategy for EDU to further develop your online education's brand awareness and as well as revenue market share? That's number one.

I'm going to give you the second question also, which is -- it seems like your tone for next fiscal year is much more optimistic than last year. So what are the drivers behind those optimistic tone for this fiscal year?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. Thanks, Tian. Your first question is related to online education. With the goal to tapping into the market opportunities in the pure online sector, I think we continue to invest, but we would rather spend more money on the content development, R&D and teachers recruiting and training. And also, we will spend some money on the marketing -- selling and marketing expenses. But I think the spend on the marketing will be reasonable because we won't use the -- burning money way to acquire students as we did in our off-line business historically. So this is our online strategy, okay?

And the -- sorry, your #2 question is about the guidance, okay? The guidance.

Tianxiao Hou - *T.H. Capital, LLC - Founder, CEO & Senior Analyst*

Yes, yes.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Actually, in this quarter, we got very strong numbers. And I think -- in the fiscal year '19, we opened 24% new learning centers in square meter size, and it brought us more student enrollment. And we beat the top line guidance again this quarter. And we're seeing the higher student [retention] rates. So I think this is a result of the investment on the products since several years ago. And there's still -- I think we are more confident about our products, that is, we're providing better quality service to students compared to before. And second, even though we have raised the price of the summer promotions versus what was -- we'd we still got the full numbers. And we believe that retention rates after the summer promotion will be higher. And if you look at the competition environment, I don't think it changed. So our job is to provide the best service as we did before going forward and to take market share as much as we can going forward, okay?

Operator

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

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

Congratulations on the good results. So I want to follow up your revenue outlook of 30% year-over-year -- more than 30% year-over-year growth. Can you give us a breakdown of the growth expectation for the different business lines? And also, you are also very confident about the margin expansion. Can you give me -- can you give us more color on the margin expansion magnitude if possible?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. The breakdown of the different -- the all business lines, I think our K-12 business will be the key -- our revenue driver in fiscal year '20. So we guided -- we guide the top line growth of the K-12 business will be 40%, somewhere around 40% year-over-year. All what I'm saying is in RMB terms, okay? And the overseas test prep, I think the top line growth will be 10% plus, year-over-year, okay? And the domestic test prep, I think the growth rates will be somewhere between 15% to 20% in the RMB terms. And I'm sorry, I can't give the detailed guidance of the pure online, the koolearn.com. But I think the revenue will be strong, yes? And overseas consulting, I think the top line growth will be somewhere around 20% -- 15% to 20%. So this is my guidance by different business lines, okay?

And margin, yes, so I think we do believe we have the more operating leverage going forward because we -- I give the guidance -- our top line guidance of 30% -- over 30% in fiscal year '20 but last year and -- fiscal year '19, the expansion was 24%. Last year, it's -- no, in fiscal year '18, we opened a lot of learning centers, I think so. It's worth over 40%. So I think the first job in fiscal year '20 for us is to fill more students into the learning centers we set up in the last 2 years. And in next fiscal year, as I said, we plan to expand 20% new learning centers so the top line growth will be over 30%. So you will see more leverage going forward. So that's why I have the margin expansion guidance for this new fiscal year '20, yes.

And yes, as well, we do have the more operating leverage on the selling and marketing expenses and G&A because if you still remember, so this quarter, our selling and marketing expenses just increased by low single digits, okay?

Operator

Your next question comes from the line of Terry Wen from Blue Lotus.

Tianli Wen - *Blue Lotus Research Institute - Founder & Head of Research*

Congratulations for a solid quarter. I had one question here. We see the gross margin down 1.3% year-over-year. Could management provide more color on that?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. Yes. Thanks, Terry. I think the margin was down by 130 bps. I think that it's mainly due to the lower-than-usual revenue this quarter. As I said, we moved the 1-week revenue from Q4 to Q1.

Sisi Zhao - *New Oriental Education & Technology Group Inc. - IR Director*

Because of regulation.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes, because of the regulation. And this quarter, this one-time impact of the overseas consulting revenue. So I think -- but we do have some -- the fixed costs of the teachers and staff costs in Q4. But I do believe we will have the gross margin expansion in the coming new quarter, okay?

