

**First High-School Education Group Co., Ltd. [FHS]
First Half 2022 Earnings Conference Call
September 8, 2022, 8:00 AM. Eastern Time**

Executives:

Tommy Zhou, Chief Financial Officer

Analysts

Zu Chou, Private Investor

Presentation

Operator: Good day, ladies and gentlemen. Thank you for standing by, and welcome to the First High-School Education Group First Half 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 call over to Mr. Tommy Zhou, Chief Financial Officer of the company. Mr. Zhou, please proceed.

Tommy Zhou: Thank you, operator, and greetings to all investors and friends of the Company. Welcome to the First High-School Education Group first half 2022 earnings conference call. I'm Tommy, Chief Financial Officer, who will lead today's conference call.

We released results earlier today prior to market open. 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 mentioned earlier.

Before we continue, please note that today's discussion will contain forward-looking statements made under the Safe Harbor provisions of 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 for again joining us. I will briefly spend the next 30 to 40 minutes updating on our first half 2022 results. For today's earning release, all of our financial data will

be dated to June 30 of 2022. And because we are in September, which means the new school year has already started, thus, operating data such as number of enrollments and the number of schools will be dated as of September 8 today for more precise and present understanding of our business.

The second quarter of 2022 continues the positive trend we have already set forth. In the first half of 2022, the Company's revenue from continuing operations increased by 20.9% to 211.4 million. Net income increased to 42.7 million, and adjusted net income increased by 282.1% to 42.7 million as well. All the data expressed are compared to the same period of 2021. The increase in revenue was a result of two factors: for one, greater student enrollment completed in September 2021, which was last year; and two, expanded offering of education and student-related services, such as liberal education courses, sale of education materials, and meal catering services.

So in addition to the confidence of our last year's recruitment, we are also very confident, and we believe our revenue will continue to increase with the recently completed student enrollment for the new class of 2022 at an increased class size. For our continuing operations, which is only high school, not including middle schools, we were able to admit 7,963 students for the class of 2022, compared with 7,268 for last year's class of 2021. This reflected a 9.6% increase in student enrollment. Among the admitted students, the number of self-funded students increased by 1,008, reflecting our great education quality and strong brand recognition.

The increase in student enrollment of about 9.6% will lead to an even higher percentage of growth in revenue because of the multiplier effect in having an expanded offering of education and student-related services I mentioned earlier. So, we actually really look forward to providing excellent services to all the students in the class of 2022, all the previous students that we admitted in previous years and concurrently, we believe this good service that we provide will achieve a very positive operating result in the upcoming quarters and years, as any responsible business should.

For the noticeable increase in net income and profitability, was a result of the Company's perennial drive for increasing operating efficiency. The many measures we have put in place such as, one, building a stricter and more scientific budget system; two, increasing horizontal comparison between business units; and three, tying compensation to performances, are yielding positive results now, and will continue to do so in the future.

I mentioned previously in the first quarter, all these tools and metrics are already in place. And during last time, the first quarter earning call, I've also said, we want to make sure that every dollar is well spent. We are continuing this great commitment to this day. One thing to note on that, the redesign of our budget system particularly is actually yielding very positive results. Not only did it save cost, able to forecast cash flow; it also provided revenue for us.

For example, due to the more precise forecast on cash flow, we are able to communicate with banks on when and how much capital is needed and deposited at any given time. We achieved a 2.6% checking account interest rate, which is quite remarkable, given that we're not a huge conglomerate or a state-owned company. The checking account is 100% liquid, you can use the cash anytime. It is given to us by actually two of the largest banks in China. Previously, the same

type of account only had an interest rate of 0.5%. So just by having the cash in these accounts, we're actually able to generate a healthy amount of profits.

Another noticeable reflection of cost control is obviously, the decrease in general and administrative expense. For the first half of 2022, we saw a decrease of 36.6% or 20.6 million RMB in G&A expense. This again was due to improved cost control provided by the updated budget system, and also the elimination of many non-recurring expenses in relation to the Company's initial public offering of March last year. So the net income achieved during the first half of 2022 was 42.7 million RMB, which is in line with our annual target. The Company will continue to work hard in the second half of the year, and I personally look forward to continuing the metrics and tools that we've put in place.

