

[FHS] - First High-School Education Group Co., Ltd.
Q4 and FY2020 Earnings Conference Call
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Executives

Susie Wang, Director of The Blueshirt Group Asia
Lillian Liu, Head of Investor Relations
Shangwei Zhang, Chief Executive Officer
Benjamin Zhu, Chief Financial Officer
Tommy Zhou, Manager of Investor Relations

Analysts

Long Lin, Benchmark
Mona Tu, Jinhai Capital
Jackie Chen, AMPD

Presentation

Operator: Good day, ladies and gentlemen. Thank you for standing by, and welcome to the First High-School Education Group fourth quarter and full year of 2020 earnings conference call. Currently, all participants are in listen-only mode. Later, we will conduct a question-and-answer session, and instructions will follow at that time. As a reminder, we are recording today's call. If you have any objections, you may disconnect at this time.

I now will turn the call over to Susie Wang, Director of The Blueshirt Group Asia. Ms. Susie, please proceed.

Susie Wang: Thank you, operator, and hello, everyone. Welcome to the First High-School Education Group fourth quarter and full year 2020 earnings conference.

Joining us today are Mr. Shaowei Zhang, Chief Executive Officer, and Mr. Lidong Zhu, Chief Financial Officer, and Lillian Liu, Head of Investor Relations and Tommy Zhou, Manager of Investor Relations.

We released the results earlier today. The press release is available on the Company's IR website at ir.diyi.top, as well as from newswire services. A replay of this call will also be available in a few hours on our IR website.

Before we continue, please note that today's discussion will contain forward-looking statements made under the Safe Harbor provisions of the US Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the Company's actual results may be materially different from the expectations expressed today.

Further information regarding these and other risks and uncertainties is included in the Company's public filings with the SEC. The Company does not assume any obligation to update any forward-looking statement, except as required under applicable law.

Also, please note that unless otherwise stated, all figures mentioned during this call are in Chinese Renminbi.

With that, let me now turn the call over to our IR Director, Ms. Lillian Liu. Lillian will initiate the call with the key metrics in this quarter and full year of 2020. Our CEO, Mr. Shangwei Zhang, will then talk about our vision and business strategy in Chinese; Tommy Zhou will translate his remarks in English. After that, our CFO, Mr. Benjamin Zhu, will discuss our operations and financial highlights both in Chinese and English. Go ahead Ms. Lillian Liu.

Lillian Liu: (Speaking foreign language).

(Translated). Hello, everyone. Good to seeing you. We got off to a great start as a newly public company. We delivered strong financial results with impressive operational and financial growth: Q4 revenues of RMB163.6 million, up 36.2% year-over-year, Q4 net income of RMB47million, up 94.6% year-over-year, full year revenues of RMB445.8 million, up 32.5% year-over-year, full year net income of RMB80.9 million, up 155.3% year-over-year, full year student enrollments of 25,867, up 21.8% year-over-year. These strong financial results are a testament to our vision, solid growth strategy and excellent execution capabilities.

Now let me turn the call over to our CEO, Mr. Shangwei Zhang. Mr. Zhang will talk about our vision and business strategy in Chinese, and Tommy will translate his comments in English. Go ahead, Mr. Zhang.

Shangwei Zhang: (Speaking foreign language).

(Translated). Hello, everyone. Thank you for joining our earnings conference call today. We are thrilled to host our first call as a public-traded company, and excited to report our outstanding business results in Q4 and full year 2020.

Clearly, the successful closing of IPO and concurrent private placement was a key milestone and significant accomplishment for us. We raised capital for growth and also significantly raised our visibility. Being a public company will further strengthen our brand recognition and enable us to collaborate with more third parties to further scale up our business.

Our mission is to become a leader and an innovator of private high school education in China. With our highly scalable asset-light business model and superior education quality, we believe we are well-positioned to capture the enormous and sustainable demand for high-quality private high school education in China.

We are the fastest-growing private high school in China, according to CIC report. In last 4 years, since year 2015, we have near 41% CAGR for number of high schools and 77% CAGR for high school students' enrollment. Our superior education quality was proven by exceptional admission rate to the university and tier-1 university. Especially for tier-1 university, our admission rate is 29%, which is more than double of average admission rate in western China. We believe the

standardized and centralized management system will enable us to have consistent high-quality education and faster expansion.

