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EDU - Q1 2020 New Oriental Education & Technology Group Inc  
Earnings Call

EVENT DATE/TIME: OCTOBER 22, 2019 / 12:00PM GMT



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## PRESENTATION

### Operator

Ladies and gentlemen, good evening, and thank you for standing by for New Oriental's First Fiscal Quarter 2020 Earnings Conference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the meeting over to your host for today's conference, Ms. Sisi Zhao.

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

Thank you. Hello, everyone, and welcome to New Oriental's First Fiscal Quarter 2020 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 and I 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](http://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. Welcome, everyone, and thank you for joining us on the call. We are very pleased to begin fiscal year 2020 with a robust top line growth which exceeded the high-end of our expected range in RMB terms.

For the first quarter of 2020, New Oriental reported net revenue of \$1,071.8 million, representing a growth of 24.6% or 29.7% if measured in RMB. Net revenues from educational programs and services for the quarter were \$996.5 million, representing a 25% increase year-over-year or 30% if measured in RMB.

Our key growth driver, K-12 after-school tutoring business recorded significant increase in student enrollment. Together with the overwhelming responses received from the summer promotion campaign, both segments made great contributions to this quarter's outstanding performance.

In the first quarter of fiscal year 2020, we continue to implement our well-proven Optimize the Market strategy and carried out capacity expansion in cities where we see potential for rapid growth and strong profitability.

During this quarter, we added a net of 7 learning centers in existing cities. The total square meters of classroom area by the end of the quarter increased approximately 24% year-over-year and 3% quarter-over-quarter in line with our expansion plan.

Our total student enrollments in academic subjects tutoring and test prep courses in the first fiscal quarter of 2020 increased by 50.4% year-over-year to approximately 2,609,200. On this point, please note the higher-than-normal increases in a number of student enrollments is primarily due to the split of autumn semester into 2 sections, a change we adopted to meet the latest regulatory requirements since November 2018, which means student enrollments for each half of the autumn semester were calculated separately.

To explain, the number of student recruitment and fees collected for the first half of the autumn semester were booked in previous quarter, while those for the second half were booked in the both the current report, the first quarter, as well as the following second quarter. Prior to the change, we historically collected the full sum of the tuition fees and the recorded student enrollments for autumn semester in the fourth quarter of the prior fiscal year.

Meanwhile, we also continued to deepen our online-merge-offline standardized classroom teaching system, and in particular rolled out an innovative interactive courseware for the POP Kids program in some main cities, creating more interactive and high-quality learning experience for our students.

We also made further strategic investments into dual-teacher model classes and new initiatives for pure online K-12 tutoring through koolearn.com. With our core competencies in both offline and online education service, we're confident to capture the substantial business opportunities in low-tier cities and remote areas in China moving forward.

Furthermore, we would like to take this opportunity to highlight the success of our summer promotion campaign as briefly mentioned earlier. Similar with the previous years, we offered low cost offline trial courses for multiple subjects across most of our existing cities during the summer period, targeting students before they begin secondary school.

The large-scale promotion this year was launched in 43 cities. And we're very encouraged to see that, even with the doubled average promotion price compared to last year, our total promotion enrollments reached 820,000 and 8% interest year-over-year accompanied by improved student retention rate year-over-year. Please note that these promotion enrollments were not included in our reported enrollments.

Overall, 59% of students recruited from summer promotion campaign were successfully retained as customers for our full-priced courses for the autumn semester, which is 5% higher than the rate last year. We are confident that this will boost our revenue and drive positive growth throughout the whole of fiscal year 2020.

We have firm belief in our summer promotion strategy in generating long-term benefits, and foresee this to continue to be a successful and effective strategy to rapidly capture market share and acquire long-term loyal student customers in K-12 after-school tutoring market.

As these students move from grade 7 to grade 12, we expect to continue the improvement in retention rates as customer loyalty will further drive enrollment growth in the next 3 to 6 years. These investments lay down a solid foundation for stronger growth in the long-term and further cements our leadership in the market.

