Bright Scholar (BEDU)
First Quarter 2020 Earnings Conference Call
<u>Friday, January 17, 2020 8:00AM ET</u>

Company Representatives:
Ruby Yim, Investor Relations Counsel
Jerry He, Executive Vice Chairman
Derek Feng, Chief Executive Officer
Dora Li, Chief Financial Officer

Analysts:
Elsie Sheng, Morgan Stanley
Christine Cho, Goldman Sachs

Presentation

Operator: Good morning, and thank you for standing by for Bright Scholar's 2020 first fiscal quarter earnings conference call. At this time, all participants are in listen-only mode. After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded.

I would now like to turn the meeting over to your host for today's conference, Ms. Ruby Yim, Investor Relations Counsel.

Ruby Yim: Thank you, operator. Good morning and good evening. Welcome to Bright Scholar's first fiscal quarter ended November 30, 2019 earnings call.

Joining me today are Jerry He, our Executive Vice Chairman; Derek Feng, our Chief Executive Officer; and Ms. Dora Li, our Chief Financial Officer.

As a reminder, today's conference call is being broadcast live via webcast. In addition, a replay will be available on our website following the call. By now you should have received a copy of our press release that was distributed on January 16, 2020 after market close Eastern Time. If you have not, it is available on our IR section of our website.

Before we get started, let me review the forward-looking statements regarding this conference call. That is, statements related to future, not past, events, often address expected future business and financial performance and financial condition, and often contain words such as "will," "estimate," "project," "predict," "believe," "expect," "anticipate," "intend," "potential," "plan," or "goal".

Bright Scholar may also make written or oral forward-looking statements in other reports, in presentations, in material delivered to shareholders and in press releases.

In addition, Bright Scholar's representatives may make oral forward-looking statements. Forward-looking statements, by their nature, address matters that are, to different degrees, uncertain, such as statements about the Company's goals and strategies; its future business development, financial condition and results of operations; its ability to retain and grow its customer base and network of schools; the growth of, and trends in, the markets for its services in China; the demand for, and market acceptance of, its brand and services; competition in its industry in China; relevant government policies and regulations relating to the corporate structure, business and industry; fluctuations in general economic and business conditions in China.

Further information regarding these and other risks is included in Bright Scholar's filing with the Securities and Exchange Commission. Bright Scholar undertakes no duty to update any forward-looking statement, except as required under applicable law.

During this call, we'll be referring to GAAP and non-GAAP measures, financial measures. We use certain non-GAAP measures as supplemental measures to review and assess our operating performance. These non-GAAP financial measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for net income attributable to Company or other consolidated statement of comprehensive income data prepared in accordance with the U.S. GAAP.

Please note all numbers are in RMB and all comparisons refer to year-over-year comparisons unless otherwise stated.

With that, I'll turn the call over to our Executive Vice Chairman, Jerry He. Jerry?

Jerry He: Thanks, Ruby. Thank you, everyone who's joining our call today to review 2020 first fiscal quarter results. First and foremost, let me wish everyone a Happy New Year with every happiness, good health and continued prosperity in 2020. Now let's get started.

For those who are new to Bright Scholar, we have included in our earnings presentation a brief corporate introduction from Slide 5 to 13, which you can download from our IR website. Again, all numbers are in RMB and all comparisons refer to year-over-year, unless otherwise stated.

I will start today's call before pass to Derek to provide an update on our business operational performance for the quarter, and also share our strategic initiatives for fiscal 2020. Dora will then provide a detailed financial review before we take your questions.

Please turn to Slide 15. We are very pleased with the tremendous progress we continue to make as we transform and scale Bright Scholar to better serve the evolving needs of our students in a fast-changing education industry. The strategic investments we made across our business segments in the past years have given us a strong start to the 2020 fiscal year.

We scaled our business significantly with acquired businesses contributed to over RMB315 million in revenue and RMB46 million in adjusted EBITDA in the first fiscal quarter of 2020.