As of December 31, 2020, we had developed a network of 19 schools and enrolled nearly 26,000 students in China. We will leverage our asset-light business model, highly scalable education system and superior education quality to accelerate our growth. In 2021 we are planning to open 7 new high schools, and 10 to 15 new Gaokao tutorial schools.

Our management team are all from education background, seasoned and passionate. We are committed to attract more highly qualified teachers, provide ongoing training, drive standardization and consistency in education management system across our schools.

Furthermore, we will also deepen our existing collaboration with well-known education and research institutions to further explore innovative teaching methods. We believe our optimized business model and outstanding execution capability will enable us to accelerate growth and expansion.

Now let me turn the call over to our CFO Ben, who will provide details on our business and financial performance.

Benjamin Zhu: (Speaking foreign language). Thank you, Mr. Zhang, and thank you, everyone, for joining our call today. As Mr. Zhang mentioned, we successfully completed our NYSE IPO, raising approximately \$79.5 million from IPO under the concurrent private placement. Our solid cash position gives us extra strength and flexibility to expand our school network and invest the money into our education service fields.

(Speaking foreign language). We are also very pleased with our strong accomplishment to Q4 2020, because we achieved good growth momentum across private high schools and Gaokao [repeater] tutoring schools business.

Our student enrollments grew 22% year-on-year business, while our total revenues grew by over 36% to RMB164 million. And our net income for the fourth quarter of 2020 grew by 94.6%, reaching RMB47 million. The better bottom line was due to the strong revenue growth, effective cost management, as well as better synergies between our [inter]-school system.

(Speaking foreign language). Now I will go through our financial highlights for the fourth quarter and full year of 2020. Before I go into details, please note that, unless stated otherwise, all numbers are presented in RMB. All percentage changes are based on a year-on-year basis. A detailed analysis is contained in our earnings press release, which is available on our IR website.

(Speaking foreign language). For the fourth quarter of 2020, our revenue increased by over 36% to RMB164 million. This increase was primarily driven by the increases both in our student enrollment and the tuition fee levels. In 2020, we opened up 5 new private high schools, which all opened in September last year. And our Q4 results reflected economic interest from these newly-opened schools.

As of (inaudible) 2020, our student enrollment, which is at 26,000, increased by 22% year-on-year basis, comparing with over 21,000. Because of our higher admission rate to university and

tier-1 university, we are expecting to attract more students enrolled with our school network, and lastly, increase our utilization rate for our 19 existing schools.

We will continue to assess the opportunities to keep premium pricing, to increase tuition fee level. Meanwhile, we continue to retain and attract more highly-qualified, superior teachers. We already developed highly standardized education platform, teaching training system and solid partnership mechanism to accelerate our business expansion into different regions

(Speaking foreign language). For the fourth quarter of 2020, our cost of revenue reached at RMB96 million, increased by 27% year-on-year. Such increase was in line with our revenue growth. This increase was primarily due to the increased staff costs and other expenses because of the greater student enrollment under the opening of our new schools.

(Speaking foreign language). For the fourth quarter of 2020, our gross profit amounted to over RMB67 million, increased by 52% year-on-year basis. Our gross margin increased to over 41%, which is higher 4.3 percentage than the last year same time. The increased gross margin was primarily driven by our higher utilization rate for existing schools and [straight-line] operating efficiency.

(Speaking foreign language). Moving to our operating expenses, our net operating expenses were RMB6.8 million, decreased by over 58% from last Q4. It was mainly driven by the reduction in general and administration expense and the increase in government grants.

(Speaking foreign language). General and administrative expense was RMB11.1million, compared with RMB19.4 million of our last Q4. Such reduction is mainly due to high bases of one-time building maintenance fee and discretionary bonus expense incurred in last Q4.

(Speaking foreign language). Sales and marketing expenses is RMB1.5 million, increased by 55% year-on-year business. Such increase resulted from promotion and advertising expenses of 2021 new school open-ups.

(Speaking foreign language). Government grants is RMB5.8 million, increased by over 41% compared with RMB4.1 million over the same time of 2019. This increase is in line with the increase in student enrollments under new schools opening up.

(Speaking foreign language). For the fourth quarter of 2020, our net income reached at RMB47 million, increased by over 94% comparing with over RMB24 million of the last same time. We continued to enhance our profitability by optimizing our pricing strategies and improving our school utilization rates, [leveraging] our centrally management system. As mentioned earlier, we will periodically assess and increase our pricing to maintain the high quality of our education resources.