Another highlight of the first quarter of fiscal year 2020 is our year-over-year operating margin expansion, which is compounded by a strong bottom-line performance. Our non-GAAP operating income increased by 46.8% year-over-year in dollar terms to approximately \$257.2 million, while non-GAAP operating margin rose by 360 basis points to 24.0% from 20.4% a year ago attributable to a strong utilization rate and operational efficiency, in addition to our one-off summer promotion drive. We will continue to focus on furthering these improvements, and we are confident in our ability to deliver a stable and positive margin expansion this year and create sustainable long-term value for customers and shareholders.

I will now turn to pricing. Per program blended ASP, which is cash revenue divided by total student enrollment, decreased by about 13% year-over-year. We'd like to note that the lower-than-normal blended ASP is primarily due to change in tuition fee collection schedule for our K-12 after-school tutoring courses as explained above. The number of students we recruited and the amount of fee collected during the quarter only reflect the second half of the autumn semester. Therefore, our blended ASP for the first quarter of 2020 appears to be lower.

Hourly blended ASP, which is GAAP revenue divided by the total teaching hours, increased by approximately 5% year-over-year in RMB terms. Breaking down our hourly blend ASP, the U-Can middle school/high school rate increased by 7%, POP Kids increased by 9% and overseas test prep program increased by 7%, all year-over-year in RMB terms.

Now we will move on to the first 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 35% in U.S. dollar terms or 40% in RMB terms.

To provide a breakdown of the growth. The U-Can middle school/high school all-subjects after-school tutoring business reported revenue increase of 33% in dollar terms or 38% in RMB terms for the quarter. Student enrollments grew approximately 55% year-over-year for the quarter.

Our POP Kids program delivered outstanding results with revenue up about 38% in dollar terms or 44% in RMB terms for the quarter. Enrollment was up about 70% for the quarter.

Overseas test prep business recorded a revenue increase of 5% in dollar terms or 10% in RMB terms for the quarter. Our consulting business recorded revenue growth of about 23% in dollar terms or 28% in RMB terms year-over-year for the quarter.

Finally, VIP personalized classes business recorded revenue growth of about 19% year-over-year in dollar terms or 24% in RMB terms year-over-year for the quarter.

Next, I'll provide some update on the progress we are making with our Optimize the Market strategy. In terms of offline expansion, as mentioned earlier, this quarter we added a net of 7 learning centers in existing cities. Altogether, this increased the total square meters of the classroom area by approximately 24% year-over-year and 3% quarter-over-quarter by the end of this quarter.

Our dual-teacher model has been proven successful. It has been introduced into the POP Kids program in 46 existing cities and the U-Can program in 30 existing cities, and for both programs in 7 new cities, further deepening our market penetration in those markets we have tapped into. The model also supported the further improvements on customer retention and scalability of the new model. With these proven results in mind, we will continue this strategy in the coming quarters.

On the digital technology front, we invested \$30 million in the first quarter to improve and maintain our online-merge-offline standardized platform teaching system. Most of our investments were recorded in our G&A expenses. In particular, we would like to highlight the implementation of our digital interactive courseware for POP Kids program in certain major cities.

The digitally enabled courseware strengthens and standardize our teaching and learning qualities, boosting classroom efficiency and delivers improved student experience and satisfaction. It also means higher stickiness of our enrollment student customers. Furthermore, we also made stable progress in the pure online koolearn.com business line and other supplementary online educational products, which is experiencing growing market demands.

More resources are invested into executing existing initiatives in online K-12 after-school tutoring business in fiscal year 2020. The investment includes constant developments, teachers' recruiting and training, sales and marketing, R&D and other necessary cost and expenses to drive the growth of new pure online programs. With these programs, we're able to reach more students in low-tier cities in an interactive and scalable manner. We believe this will help koolearn.com to gain new market share in the online education area and drive up top line growth.

Now let me walk you through the other key financial details for the first quarter. Operating cost and expenses for the quarter were \$825.6 million, representing a 17.9% increase year-over-year. Non-GAAP operating cost and expenses for the quarter, which excludes share-based compensation expenses, were \$814.6 million, representing 18.7% increase year-over-year.