In addition, we further diversified our revenue streams, as you can refer to Slide 16. Revenue from domestic K-12 schools only accounted for close to 61% of total revenue in the first fiscal quarter of 2020. The impact is transformational as we move into the next phase of our growth journey by taking additional steps to further position Bright Scholar as a global premier education service provider.

We see enormous opportunities in leveraging our global platform to expand our ancillary business, such as language training, college counseling, study tours and camps. We also see the benefits of entering into the career readiness market, offering career counseling services that will help our students post their education overseas. While the initiatives are in their early stages, we believe that the power of international education ecosystem, we will continue to drive our long-term growth.

In the 2020 fiscal year, we remain firmly focused on three fronts. First, continue to build our global network and capitalize on our synergistic business opportunities from our domestic and overseas businesses. Second, continue our organic growth initiatives in accelerating ramp-up to improve utilization, optimizing operational efficiency, and broadening our service offerings. Third, continue to strengthen our leadership in international education by acquisition of strategic assets.

Following a transformative fiscal year 2019, we remain committed to the execution of our strategy and expansion opportunities to drive enhanced value for our students, employees, shareholders and stakeholders.

With this note, I will turn the call to Derek. Derek?

Derek Feng: Thank you, Jerry. Good morning and good evening. We are off to a very strong start in the first fiscal year. Please turn to Slide 17 for our performance highlights and Slide 18 for detailed breakdown by segments.

I am very pleased to report that our overall revenue grew by 69% and operating profit grew by 46.7% year-over-year.

More importantly, the operating margins of our China-based operations, including domestic K-12 schools and complementary education services, continue to expand.

Jump to Slide 27, you can find that the adjusted SG&A of headquarter have declined year-over-year despite of increasing scale and complexity of our businesses. These are the early results from the operational improvement initiatives that we started last year.

Meanwhile, as we expand our business to reduce risk exposure to domestic K-12 related regulations, as well as to enhance competitive advantages, our overall margin profile is also changing in the near term, driven by the different cost structure of the acquired overseas businesses. However, we have a number of initiatives underway, including setting up shared-service centers in the UK to achieve both revenue and cost synergies among all of our business segments that will enhance the overall margin over time.

Continue to Slide 19. Underpinning the performance of our domestic K-12 schools was the strong enrollment growth of 25.2% with the expansion of our school network. Including the newly acquired overseas schools, our global school network increased by 29.4% to 88 schools, with capacity increased by 14.6% to a total of 67,194 students.

Our blended utilization of the quarter was 77%.

Let's continue on to Slide 20. Our efforts to improve the effectiveness of marketing and the student recruitment have yielded very positive results in driving growth in average student enrollment of domestic K-12 schools, with international schools, bilingual schools and kindergartens increased by 18.6%, 12.3% and 23.1% respectively.

Our robust performance reflects our commitment to delivering quality education as shown in Slide 21. As of December 19, 2019, approximately 57.1% of students in the 2020 graduating class of our international schools have received over 310 offers from global top 50 institutions.

As of the release date, our flagship school, Guangdong Country Garden School, received three conditional offers from the University of Oxford, three conditional offers from the University of Cambridge and one unconditional offer from the University of Chicago. We expect more students will receive offers from these elite institutions, and the grades of our students will continue to improve across all age groups.

Continue to Slide 22. The deep collaboration with Country Garden is critical to expand our domestic network with an asset-light model. As of the release date, we have signed 60 contracts, including 5 outside Country Garden contracts, to operate a total of 53 kindergartens, 6 bilingual schools and 1 international school, with a total capacity of approximately 29,800 students.

In addition, we have made significant progress to capture incremental growth opportunities among our businesses. First, we commenced international student recruitment for three independent schools in UK through CATS. Second, we launched basketball and baseball pilot programs in two Bright Scholar schools with early success. These programs are after-school and weekend activities designed for students from both Bright Scholar and local communities.

Finally, our study tours programs have been well received in our own schools. In fiscal first quarter of 2020, we served over 4,000 students with 80% from Bright Scholar K-12 schools. We are expanding our service offerings to better serve more students both from Bright Scholar as well as schools outside our network.