(Speaking foreign language). Now let me quickly brief to you our full year financial highlights. For the full year of 2020, our total revenues reaching at RMB446 million, up 32.5% from RMB336 million for fiscal year 2019. This increase is mainly driven by the greater student enrollment and the liquid tuition fee level.

(Speaking foreign language). For fiscal year 2020, our gross profit reached at RMB 159 million, increased by 52%, and the gross profit margin is at 36%, increased by 5 percentage points comparing with the (inaudible) of 2019. The higher margin is primarily driven by our ability to increase our revenue side into our operation efficiency and further improve our school network utilization rates.

(Speaking foreign language). For the financial year 2020, our net operating expenses recorded at RMB59 million, decreased by over 10% year-on-year basis. Despite the increase in the expenditure of marketing, branding and other outside professional services, we were able to offset such expenses and realize a reduction by obtaining the higher government grants.

(Speaking foreign language). The growth in gross profit and the reduction of net operating expense have generated outstanding financial performance. Our net income for 2020 reached at RMB81 million, increased by 155% comparing with RMB32 million of 2019.

(Speaking foreign language). As of December 31, 2020, our cash balance is RMB210 million, compared with RMB153 million as of the end of 2019.

(Speaking foreign language). Now, let me talk about fiscal year 2021 revenue guidance. In 2021, we continue to open up our new school networks. We plan to open up 7 private high schools, and open up at least 10 Gaokao repeater tutoring schools. Secondly, we will [raise] utilization rates of our existing 19 school networks. Thirdly, we continue to expand our delivery of our management services to third-party schools to increase our revenue stream from such management services.

Fourthly, we will continue to perform strategic acquisition on single private high school and Gaokao repeater tutoring schools. Fifthly, at the same time, we continue to streamline our centralized management system in-house our standardized education quality system to continuously boost our operation efficiency (inaudible), we expect our total consolidated revenue side to be between RMB770 million to RMB820 million, representing an increase of 73% to 84% on a year-on-year basis.

(Speaking foreign language). For the first quarter of this year, the consolidation revenue side is expected to exceed RMB110 million, representing an increase of 27% year-on-year basis.

I should emphasize that due to our statistic error, as mentioned in our earnings release, we (inaudible) for our first quarter of this year, an increase rate is 22 was not correct. Thank you.

(Speaking foreign language). Now concludes my prepared remarks. Let's now open the call for questions. Operator, please go ahead.

Question-and-Answer Session

Operator: Yes, thank you. We will now begin the question-and-answer session. (Operator Instructions). The first question comes from Long Lin with Benchmark.

Long Lin: Congratulation on solid results. So my first question is about your revenue guidance for 2021, which shows a very strong acceleration from 2022 (sic). Can management talk about more detail about the key drivers behind this acceleration? And specifically, what percentage of growth is coming from like new school expansion and what percentage from improving utilization of existing schools? And what percentage of growth is coming from some other new initiatives, such as management fees as well as M&A? That's my first question.

My second question is about the company's margin outlook in 2021. So management talk about the accelerated capacity expansion that you're planning to open like 7 high schools and 10 tutor schools in 2021. Just wondering how will this capacity expansion will impact the company's margins in 2021. And also just can management share more color about the margin profile for different school category segments, like between the high schools and tutorial schools? Since you're going to open more tutorial schools in 2021, how will this opening more tutor schools will impact the -- will actually change the overall margin profile for the 2021?

I also have a question. My last question is a housekeeping item. So can management share about the utilization rates of the existing school by the end of 2020 and including for each category of the school, like high schools, tutorial schools and middle schools, as well as the [brand] utilization?

Tommy Zhou: (Speaking foreign language).

Lillian Liu: Tommy actually just cut off. I will first translate the question to CEO. (Speaking foreign language).

Tommy Zhou: (Speaking foreign language).

Shangwei Zhang: (Speaking foreign language).

(Translated). Okay. So regarding the [third] question, the Chairman said in 2020, they have 6 schools opened, and the utilization rate is very low. To give an example, the school in [Chaobao] District has a capacity of 3,000 students, while the first year recruitment was about 150 students, which is about 2%. And in 2021, it's expected to be around 30%, so marginal increase very visible. And by the end of 2020, the Gaokao repeater schools had the utilization rate of 57%, and high schools, around 29.7%. So in 2021, since the [technical difficulty] increased significantly compared to first year openings of these schools.

