

**First High-School Education Group Co., Ltd. [FHS]
Q1 2022 Earnings Conference Call
Wednesday, May 18, 2022, 8:00 A.M. Eastern Time**

Executives:

Tommy Zhou, Chief Financial Officer

Presentation

Operator: Good day, ladies and gentlemen. Thank you for standing by, and welcome to the First High-School Education Group First Quarter 2022 Earnings Conference Call. (Operator Instructions). 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.

Now I will turn the conference over to Mr. Tommy Zhou, Chief Financial Officer of the company. Mr. Zhou, please go ahead.

Tommy Zhou: Thank you, operator, and greetings, investors and friends. Again, welcome to the First High-School Education Group first quarter 2022 earning conference call. I am Tommy Zhou, the Chief Financial Officer who will lead today's conference call.

We released our results yesterday prior to market open, and the full press release is available on the Company's IR website at <https://ir.diyi.top>, as well as 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 U.S. 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 statements, except as required under applicable law.

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

With that, thank you all again for joining us. I will briefly spend the next 30 minutes to update our first quarter 2022 results. So May 2022 had been a busy month for the Company. Not only have we finished our 2021 annual filing, we also completed our 2022 first quarter results

consolidation. Historically, we did not report quarterly. As international listed company in the United States, we're only obligated to do an annual report and half-year report. But from now on, the company will report quarterly to provide for everyone a better insight into our operation.

The entire team in the company worked tirelessly because we want to show all investors and friends, that despite unexpected regulatory changes, the Company and its team have adapted, and is now on-trend to produce great results for this year and the future years.

For 2022 first quarter, the company achieved revenues of RMB89.3 million, a 14.2% increase compared to last year of the same period. More exciting is that we did achieve net income of RMB19.5 million, which is 264% increase compared to last year of the same period.

And allow me to explain the positive trend that we are setting forward into 3 different key items: Item #1: We achieved marginally increased net income results, mainly due to our ability to adapt in a changing environment. Prior to a series of regulatory changes introduced in 2021, I believe all education companies, large and small, had mainly one strategy, which is to expand and to expand fast. Initially, for the first half of 2021, that was mainly the case for us also. We too wanted to expand, and wanted to have more schools open before each year's September season, before school starts.

But I think for us, a bit quicker than most, when the regulatory changes did publish throughout the year, actually, several times. But mainly around July-August of last year, we did not hesitate in any disbelief; we simply adopted to the changing regulatory environment. Especially since last year third quarter, we assertively shifted our strategy from a purely outward focused to more inward focused.

We wanted to make sure that before we go out to expand into new territory, we have a solid foundation first, that all of our existing schools will be operating in near perfect conditions before we expand into new areas. So I think that our ability to adapt is a key to thriving in a changing environment, and visibly from this quarter's result, we were able to set that trend. Moving forward, we again think regulatory environment is constantly changing. No one knows what will be released, but the ability to adapt is extremely important going forward.

Item #2: Our revenue increased notably 14% compared to last year of the same quarter, which is always a healthy indicator of a growing business. But it was actually our improvements in operating efficiencies, especially cost saving measures, that contributed mostly to the significant increase, 264% in net income. We want to make sure that every dollar we have is well spent. So since last year third quarter, we did a rigorous redesign of the budget system and our compensation system as well, all for the reason to better allocate resources and to better align spending and results.

For our budget system, we've updated it entirely. We still use the same accounting system, but we implement each module much better. Now we can forecast our cash flow a month to 2 months prior to the actual expenditure. This is done by both analyzing historical data and also reporting from the department or school who wish to use the cash. By actually knowing the forecast, the cash flow, ahead of time, this allows us not only to have a better cash management, but also to foresee if those costs are actually necessary. Nowadays, almost any spending is at

least 1 month seen ahead, so we have plenty of time to make sure it is absolutely necessary, and nothing goes to waste.

Moreover, we also increased horizontal comparison between each school, and set metrics to determine anomalies. For example, we now have a target team to identify the school which might be running below average efficiency and tailor solutions specifically for them. If we have normally a school with the teacher ratio between 1 to 15, and we have schools that are, say, 1 to 10 or 1 to 9 teachers ratio, we have to tailor solutions for that school, either to reduced headcount or increase some interim student recruitment.