Please turn to Slide 23. Driving integration of newly acquired overseas businesses is another strategic imperative. We are setting up shared service operations in UK that not only could serve our business needs better, but also can significantly reduce cost. We are in Phase 1 with focus on the finance, IT, human resources and legal functions, of which we are on track to complete by the end of this fiscal year. Phase 2 will cover operation and procurement, marketing and admission, as well as risk and compliance, of which we target to complete before the end of fiscal 2021.

In closing, I would like to reiterate that our number one goal remains to be helping students grow. That means continue to invest in teachers and teacher training, to increase complementary service offerings, and to expand global programs that can leverage our global platform and resources. We believe that our focus on academic excellence, in addition to driving an efficient business model, will produce consistent growth in revenue and in earnings for our shareholders.

So at this point, I would like to turn the call over to Dora to discuss our financials. Dora?

Dora Li: Thank you, Derek. Let's turn back to our financials. Please be reminded that all numbers are in RMB, and all comparisons refer to year-over-year comparisons, unless otherwise stated. Please also refer to our earnings press release for detailed information of our comparative financial performance on a year-over-year basis.

Please turn to Slide 25. Revenue for the quarter was RMB1,098 million, up 69%.

Revenue from our domestic K-12 schools, including international schools, bilingual schools and kindergartens, for the quarter, up 21.7% to RMB669.7 million, accounted for 60.9% of total revenue as compared to 84.7% of last year.

Revenue for our international schools, up 25.3% to RMB273.9 million, primarily driven by 18.6% increase in student enrollment, and a 5.1% increase in average tuition and fees during the comparison periods. Revenue contribution from our newly-acquired Sannew school was RMB16.1 million for the quarter.

Revenue for our bilingual schools, up 18.5% to RMB229.8 million, driven by 12.3% increase in student enrollment and a 5.5% increase in average tuition and fees.

For our kindergartens, revenue was up 20.5% to RMB166 million, primarily driven by 23.1% increase in student enrollment. The average tuition and fees was down 2.8% due to the impact from newly-acquired Qiqiaoban kindergarten. Excluding Qiqiaoban impact, the average tuition and fee would have increased by 3.1%. The revenue contribution from Qiqiaoban was RMB7.9 million for the quarter.

You can refer to Slide 19 and 20 for more detail on the enrollment and average tuition fees.

Revenue for our overseas schools, including Bournemouth, St. Michael and Bosworth, and also CATS for the quarter was RMB259.2 million, accounted for 23.6% of total revenue. Overseas schools' average number of students was 3,220.

Revenue from our complementary education services for the quarter, up 69.7% to RMB169.1 million, accounted for 15.5% of total revenue as compared to 15.3%. Revenue contribution from Hangzhou Impression was RMB9.7 million, and DreamBig Career, or DBC, contributed RMB22.4 million for the quarter.

On Slide 26, our cost structure, cost of revenue for the quarter was 56.9% of total revenue, compared to 54.4% in same quarter last fiscal year.

Teaching staff cost, the primary cost contributor accounted for 29.5%, down from 34.4%. And also the average student-teacher ratio for domestic schools for the quarter was 10.9 from 9 in the same quarter last fiscal year.

Continuing to Slide 27, for first fiscal quarter, our adjusted SG&A, as percentage of total revenue, was 18.2% compared to 17.7%. Adjusted SG&A, as percent of revenue for domestic schools, was 11.1%, down from 13.1%. And headquarter expenses was RMB22.4 million compared to RMB29.8 million. As a percent of group revenue, headquarter SG&A expense was down 2.6% from 4.6%.

On Slide 28, to elaborate our adjusted SG&A as a percent of revenue by expense type, the primary increase was due to our marketing efforts to drive our enrollment marketing expenses was 1.1% compared to 0.5%. Also as a percent of revenue, managerial staff cost was down to 9.8% from 10.2%; also, professional fees, down to 1.7% from 2.6%.