Costs of revenue increased by 19.8% year-over-year to \$440.2 million, primarily due to increase in teachers' compensation for more teaching hours and rental costs for the increased number of schools and learning centers in operation. Selling and marketing expenses increased by only 1.9% year-over-year to \$101.2 million.

General and administrative expenses for the quarter increased by 21.6% year-over-year to \$284.2 million. Non-GAAP G&A expenses, which excludes share-based compensation expenses, were \$273.5 million representing a 24.5% increase year-over-year.

Total share-based compensation expenses, which were allocated to related operating costs and expenses, increased by 20.8% to \$11 million in the first quarter of 2020.

Operating income was \$246.2 million, representing a 52.6% increase year-over-year. Non-GAAP income from operations for the quarter was \$257.2 million, representing a 46.8% increase year-over-year.

Operating margin for the quarter was 23.0%, compared to 18.8% in the same period of the prior fiscal year. Non-GAAP operating margin, which excludes the share-based compensation expenses for the quarter, was 24% compared to 20.4% in the same period of prior fiscal year.

Net income attributable to New Oriental for the quarter was \$209.0 million, representing a 69.6% increase from the same prior period of prior fiscal year. Basic and diluted earnings per ADS attributable to New Oriental were \$1.32 and \$1.31, respectively.

Non-GAAP net income attributable to New Oriental for the quarter was \$230.2 million representing a 25.0% increase from the same period of prior fiscal year. Non-GAAP basic and diluted earnings per ADS attributable to New Oriental were \$1.45 and \$1.44, respectively.

Net operating cash flow for the first quarter of 2020 was approximately \$364.6 million. Capital expenditures for the quarter were \$64.3 million, which were primarily attributable to opening of 43 facilities and renovations of the existing learning centers.

Turning to the balance sheet. As of August 31 of 2019, New Oriental had cash and cash equivalents of \$973.2 million. In addition, the company had \$351.6 million in term deposit and \$2,010.7 million in short-term investments as of August 31, 2019.

New Oriental's deferred revenue balance, which is cash collected from registered students for courses and recognized proportionally as revenues as the structures are delivered, at the end of the first quarter of fiscal 2020, was \$1,330.7 million, an increase of 16%, as compared to \$1,146.7 million at the end of fiscal quarter 2019. The lower-than-usual increase was due to the change of the tuition fee collection schedule for K-12 business, in compliance with the latest regulatory requirement. This change was implemented during the second quarter of fiscal year 2019.

Before moving on to our priority for the second quarter, I would like to take a moment to reiterate our broader goals and our Optimize the Market strategy.

First, we will continue to focus on expansion of our off-line business. We aim at around 20% of capacity in fiscal year '20, which includes new learning centers and growing classroom area for -- of some existing learning centers for K-12 business mainly. In addition, we will continue to roll out our dual-teacher models schools to a number of new major cities in certain provinces for the whole year.

Second, we will continue to leverage our investments in the digital technology front, extending new features of our OMO system to more off-line language training and test prep offerings, especially for K-12 due to our overseas test prep business. We will continue to make such investments and we believe that the total spending in absolute dollar terms in fiscal year 2020 will increase moderately compared with the prior fiscal year.

Furthermore, we will also continue to invest in and execute new initiatives, including product content development, teachers' recruiting and training, R&D, as well as sales and marketing in our pure online K-12 tutoring business, our koolearn.com platform.

At this point, I would like to reiterate that we believe the strong growth in our off-line business will offset the online investment expenses on our bottom line.

Third, our top priority will remain as the focus on optimizing the utilization of facilities and controlling costs and expenses across the organization to drive continued margin expansion and increase operational efficiency.

The new facilities built in fiscal year 2018 and 2019 are being ramped up at a more efficient level. We expect our non-GAAP operating margin of the off-line language training and test prep business to continue to expand in the rest of the fiscal year 2020.

With the strong operating leverage consistently improves utilization rate, our robust off-line business growth will be able to cover the margin pressure from our online investment.