Again, the metrics we set, it's a wide range between utility cost to teachers' compensation to staffing cost to ratios. So we want to do more horizontal comparisons to make sure all schools are running at equal or greater efficiencies. And similarly, to staff compensation, we now included a larger portion of performance-based pay, to precisely align data-backed results with the compensation we pay out. Teachers are paid accordingly to the hours that they give out lectures, the questions that they laid out for the students, rather than a more uniform pay.

So the above improvements in efficiencies were visible in both our annual report and quarterly reports. If we just take a look at some examples, if we look at our 2021 half-year results, the cost of revenue was RMB170 million, and then the entire year was RMB251 million, which means we spent 70% of our cost of revenues during the first half of the year, only 30% during the second half. Usually, if you do your accrual accounting, it should be a 50/50 split. But for us, we actually spent 70% of it during the first half of the year of 2021, only 30% of it in the latter half, just to show how rigorous we did to save money.

And the results were even more apparent in our general and administrative expense. For half a year, it was RMB60 million. For the entire year, it was RMB74 million. So in the second half, we spent about 1/5 of what we did spend in the first half of the year. Again, all these trends are showing that we tried to save a lot of money during last year's second half. And that continued into this quarter as well.

For the first quarter of 2022, despite we increased our revenue by 14%, our number of students increased roughly 3%, the number of schools increased, and we have much more self-operated schools in 2022, but our cost of revenue actually stayed the same. So we have all these factors that increased, but our costs did not increase. Therefore, that was able to increase our profitability quite significantly.

Again, I just want to stress for the point that for the second half of 2021 and continuing into 2022, we were able to drastically improve on our cost efficiencies. We also believe that these improvements will continue to happen throughout 2022; it's not a one-time. And all the budget, metrics, and the compensation redesign I spoke about, will be even better as we have more tools to implement these.

Another note for the fiscal year 2021 annual report, it is important to update that our audited financial results were actually improved compared to our previously-announced unaudited results. Our audited net income was RMB52.7 million, which is about 32% higher than the previously-announced unaudited net income of RMB39.9 million. This was caused mainly

because our auditor was able to correct some cost of revenue-related offsets in the working papers for the improved results. The company and the accounting teams were actually more conservative in some of the offsets.

Lastly, I think Item 3: You cannot win the battle by just saving money. But you have to go on the attack, you have to increase revenue. So in addition to the ability to adapt faster than most companies in a changing environment, as well as perfected operating know-how, I think, we did and we will introduce new business and further drive growth.

So the third point I want to say is that this year, this upcoming September in 2022, we will have 2 complete new school openings. And on top of that, we have increased number of liberal education classes such as fine art, media studies, dance and music majors, as well as vocational classes. Currently, we have a pretty accurate estimate that about 850 students are expected to enroll into these newly-established programs and majors this upcoming September. It will provide us with new factor of growth. Some of the tuition and related recruitments are already, I can't say signed, but it's already pretty much confirmed. So we're very happy about that.

Also, a bit of detail on the 2 new schools. I do not want to say specific names and locations yet, since some authorizations are still in process. But I can say that 1 campus is completed finished, from the building to the renovation, to all the equipments; they're completely new. And actually, a small number of students is already in the school since last year September before it was managed by us. So the school is completely ready to go, and is located in one of China's four municipality cities, so one of the four biggest cities in Chia. We are very excited for the new growth into that market and the student body we can serve there.

The second new school is much closer to our headquarter; it is still under construction. We expect all preparation to be done before June 30th. And we are working very closely with local partners and authorities to have a successful recruiting year.

In addition to the self-operated school, we also signed with a central China-based private school in May, to provide our management service. School management service is very similar to hotel management service, where the owners owns the property and hires a majority of the staff. And then we, as the management service provider, we send key top management employees to set the standards of operation, the standard for education. The current owner and us spoke a lot, and he deeply trusts us and believes in our ability to operate schools. And we mutually are dedicated to provide our best know-how to make sure the school is running in the best shape possible.

The good news is that majority of the management fees have already been paid to us. So this is a very asset-light business. We send about 8 employees, generating several millions RMB of income. And we are very happy for this opportunity as it also furthers expand our strong brand name and reputation.

As a combination of what happened already, and what will happen as recruiting season is about to begin, I think the Company is extremely excited on the positive trend forward. Again, I just want to stress that we are delighted for the convincing growth of our net income compared to last year's same quarter.