Move to Slide 29, our gross profit and margins. Gross profit for the quarter, up 59.7% and gross margin was 43.1%, compared to 45.6%.

For domestic K-12 schools, gross profit, up 23.6% and gross margin, up from 47.8% to 48.5%.

Overseas schools, gross profit was RMB83.4 million with gross margin of 32.2%.

Our complementary education gross profit for the quarter, up 94.4% and gross margin was 38.6%, up from 33.7%.

Our EBITDA, move to Slide 30. Our adjusted EBITDA for the quarter, up 62.1% and adjusted EBITDA margin was 32.1% compared to 33.5% last year.

Adjusted net income for the quarter, up 34.5% to RMB225.4 million. And our adjusted net margin was 20.5% compared to 25.8%.

We are reaffirming our guidance for fiscal year 2020 on Slide 32. For the fiscal year ending August 31, 2020, we expect our total revenue in the range of RMB4 billion to RMB4.1 billion, representing a year-over-year growth of 56% to 60% based on our existing business and without potential acquisitions.

We also expect our average student enrollment to be between approximately 53,200 and 53,600, representing a year-over-year increase of 14% to 15%. We expect to open 7 new kindergartens during fiscal year 2020. We are also in preparation to open 13 new kindergartens and 3 bilingual and international schools in fiscal 2021. Beyond fiscal 2021, we have 4 schools and 33 kindergartens contracted for operation.

Please refer to the tables in Slide 34 and 35 for the condensed income statement.

Slide 36 shows the reconciliation for SG&A, EBITDA and net income on a GAAP to non-GAAP results.

A quick note on our cash and bank balance in Slide 37. As of November 30, 2019, the Company's cash and cash equivalents and restricted cash totaled RMB2,426.6 million or US$345.1 million, as compared to RMB3,265 million as of August 31, 2019. For the first fiscal quarter ended November 30, 2019, the Company’s capital expenditure was approximately

RMB60.9 million, up 90.8% compared to last fiscal year. That's including new kindergarten openings and improvement and ramp-up capex for existing schools.

This concludes my financial updates. Now, I will turn to Derek for his closing remarks.

Derek Feng: Thank you, Dora. Moving forward in fiscal year 2020, we are committed to the ongoing execution of our strategy in the next chapter of our transformation and growth. As we work together to achieve our shared purpose to enrich student learning experience, our team remains focused on pursuing growth opportunities, enhancing operational efficiencies and unlocking values for the benefit of our students, teachers, employees and shareholders.

This concludes our prepared remarks and we'd like to open the call for questions. Operator?

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Elsie Sheng, Morgan Stanley.

Elsie Sheng: My question is about the margin outlook because you also mentioned that the cost structure changed with the acquisition of overseas schools. And on the one hand, the margin of the overseas school is lower than the domestic, but on the other hand, the margin of your domestic schools, and also the complementary education services, is going up year-on-year. So I'd like to know what do management see the margin trend of this fiscal year.

And also you mentioned that you have some initiatives to improve the operation of overseas schools. So do you have any more details about how that will change the margin of overseas schools?

Derek Feng: Okay. So let me take on the question. So because we are just consolidating the overseas business into the portfolio. So therefore, today is a simple mathematic weighted average of margins. As you can find out, the domestic business tends to have high margin, or continue to go up a lot, and the international business, because of the nature of the business model, so the margins are lower. Obviously, because the margin is lower, we also paid a relative lower price, in addition to a mathematical weighted average, which we are seeing today.

And we would -- obviously confident that we can take various operating initiatives that will increase the weighted average over time in comparison to a simple mathematic average. For example, right now as we mentioned, we're building up shared services centers in the UK, which that would serve several acquisitions that we have acquired in UK over the past year. So that would take out some of the costs.

At the same time, we're also doing recruiting shareholders, that we're taking the CATS recruiting capability to recruit international students for the other 3 independent colleges. So in the long run, we're certainly hoping we will do much better than today's mathematical weighted average. Does that answer your question?