Operator

Your next question comes from the line of Alex Liu from China Renaissance.

Zhangxiang Liu - *China Renaissance Securities (US) Inc., Research Division - VP*

Two questions. First, I think given the recent regulations, which basically limits the competition and admission selection for middle school, do we see any positive spillover effect for our middle and high school tutoring business going forward?

And second question is on the -- a financial question. We see the noncontrolling loss was actually expanding a bit this quarter sequentially and year-on-year. But is that something related to the loss of koolearn or is that something from other business?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. My second question -- for your question 2, yes, it was some impact from the koolearn.com, okay, the [NCI].

And to the regulation, okay -- yes. And the regulations -- yes, there's some regulations, it seems, last year. But our -- actually, we are fully supportive of the government reforms and the implementations. Actually, for the off-line side, the regulations is carried out on city-by-city basis. But we do not foresee any material impacts from the regulations. And on the contrary, we fully support the regulations from the government because I think it's good for the whole industry. And so we're doing our jobs and to provide better service to the students and to provide with better products and to give a better feedback from the parents and kids. So this our target. So I think it's good timing for us to take more market share by providing the better product. So this is our attitude to the policy, okay?

Operator

Your next question comes from the line of Jin Yoon from New Street Research.

Jin-Kyu Yoon - *New Street Research LLP - Analyst*

Just a couple from me. On the summer program, with the pricing increase, has there been a change in content in relation to that pricing increase? That's my first question. And then what percentage of the, I guess, the summer program or the programs today that you see is coming from the dual-teacher program? And how should we expect that for the fiscal '20 going forward?

And then my second question is related to your FX. Not sure if I calculated this right, but I think my FX has been, in the prior quarter, was a little bit different than what you guys provided. Hence, there was probably somewhere like a 300 basis point impact to FX according to my numbers, which impacted revenues upwards of $20 million. I'm just wondering if there was something different about FX in the quarter. Or is it something that I was just kind of mistaking myself? Anyway, anyhow, any color on there would be great.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes. And yes, the -- I think we keep almost the same the price strategy. This quarter, the hourly rate for all business lines is -- was 10%. And yes, we're surprised by a reasonable price. And going forward, I think our price increase will be 5% to 10% year-over-year in the end of fiscal year '20. And -- but we made some change of the products for both the U-Can and POP Kids. We spent a lot since 2 -- or 3 years ago. And even in the last trailing 12 months, we update our product for the POP Kids product. And that means we add more and more the online and off-line elements to our off-line classes. So the kids in our classes are taking better classes than before. And -- but as I said, we'll keep the same price strategy. This is our price strategy.

And the exchange rate. The Q4 -- this quarter, we used the 6.7601. And last year Q4, we used the 6.3287. So this is the exchange rates we used to calculate the revenues. And in the coming new quarter, the Q1 '20, we use the 6.8851 compared to the last year Q1 6.6757. So this is the only numbers we're using, okay? Is it clear?

Jin-Kyu Yoon - *New Street Research LLP - Analyst*

Clear, yes.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. Thank you.

Operator

(Operator Instructions) Your next question comes from the line of Christine Cho from Goldman Sachs.

Hyun Jin Cho - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Stephen, Sisi, congratulations. I think quickly, on the tax rate this quarter, I noticed it was a bit higher than usual. Was there any specific that you would highlight regarding that? And then in terms of looking at FY '20, what would be your expected tax rates?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. Thanks, Christine. It's a good question. In this quarter, the GAAP effective tax rate was 27%. It seems to be high. There are 2 reasons: Number one is if you take out the loss from the fair value change, the ETR was 20%. So this is number one reason. Number two reason, most our software are high-tech entities, have a certain period of tax holidays. When they expire, the tax rates tend to go up. And -- but I think that this quarter, I think, is very special. So going forward, we expect the GAAP ETR in fiscal year '20 will be somewhere between 20% to 23%, and -- because we don't believe we will have such a big fair value loss in fiscal year '20 as we had in fiscal year '19. On the contrary, if we get a fair value gain in fiscal year '20, the ETR will be lower, okay?