And next, maybe 10 to 15 minutes, I will go through our line by line financial highlights for the first quarter of 2022. Again, please note that all numbers presented are in RMB, unless otherwise stated. All percentages changes are on a year-over-year basis, unless otherwise specified. A detailed analysis is contained in our earnings release, which is, like I said, available on the IR website.

Total revenues was RMB89.3 million, an increase of 14.2% from RM78.2 million in the first quarter of 2021. The increase was primarily driven by greater student enrollment due to the increased number of students enrolled in our schools.

Revenues from customers were RMB76.9 million, an increase of 13.3% from RMB67.8 million in the first quarter of 2021. The increase was primarily driven by greater student enrollments.

Revenue from government cooperative agreements was RMB12.5 million, an increase of 20.1% from RMB10.4 million in the first quarter last year, primarily due to increased number of publicly-sponsored students we served.

Cost of revenues was RMB57.3 million, a decrease of 3.3% from RMB59.3 million in the first quarter of 2021. The decrease was primarily due to the improved control of campus-related costs, and more efficient compensation structure for teachers and staffs.

Gross profit was RMB32.1 million, an increase of 69% from RMB19 million in the first quarter of 2021.

Gross margin was 35.9%, compared with 24.2% in the first quarter of 2021. The increased gross margin was primarily due to the improved cost measures, resulted from improved school operating efficiencies, such as reduced repair, tighter utility usage, stricter budget control, and also, our revised compensation structure for teachers and supporting staff, for an overall more efficient system tying pay to performances.

Net operating expenses were RMB9.7 million, an increase of 21.5% from RMB8 million in the first quarter of 2021. To break them down, selling and marketing expenses was about RMB0.1 million, a decrease of 60% from RMB0.3 million in the first quarter of 2021, mainly because most of the marketing had not happened yet for the first quarter. It usually happens between the second quarter to the third quarter.

General and administrative expenses were RMB9.9 million, an increase of 12.9% from RMB8.7 million in the first quarter of 2021. The increase was primarily due to the increased professional service costs related to complying with our reporting obligations under security law after we become a public company since March last year.

Government grants was RMB0.3 million, a decrease of 72% from RMB1.1 million, majority because the government grants were paid to the discontinued operations of middle schools.

I just want to add that net operating expense were relatively small. The net total operating expenses were only RMB9.7 million versus the cost of revenue, nearly RMB60 million. So, despite the small increase, the majority decreased in cost of revenue contributed to the higher profit margin.

Income from operations was RMB22.4 million, an increase of 103.4% from RMB11 million in the first quarter of 2021.

Net income from continuing operations was RMB21.1 million, an increase of 125% from RMB9.4 million in the first quarter of 2021.

Net loss from discontinued operations was RMB1.5 million compared with a net loss of RMB4 million in the first quarter of 2021.

And our net income is RMB19.6 million, an increase of 264% from the RMB5.4 million in the first quarter. As most investors and friends know, that last year, half a year, we only did about RMB11 million adjusted net income. So I think having the trend that we set forward today is definitely a very positive trend.

And again, adjusted net income is the same as net income. It was RMB19.6 million, an increase of 264% from the RMB5.4 million in the first quarter of 2021. There was no adjustments.

For business outlook for the fiscal year 2022 is the same as we did for our annual report. The Company expects total revenues of operation, of continuing operation, to be between RMB480 million to RMB520 million, representing an increase of 15% to 24% on a year-over-year basis. This outlook reflects the Company's current and preliminary views on the market and operational conditions. And the outlook ranges for the fiscal 2022 reflects a number of assumptions that are subject to change based on uncertainties.

Above is my financial highlight briefing. Both Mr. Zhang and myself wish to thank everyone for your time in participating. We do plan to host another small group Chinese conference call sometimes in the next 2 days. So feel free to reach me and we can organize. In the Chinese call, our CEO Mr. Zhang will communicate directly in Chinese to help everyone explain anything that they wish to inquire. We understood that English is not the first language for most of our investors, and we wish to host the Chinese call as well.

So with that being said, let's open the call for questions. Operator, please go ahead.

Question-and-Answer Session

Operator: We will now begin the question-and-answer session. (Operator Instructions). Seeing as there are no questions, this concludes our question-and-answer session.

I would like to turn the conference back over to Mr. Tommy Zhou for any closing remarks.

Tommy Zhou: Yes, thank you, Operator. Again, we thank everyone for participating today, and everyone for your support. We appreciate everyone's interest in our company, and greatly look forward to reporting to everyone again next quarter on our progress. Thank you, operator.

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