On the whole, we expect our overall non-GAAP operating margin to improve year-over-year in fiscal year 2020 compared to the year-over-year decline last 2 fiscal years, reflecting a healthy strong-growth trend.

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

Again, I would like to emphasize that the fundamentals of our business remains strong as we believe. With our optimize market strategy being the focus as always. We are confident that New Oriental will continue to capture substantial growth opportunities in the market and deliver long-term value for our shareholders.

Looking at the near term and our expectations for the next quarter, we expect total net revenues in the second quarter of fiscal year 2020 to be in the range of \$753.6 million to \$771.0 million, representing a year-over-year growth in the range of 26% to 29% in dollar terms. The projected growth rate of revenue in our functional currency RMB is expected to be in the range of 30% to 33% for the second quarter of fiscal year 2020.

The exchange rate used to calculate expected revenue for the second quarter of fiscal year 2020 is CNY 7.11, while historical exchange rates used to calculate revenues for the second quarter of fiscal year 2019 was CNY 6.90. 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 with Sisi. Operator, please open the call for this.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Your first question comes from the line of Mark Li from Citi.



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

Congratulations for the very strong results. My question is, I think the non-GAAP operating margin up 360 bps is a very good surprise. Do you have any analysis for the breakdown of this bit? Because it's quite a bit higher than the previous guidance.

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

Okay. Yes, the -- our non-GAAP operating margin rose by 360 basis point year-over-year in this quarter. I think this is much better than we expected 3 months ago. And I think our efforts to keep a healthy balance between the capacity expansion and the operating efficiency have paid off in this quarter. And I think there are 3 reasons.

The first one is you have seen the strong utilisation rate up in this quarter because our expansion plan -- our expansion capacity this quarter is only 3% quarter-over-quarter. But we got -- in RMB terms, we got the 29.7% revenue growth. And number two, as you know, we already have the cost control within the company. And number three, the last one, is we have the one-off summer promotion drive, because we raised the price from RMB 200 per course on average last year to RMB 400 this year. So it's a healthy margin expansion. And I think on the one-off, the summer promotion positive impact will be somewhere around 100 basis points. And so all the others only comes from the operating leverage and higher utilization rates, okay?

And keep going forward, I think we -- within the rest of this fiscal year, we're confident that we will have the margin expansion in the rest of the year. Because as I guided in the last earnings call, our expansion plan this year is somewhere around 20%, but our top line growth for the whole year will be 30% year-over-year growth. So we believe we'll have more leverage on the rental side and the SG&A side as well, okay? Thanks, Mark.

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

So may I understand if the first reason is bigger than the second and bigger than the third. Is it in this sequence? Further help.

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

Yes, yes. So yes, as I said, the measure or demand, the margin driver comes from the better utilization rate and the operational efficiency. Yes.

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**Operator**

(Operator Instructions) Your next question comes from the line of Yuzhong Gao of CICC.

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**Yuzhong Gao** - China International Capital Corporation Limited, Research Division - Analyst

Quick question K-12 [platform]. So for the full year, can we have some color on your margin guidance? And especially on your off-line/online, how did your off-line contributed to margins, [especially how well] your online is driving margin? Maybe you can quantify this a little bit. A little help.

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

Okay. As a guide, this quarter, we got a very good result of the margin expansion, 360 basis points margin expansion this quarter. And for the whole year, yes, we believe we have the margin expansion in the rest of the year. And yes, most of the margin expansion comes from the off-line business especially for the K-12 business. And yes, I think the online part or the online site is still a drag, but I think the drag will be offset by the off-line business margin expansion. I don't have the detailed numbers because we just have the 1 quarter passed. But as for the whole year, as a whole -- the company as a whole, the whole margin will be expanded into fiscal year '20. Okay.



**Operator**

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

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

Stephen, I think you mentioned on the prepared remarks that on a teaching-hour basis, that pricing was up 5%, if I heard that correctly. I guess for the rest of the year, how should we expect that? Should -- with the utilization continuing to ramp and demand environment being strong, should we see that number accelerate throughout the year?