Operator

Your next question comes from the line of Felix Liu from UBS.

Felix Liu - *UBS Investment Bank, Research Division - Research Analyst*

Congratulations on the strong results. One more question on me on the margins. So I'm just wondering if there is any drag from the online business regarding to the year-on-year GPM decline.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. Yes. We invest on the online platform, koolearn.com. But as I said, we expect the non-GAAP operating margin for -- of the off-line core business continue to be expanded in the coming fiscal year '20. So I think this margin improvement is -- expects to be covered the margin pressure from the online side. So as I said, in short, overall margin, we expect our overall non-GAAP operating margins to expand in the next quarter, the Q1, and the whole fiscal year '20, okay?

Operator

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

Unidentified Analyst

This is (inaudible). Maybe we have 2 larger questions. In your K-12 revenue by the several major cities, we noticed Beijing still achieved solid growth despite of the fierce competition and high penetration rate. And also, several other cities seems to register a tremendous growth. So can management share with us, so by ranking of importance, what are the key success factors behind those growth rate and specifically the factors for Beijing?

And the second question, we noticed that pure online [koolearn] business, that it had been (inaudible) for you the acquisition for this summer. Do you think the rising penetration of online education will be short or medium term? Why are our koolearn is still a bit smaller compared with others? Did that somehow impact the overall off-line growth?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes. What I can disclose for the revenue by city is -- what I can say is in the last trailing 12 months, our top 10 cities, the K-12 revenue growth was 37% in RMB terms year-over-year. So you can see the strong momentum. And going forward, in fiscal year '20, I think for the top 10 cities, we can still get the -- at least the same growth number, okay, in fiscal year '20. So actually, we don't care more about the competition. I think the competition environment has no change, and competition is always there, yes?

And your second question is about the online acquisition cost. Yes. We -- as I said, to answer the -- as I said before, our investment for the online platform koolearn.com, I think, most our expenses we're spending, we will spend on the R&D and content development and teachers' recruiting and training. And yes, we will expand the marketing and selling marketing expenses in a reasonable scale. And yes, this is our strategy. Yes.

And if we look at the historical, what happens in the past, New Oriental is -- we didn't like to spend too much more on the marketing because I think we relied more on the word of mouth, okay, because we have the nationwide brand name in China, okay? Thank you.

Operator

Your next question comes from the line of Mark Li from Citi.

Mark Li - *Citigroup Inc, Research Division - Director*

May I ask, actually, given the positive margin development we have, is there -- could you remind us our medium-term margin target? Is there any change?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Thanks, Mark. Great question. As I said, we guided the margin expansion in fiscal year '20. And we don't want to make any change of the mid and long-term margin guidance. Our mid and long-term margin guidance will be 17%, the margin guidance. So there's no change, okay?

Operator

Your next question comes from the line of John Wang from Macquarie.

John Wang - *Macquarie Research - Analyst*

So my question is that it seems that the quarter-over-quarter capacity expansion speeded up a little bit. But does that mean we are facing less regulatory pressures on the opening new learning centers?

And also, can management show some color on the utilization rate currently and going forward? So if considering not moving 1 week's lesson to the next quarter, is the utilization rate going to be higher?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes. The expansion quarter-on-quarter in Q4 was 9%. I think it's not related to the regulations. It's just on track compared to our budget because we need to open more learning centers to prepare for the new summer and the new year. So if you combine the new square meters we opened in first 3 quarters with the 9% this quarter, so we got the 24% for the whole year fiscal year '19. And yes, this is just on track.

And what's your second question?

John Wang - *Macquarie Research - Analyst*

The second question is on the utilization rate.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Oh, utilization, I'm sorry. The utilization rate this quarter was 21% to 22%. I think it's 100 to 200 bps up compared to the same period of the last fiscal year. And I think the math is very simple. We -- the expansion was 24% for fiscal year '19 and we got the 31% top line growth in RMB terms year-over-year in fiscal year '19. And next year, as I said, we -- our expansion plan will be somewhere around 20%, and top line growth in RMB term will be over 30%. So I think we believe the utilization rates will go up going forward.