Long Lin: So I just have a question. So just to follow-up on the utilization, what's the brand utilization in 2020? And for 2021, if you're going to open more schools, what's the trend for the blended utilization rate?

Benjamin Zhu: (Speaking foreign language). I can speak in English. For the question about our utilization rate, currently, our (inaudible) school utilization rate is 55%. Typically, for the newly set-up private high school, the utilization rate for the first year is 25%; for the second school year, this utilization rate can be reached at 60%. And the third fiscal -- third school year, the utilization rate can be reach at 90%. So that is the typical private high school utilization rate to be 100% need 3 to 4 years.

For the Gaokao repeater tutoring schools, yearly we set up this competitive (inaudible) from 600 to 1,000 capacity. That means that for the first school year, this utilization rate (inaudible) at over 30%; the second year, we can achieve it -- it can be reached at 70% [about]. For this year, we will open at least 10 Gaokao repeater tutoring schools. What we set up is these schools are we calculate, consider, the student enrollment capacity. So we estimated for this newly setup Gaokao repeater schools, in the next 2 years, these Gaokao repeater schools, we can actually -- can be reached at 80%.

(Speaking foreign language). I answer the first questions about the driving factors. I mentioned now -- I stated that for this first quarter, we complete a revenue of RMB107 million. But as per our budget for this first quarter, this amount is RMB110 million. So we think we already complete the first quarter budget [package]. (Inaudible) in China, the first quarter [yearly] students have 2 months of winter holidays. That means we only have the 1 month, 1.5 month, teaching services. So accordingly, the first quarter recorded revenue is less than other seasons.

Actually, as per our budget for this second quarter, our consolidated revenue is RMB178 million. (Inaudible) in China, for the first half of year, due to interest of students enrollment and the tuition fee level, because this factor is already (inaudible) in last September. So that means all -- for our first half of year revenue, I think is no [shift], I mean [exception no shift].

(Speaking foreign language). For the third quarter of this year, we forecast our consolidated revenue will reach at RMB160 million, but this venue is a driver of either four factors. The first factor is our existing private high schools. According to our budget and our business plan, for the existing private high school, this revenue increased by 35%. I think this increase rate is in line with our history, financial (inaudible).

The second driving factor is our existing Gaokao repeater tutoring school business because in last year-end, our average utilization rate is 55%. So for the existing Gaokao repeater tutoring schools in this year, we will increase our student enrollment to improve our utilization rate. We think this interest of Gaokao repeater business, the revenue increases -- an increase -- will increase about at least 100% because one side, we will enroll more students to reduce our utilization rate.

Another side for our existing high schools and Gaokao schools, we will increase our tuition fee level. For the Gaokao business for every year, we continue to adjust our tuition fee levels. For the private high schools for every year, we will adjust our tuition fee levels. So is the second driving factor.

The third driving factor, as mentioned, we will open up 7 private high schools, and we'll open the class in September. The third -- the fourth driving factor is our newly opened up at least 10 Gaokao schools. Typically, the newly setup Gaokao schools will start their business from the [July] middle. That means also for the third quarter, we have for the private high school students (inaudible) 2 months summer holidays.

But for our Gaokao schools yearly still (inaudible) any holiday, so that means that also we have the 2 months summer holidays. But for this third quarter, we are -- our consolidated revenue still repeat the strong growth.

(Speaking foreign language). For this year in Q4, this consolidated revenue [will] double than the Q2 because just for the fourth quarter of this year, the students have no added holidays. We just - full time of 3 months study in school. That means that for the Q4 revenue increase, keep the stronger. As for our budget for this quarter 4, this consolidated revenue is amounting to RMB370 million. So we combine the fall season (inaudible) our consolidated revenue.

(Speaking foreign language). This is all my replies to the investors, the first question. Thank you.

Long Lin: That's very helpful, that's very helpful. Thank you.

Operator: [Mona Tu of Jinhai Capital].

Mona Tu: (Speaking foreign language). Given our strong [FY] and Q1 guidance, can management share some color of our new schools to be open and being open? So regarding to the connotation of the first potential students and also the enrollment [technical difficulty].

Tommy Zhou: (Speaking foreign language). Okay. Our Chairman to reply to your questions. Go ahead, Chairman.