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

Yes. The price question first. I think the hourly rate, the hourly rates basis, the overall, the price for this quarter was increased by 5% in RMB terms. And -- so within it, 7% of the U-Can business price increased, 9% of the POP Kids percent price increased. And going forward, I think we don't change our price strategy. So in the rest of this fiscal year, the price increase for the whole business overall will be 5% to 10% in RMB terms year-over-year.

And yes, we have seen more leverage, off season leverage for the first quarter. And we do believe you will see more leverage in the rest of the year. And yes, as my answer to the first question, we do believe we will see more leverage in the rest of the year. And yes, I think -- I won't give the detailed guidance for the operating margins for the Q2 and the rest of the year, but we believe we'll have the margin expansion on the off-site.

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**Operator**

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

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

I want to have more color of you margin guidance or about the operating expense. I think, Stephen, you mentioned that in first quarter, there were more spending on the team and the product so the G&A cost is a bit similar, while the sales and marketing is lower. So if we look ahead, say, in the coming winter and the next summer season, do you expect more spending on the sales and marketing when the koolearn product is more ready? And so in this case -- so what's your guidance or outlook of the sales and marketing spending in the second half of this year?

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

Yes. This quarter, our selling and marketing expenses increased only by 1% in dollar terms year-over-year. And this is our -- the strategy, as our original plan. Within the koolearn, I think we continue to invest in more resources, more money on the products and teachers' recruitment and training and content development as well as good marketing. But we will spend a reasonable marketing expenses within koolearn platform in a reasonable way. And we're not used to burning money away to price for the students as we did in the off-line business.

And also, for -- on the other hand, for our off-line business, I think you will -- if -- I'm not sure if I remember clearly. Last quarter, our selling and marketing expenses didn't increase a lot. So I do believe we will have more leverage on the selling and marketing side going forward. And yes, that's my answer. And also, we -- if -- I think for G&A and cost effect like the rentals, we do have more leverage going forward, yes, as we did in the selling and marketing side, okay?

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**Operator**

Your next question comes from the line of Binnie Wong from HSBC.

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**Wai Yan Wong** - *HSBC, Research Division - Head of Internet Research of Asia Pacific & Analyst*

So my question is actually on the growth in the top-tier cities. So we see that there's also intensive competition, right? So how do you see that -- the trend in terms of your market share gains in those top-tier cities? And also, if we look at the next quarter growth outlook, right, excluding the FX impact, it's actually still quite strong. So can you help us to understand how much of that is driven by your enrollment growth? And then how do you see that -- the trend going forward? And also give us kind of like your update in terms of your vision on your online education strategy as well.

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

Okay. I can share with you one number. The top 10 cities, in less than 12 months, the revenue growth for the top 10 cities was 36% in RMB terms year-over-year. And I think we were seeing the good trend. Actually we're seeing the revenue acceleration in almost all the cities.

So go back to your question about the guidance. And for the Q2, we give the guidance of the top line growth by 30% to 33% in RMB terms year-over-year growth. And within it, most of the growth will come from the K-12 business. For U-Can, middle school/high school, I think the growth in the second quarter will be 45% plus year-over-year in the second quarter. And for POP Kids, the growth will be somewhere around 50%, 50%, 5-0 percent, year-over-year. And overseas test prep business growth will be somewhere around 10%. So you could calculate the total -- the overall growth will be somewhere around 33%, okay? And...

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

The enrollment is the key driver for the revenue growth.

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

Yes. The price increase will be somewhere between 5% to 10%. Most of the growth comes from the -- will come from the enrollment growth. And I do believe, the retention rate after the summer promotion was 59% from the summer promotion, and it's 5% higher than the number of last year. So we do believe most of the students will stay with us for at least 1 year, or hopefully 3 to 6 years. So it will help the enrollment growth for the rest of the year, okay? Thank you.

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**Operator**

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

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

Two quick questions. First, I think you guided around 20% full year fiscal year capacity growth, while I think this quarter you're doing 24% year-on-year growth. Does that imply some kind of a deceleration into the second half this fiscal year? And second, I think we just passed through a very fierce [super] competition summer for online. I'm just wondering whether these aggressive promotions has impacted our online and off-line business in any way.