Operator

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

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

I got one question for FY '19. How much has rental and teacher costs increased y-o-y for the fiscal year? And secondly, the selling and distribution expense for the fourth quarter, it's only up by like 5% in U.S. dollar term. How should we expect this cost item to grow in FY '20?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Sisi, can you check the numbers of the rental and teacher costs?

Sisi Zhao - *New Oriental Education & Technology Group Inc. - IR Director*

Yes. For the full year, the staff costs increased about 27%, 28%. And rental is roughly about 25% to 26%.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

This is dollar term.

Sisi Zhao - *New Oriental Education & Technology Group Inc. - IR Director*

In U.S. dollar terms.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes, dollar term. Okay. This is a whole year number?

Sisi Zhao - *New Oriental Education & Technology Group Inc. - IR Director*

Whole year.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Okay. We perform better in the second half of the year than the first half, okay? And selling and marketing expense, I think -- yes, you are right. We -- the selling and marketing expenses just increased by 5% in the Q4. And as I said, we don't want to spend too much money on the selling and marketing, on the student acquisition cost. And we care more about the word of mouth. And also, we have the very strong performance from the summer promotion, so we don't need to spend so much on the marketing expenses. And going forward, I believe we have the more operating leverage from the selling and marketing side in fiscal year '20, okay?

Operator

Your next question comes from the line of John Choi from Daiwa.

Hyungwook Choi - *Daiwa Securities Co. Ltd., Research Division - Head of Hong Kong & China Internet and Regional Head of Small/Mid Cap*

Quickly a follow-up on the margin side. It seems that you mentioned selling and marketing, you guys will see a pretty decent operating leverage. But on the G&A, should we be expecting also decent leverage? And then if you combine gross profit margin, as you mentioned, for off-line, it will continue to expand. It seems to me that the operating margin expansion is likely to accelerate versus -- this coming fiscal year versus what we think -- what we're seeing. Just quickly, there's been a lot of education start-ups and also investments around, what are our plans in terms of investing into this ecosystem?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes. And yes, I think we -- you will see more leverage from the selling and marketing and G&A expenses going forward. But the gross margin in the fiscal year '20, I believe it will be flattish or up a little bit, okay? So -- and yes. And our -- yes, our money, I think we're looking at some new start-ups for -- especially for the online education side. And if we can find the potential synergy between New Oriental and the target companies, we'll buy it. We'll make investments, okay? Thank you.

Operator

Your next question comes from the line of Johnny Wong from Jefferies.

Kin Man Wong - *Jefferies LLC, Research Division - Equity Analyst*

Congratulations. My question relates to the summer promotion. You said that we are seeing very good enrollment, 765,000. Is there a -- can you give us a breakdown between -- approximate breakdown between online and off-line? Is that mainly off-line? Or is that mainly online students? And also, I know we've had a very good conversion rate in the past, over 50% if I remember correctly. What type of target conversion rate are we seeing?

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Yes. Johnny, it's a great question. I think that the 765,000 summer promotion enrollments, as I said, is pure off-line summer promotion enrollments. We don't count any online summer promotion enrollment, okay? Is it clear? And last year -- yes, you're right. Last year, we got 54% retention rate after the summer promotion in autumn last year. And we do believe we can gather higher student retention rates after this year's summer, okay? Think about that. We raised the price of the summer promotion from RMB 200 to RMB 400. And I think it's much better for us to identify the real customers and to enhance the customer loyalty. So that's why we believe the retention rates will be higher this year, okay? Johnny, is it clear?

Kin Man Wong - *Jefferies LLC, Research Division - Equity Analyst*

It is.

Operator

Your next question comes from the line of [Lilian Wong] from HSBC.

Unidentified Analyst

My question has been answered.

Operator

We are now approaching the end of the conference call. I would now turn the call over to New Oriental's CFO, Stephen Yang, for his closing remarks.

Zhihui Yang - *New Oriental Education & Technology Group Inc. - CFO*

Again, thank you for joining us today. If you have any further questions, please do not hesitate to contact me or any of our Investor Relations team representatives. Thank you.

Operator

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