Shangwei Zhang: (Speaking foreign language).

Benjamin Zhu: (Speaking foreign language).

Tommy Zhou: Okay. So the Chairman said in the first quarter of 2021, there has been 2 contracts signed already for the high school at (Speaking foreign language). And the CFO also supplemented that another one has already signed a contract at Sichuan, and that was exclusive of the 70 openings this year. Of the 70 openings, they have -- sorry -- that was including the 7 openings. Those are 5 more, 4 at Yunnan Province, and one more in Sichuan Province, which is expecting to have the contract signed in about a month's time.

And then for [technical difficulty] already started recruitment for new students, and there are several at various provinces, such as Sichuan, (Speaking foreign language) are very close to closing and recruitment.

And for our first-tier university admission rate, it varies, depends on city tiers. So for first-tier cities and also ahead of a province, usually, the rate is expected to be at 60% or higher. For second-tier cities, such as for of the tier-one, the university admission rate is expected to be 40% or higher. And for third-tier cities or lower, it really depends on the local area. For example, in

some areas of Yunnan, university admission rate is only 20%. So first-tier university rate is really difficult to calculate.

And the school, in addition to the 70 openings, it's looking for new methods in collaboration, such as management of real estate companies build schools along these, and also our partnership opportunities.

Mona Tu: (Speaking foreign language).

Shangwei Zhang: (Speaking foreign language).

(Translated). Answer to your questions about our -- the (inaudible) in the contract liability, I think the reason having summarized the two, one reason I think there's contract liability include the government purchase education services. Normally, the government [approves] it, the money, and we will [monetize] this payment into our school years, depending our teaching time. So this monetization, this is -- just depends on the students' enrollment.

For last year, our student enrollment is big, and the (inaudible) our student enrollment is smaller. So I think this student enrollment basis [equates]. So that means our monetization speed become to us, I think that's the reason why.

The second reason I think just (inaudible) began also last year, we encountered the COVID-19 pandemic, so for the last first quarter, we believe our class delayed our teachings. That means in last July and August, we keep -- we recap the students in schools to supplement their teachings in the class. So that's -- I think this is the second reason to explain the decrease in contract leverages. Thank you.

Mona Tu: Very helpful, thanks.

Operator: (Operator Instructions). Jackie Chen with AMPD.

Jackie Chen: (Speaking foreign language). I'll translate this myself. Just wanted to ask a question about the regulation environment of school in China at the moment. What are your thoughts on the overall regulation on either the private high school regulation, regulatory requirements, or the latest regulation on the tutorial high schools.

Shangwei Zhang: (Speaking foreign language).

(Translated). Okay. So regarding to the current regulation, the (inaudible) believes that there are several trends. First of all, currently, that the regulation is promoting to expand normal high school, and also have high-quality high school education as their primary goal.

For outside schools, such as after-school training and tutoring, regulation will be much more strict compared to before, which also includes limiting their operating hours, especially for K-9 or the mandatory education levels, pretty much no new license will be distributed and issued anymore.

And for kindergartens, the guiding principle is to be affordable, rather than commercial. So the current regulation trend is to support the regulated growth, but does not expect the high schools' expansion as long as they concentrate on quality.

And another factor we believe is overall, this will benefit high school, private high school. Mainly as mentioned earlier, currently the rate is about 50% as normal high school versus trade school. This rate may increase to 85% in the future, which means that high school education will become more popular, which is beneficial to us. And with the outside school tutoring programs becoming more strict, it does not affect our high school operation as of now. (Speaking foreign language).

Shangwei Zhang: (Speaking foreign language).

(Translated). Okay. Another two regulatory guidance investors could look for is so [101100 and 101113] regulation, which has guiding principles on 4 areas, which is they are open to third-party transactions as long as they are equal in share. And then equal treatment to private and public schools, a tax benefit for educational corporations, and also specific guidance to specific business criteria regarding each of the school's operational strategies and sectors. And that's his -- Chairman's answer to all these questions.

Jackie Chen: (Speaking foreign language).

Operator: Thank you. And as there are no more questions, I would like to return the floor to management for any closing comments. Since there are no closing comments, that does conclude today's conference call. Thank you so much for attending today's presentation. The conference has now concluded. You may now disconnect your lines.

Unidentified Company Representative: Thank you.