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

Okay. The capacity question. Yes, we have the seasonality of the expansion quarter by quarters. If we go back to the last year of the expansion, we set up most of the learning centers in the second half of the fiscal year. So this year, we will use the same strategy, so we -- it's back-loaded within the same fiscal year. And the reason that we opened more learning centers in the second half of the year is because we prepare for the coming new summer, okay? And so we don't want to change the guidance of the expansion plan as the 20% expansion plan, okay, for the full year backloaded.

And yes, the online competition is a great question. I think firstly, the market's so huge. We're the -- one of the market leader. Our off-line business market share is only 2%, somewhere around 2%. So the market is huge in that. And so far, we haven't seen any negative impact from the recent aggressive online education competition. In fact, we're in the revenue acceleration runway in the offline business side. Even though we have seen some players to stand last on the online education on the marketing -- selling and marketing expenses.

But the key is you -- we -- after we raise the price, we doubled the price of the summer promotion, we still got the 820,000 student enrollments, which is 8% of the increase compared to last year. And the retention rate is higher than we expected, 59% is good result.

And -- but our strategy is we care more, we care both off-line business and online business growth. And so that means we will have 2 growth engines, off-line and online. So the online, as a fact, we are still in process of the investment period, to spend more money and time on the R&D and product development and the future training or staff training. And so the online -- so part of the New Oriental's future. But we want to -- but on the other hand, the off-line business, I think we're doing good for the off-line business, okay? So we have 2 growth engines in the future, okay?

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**Operator**

(Operator Instructions) Your next question comes from the line of Tian Hou from T.H. Capital.

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

Congratulations on a good quarter. So the question is related to your off-line dual-teacher model. So if you expand school by school, it will be somehow slower. And -- but if you do the dual-teacher, it can actually accelerated the growth. So I wonder in your future plans, how many expansion will come from the dual-teacher expansion? And also, dual-teacher, how much it contributed to the margin expansion? So that's the question.

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

Tian, it's a great question for the dual-teacher model. We have tested this dual-teacher model in 46 existing cities for the POP Kids and 30 cities for the U-Can business, and in certain low-tier cities for both POP Kids and U-Can business. And we're happy to see the increased market penetration in the low-tier -- in those market, the low-tier cities. So we plan to open 10 to 15 more new cities business with the dual-teacher model, okay, in 9 to 12 months. And so, yes, when a teacher can [teach] to so many students at the same time compared to the off-line business. So [roughly, margin will be for] dual-teacher model should be higher than the off-line business. So going forward, obviously, I think the dual-teacher model business will help the margin expansion for the whole company, okay?

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**Operator**

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



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

Stephen, you just mentioned that in the second quarter, U-Can is about to deliver 45% plus growth, with POP Kids delivering 50%. So actually the growth rate is accelerating from the first quarter. So my understanding is that better-than-expected retention rate from summer promotion might have something to do with the acceleration. Is my understanding correct?

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

Yes. Because, number one, we have a very strong retention rates after the summer promotion, this is number one reason. Number two is we have seen the student retention rate for the normal classes, both U-Can and POP Kids, are trading up. So it testifies that New Oriental is providing better service and products to the customers, student customers. So the better student retention rates and the higher retention rates from the summer promotion. And lastly, we will build more learning centers in this -- in Q1 and Q2. And also, we are ramping up the learning centers we set up in the last 2 years. So that means we will have fill students into the current learning centers, okay. They help us to [collect] the revenue acceleration in Q2 in the coming quarter, okay?

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

May I please follow-up for the retention rate for the normal class this quarter? And how is that comparing to the previous quarter?

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

Okay. The U-Can middle school/high school business, the retention rates in this quarter is close to 80%. And POP Kids is close to 90%, the retention rates. So compared to last year, we got 3% to 5% higher rate year-over-year.

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**Operator**

You're next question comes from the line of Christine Cho of Goldman Sachs.