Elsie Sheng: Okay, understand. Just a follow-up question on the UK schools. You mentioned that the centers that will cost -- save the cost for light operations. Do you have more details about how much that can help on the margin?

Derek Feng: Oh, yes. So we can't give you the specific numbers, but what I can tell you, if you add up all the finance people, labor cost of all the 7 campuses we have in UK, including the headquarters' finance staff in UK, using that example, as well as the cost with individual systems, that we put them all together in relationship with the shared services, going forward, we would see significant cost reduction.

Elsie Sheng: Okay. I see. Thank you.

Operator: Christine Cho, Goldman Sachs.

Christine Cho: I think as the follow-up to the previous question, it seems like the unallocated corporate expenses dropped quite substantially this quarter. Is it fair to read this as kind of the early results of the operational improvement initiatives that you've discussed in detail? And if so, is it fair to assume that we will continue to see a very similar trend throughout the year?

And then secondly, to the extent of how much you can share, can you just elaborate on the impact of the newly-acquired schools that were newly consolidated to this quarter?

Dora Li: Hi, Christine, this is Dora. Just to answer your first question regarding the so-called unallocated corporate expenses, it's actually the high school expenses we referred to, that's mainly the domestic or China operation headquarter expenses. So remember we have just passed our initiative to lower our SG&A expenses since last quarter, and we have taken initiative to reduce the China operation old headquarter expenses , if you have come over to Foshan, so that's our headquarter, so that's the expense.

And the so-called shared services center, as Derek just mentioned, is truly will be overseas cost reduction initiative we just started after we completed the acquisition, or the closing of UK. So will be some -- we're expecting to see some results from -- after we complete our first phase, and then second phase, setting up of the shared centers. Does that answer your first question?

Christine Cho: Yes, okay, okay, yes. That's clear.

Dora Li: Yes, so the second question, it's also similar or related to the first one. So after we gradually finish our shared service center in UK, we'll first complete our consolidation or improvement in finance, IT, and then legal, human resources. All this corporate function for the overseas operation will be consolidated, and so we are expecting some improvement from the efficiency part after the centers are fully operation.

Christine Cho: Yes, I see. I'm more referring to kind of the sales and OP impact just from the consolidation that was newly done in the first quarter.

Dora Li: First quarter sales initiative.

Derek Feng: Yes, sorry, could you repeat your question again?

Christine Cho: Yes, sorry. The new consolidated schools in the first quarter of 2020, there are 2 schools that are newly consolidated.

Dora Li: Oh, yes, yes, yes, yes. So you are talking about the 2 independent schools, which is Bosworth and St. Michael.

Christine Cho: Yes.

Dora Li: Yes, those 2 schools are consolidated in the first quarter. Yes, you're right.

Christine Cho: Yes. So I was just wondering what's roughly the size of the impact on sales and OP during this quarter from that consolidation.

Dora Li: Actually, the 3 independent schools are doing well on track in terms of impact. I think that the overall margin from the overseas segment, the only impact was from CATS because the third quarter CATS had some impact from student intake during some macro-economic or political reasons. For the other 3 independent schools, they are doing okay.

Christine Cho: Okay. Thank you.

Operator: Again --

Derek Feng: Yes, so thanks for the --

Operator: Again --

Derek Fend: Yes, sorry. The 2 schools are -- generally, these are very small and didn't really add too much to the first quarter. Those 2 schools, add together, is approximately 800 students in total. So therefore, they are not that material from an overall perspective.

Jerry He: To just give you some idea -- this is Jerry -- just to give you some idea of the size of the 2 schools, last year, in terms of revenue, they did about approximately £12 million. So if you add first quarter, those 2 schools are reasonably stable, so you can figure out what approximately the first quarter is.

Christine Cho: Okay. Thank you.

Operator: (Operator Instructions). As there are no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to Derek Feng for any closing remarks.

Derek Feng: Thank you very much for joining the conference call. Please feel free to contact us if you have any further questions. We wish everyone a good day. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.