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

Congratulations. Stephen and Sisi. I just have one question. So it seems like -- even pretty mature cities like Beijing is off to a very good start this year. What are some key drivers behind this acceleration?

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

I think, yes, sort of -- it's not only for Beijing schools did good result, but also for the other big cities. And I think it seems that this is a long story. We started to invest on new products since 3 years -- 3, 4 years ago. And so this -- we started to bear fruits of these historical investments. And also, we issued a new, revamped POP Kids program product. Compared to before, it's more interactive, more adaptive for kids. So the kids and their parents love the new products than we expected. So it helps us to get better retention rates. And so anyway, we do believe the big cities -- even with the high base number, we believe they can give healthy growth in the future going forward, okay?

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**Operator**

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



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

I think you mentioned that the biggest reason for the margin expansion this quarter is the utilization improvement. So may I know what is the current utilization level and how much upside do we expect going forward?

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

Sisi, can you answer the question?

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

Yes. This quarter, the overall utilization is 21% and 2% improvement compared with last year. So the key driver is U-Can and POP Kids K-12 business. So the learning centers are ramping up faster than before and the utilization got improved.

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

And going forward, I think we will see higher utilization rates in the rest of the year because U-Can -- I think it's simple math. You can -- I suggest that your guys compare the top line growth with the expansion plan, okay? So that means we fill more students into the existing learning centers. This is the math. Okay.

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**Operator**

Your next question comes from the line of Alex Xie from Crédit Suisse.

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

So I'll ask about if we exclude the impact from the regulation changes in tuition fee collection, what will be the student enrollment growth for U-Can and POP Kids?

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

For this quarter?

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

Yes.

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

I think the -- for the K-12 business, if you take out the impact of the regulation, I think the enrollment growth for the U-Can and POP Kids together will be somewhere around 30% to 35%. This is the real enrollment growth, okay?

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**Operator**

Your next question comes from the line of Tommy Wong from China Merchants.



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**Tommy Wong** - China Merchants Securities (HK) Co., Ltd, Research Division - Research Analyst

You mentioned a lot about your success in the retention rate improvement this year. Can you share with us some anecdotal maybe strategies? Or at a learning centre level, what kind of efforts did the teacher made? Or any kind of special programs that led to such a good result? Maybe just a little bit of anecdotal evidence.

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

Yes. Actually, for product side, we keep growing out our online/off-line merged standardized teaching system to the whole network. And also we invested money and also our teaching resources to refine the standardized product. For example, like POP Kids, right, this year from the summer, we rolled out our new courseware to make the class more interactive.

And also a very, very important new feature of the new courseware is that our teachers can save a lot of time, and the teaching quality can be improved because it's more and more standardized teaching process. And also by interactive features, new features, students are more interested in the class. And also, the effectiveness and stickiness of the customer are also improved. And it's shown by the numbers in those cities are using the new product. So that's one new feature of the whole standardized system.

And going forward, we'll keep investing in having more and more new features, new services, better services to our customers. So that's one key driver. And also, like teachers, because their service quality are -- also got improved, our training process for teachers are getting more and more standardized because the product is standardized. So for example, like starting from last year, last summer, we train our U-Can teachers using the new modularized new system to train our teachers, especially new teachers, to help those teachers to improve the teaching quality in a short period of time. And also the teaching -- overall teaching quality got improved a lot. So that's the benefit that we can get from the standardization of the teaching products, okay?

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

So think about that. We raised the price, we doubled the price of the summer promotion this year, but we still got the 8% enrollment growth, yes, from the RMB 200 per course to, this year, RMB 400 per course. RMB 400 is something, it's many. So I think the strategy for us is it's better for us to identify who are the real customers. And also, we do believe we were providing better quality service and products to the customer students.

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**Tommy Wong** - China Merchants Securities (HK) Co., Ltd, Research Division - Research Analyst

Congrats on the strong results.

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

Thank you very much.

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

Thank you.

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**Operator**

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

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

Thank you all again for joining us today. Should you have any further questions, please do not hesitate to contact me or any of our Investor Relations representatives. Thank you.

**Operator**

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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