Next, I want to highlight a few changes on the balance sheet, on the cash flow, and also with some closing remarks on new school opened. So in addition to our income statement, the balance sheet is a continuation of that. The only thing I think people will look into, and I want to highlight, is the banking, the loans and borrowings under financial agreements. So as of last year, June 30, 2021, our short-and-long-term loans were combined at 179 million RMB. As of June, 2022, our combined loan amount is 143 million RMB. All the figures are disclosed in the earning release. You can add it yourself.

So I want to express a few things. First of all, all the loans we have are credit-based. We did not pledge any assets of any kind, which means the bank have confidence in our business and our credibility, which is actually kind of rare in China, because most of the bank loans are actually asset-pledged. Second, our loans used to be almost completely issued by financial leasing companies. So these loans before were not issued by banks but by financial leasing companies, which had a much higher interest rate. Now, almost all of our loans are bank-issued, which first of all, it's harder to acquire because banks have much higher risk control measures. And secondly, the interest rate is much lower at about only 5%, which is pretty much half of what financial leasing companies provide, meaning we have less liabilities to pay off.

Lastly, I think most importantly, I want to mention our loans are at a controlled level. We all understand to achieve high return on equity, a company should properly use leverage. In the second half of the year, we aim to further reduce leverage a bit more just to be on the safer side because across the globe, talk of recession is looming. So we actually want to decrease leverage a bit just to be on the safer side. But we want to maintain some leverage also to make sure the Company can grow at a much higher ROE than the interest rate that we can acquire.

The next key item, like I said, is cash flow. All well-operated education company should achieve very positive cash flow targets. For us, the tuition collection, we are at about 92% completed, which means nearly all of our students have paid. And for most of our schools, it's actually paid for both the fall semester and the spring semester. For expanded offering of education and student-related services, we are at about 70.8%, so 71% completed. So again, like I said, it's a very cash flow positive business. We will recognize the cash flow as revenue throughout the year, and strictly follow all accounting procedures and standards. Similarly, we'll manage cash very responsible and strictly follow all the regulations and standards.

So one last thing I want to touch on for my highlights is the new school openings. So for this new school year starting this September in 2022, we opened three new schools. The three new schools, one of them is located in Hunan Province and two in the Yunnan Province. The school in Hunan Province is a management service type, meaning we provide recruitment, we provide teaching, and we provide guidance to the school. So this school, I think I mentioned earlier, it is actually an insight and opportunity for us to expand into the large and populated province.

The two schools located in Yunnan, one is actually in the southern part of Yunnan Province. It is fully operated by us. We run from day-to-day business to recruiting, to the principal's office, to everything. For this completely new school year, we recruited 373 students for the first-ever class here. And it is a very beautiful campus and we're extremely excited to operate it. I think it is actually not a bad number for a rather small city and beautiful city in Yunnan.

For the second Yunnan Province School, it's located in the northeastern part of the province. We are very happy to say that we actually signed the contract today in about maybe 5 or 6 six hours ago. We will begin to provide school management service for very, very large school, currently with over 3,500 students. Since we signed the contract today, which is after recruitment period, recruitment has already started, or has already completed this year. We will only do management service this year and aim to fully operate it next year. So we will have time for our designated principal to know the inner workings of the school. So next year when it comes, we'll have confidence in the recruitment and operating of the school. The school's principal is already designated to be one of our senior principal, who are very familiar with the area; he's been living in the area since 2016. We have a school near, not very far from there. So again, just happy to stress, we're very happy to sign the contract today and provide management service as of now, and look really forward to operating fully next year.

Additionally, on the vocational education side, we are in the final stages of signing a vocational school in Kunming City. We already provided recruitment and curriculum service to them, and is looking into entering a long-term management service contract or engagement with them. So school have already started for this school and it's a very high probability that we will sign with them. And we look forward to testing the water of our vocational capability with this new school in Kunming, Yunnan Province. And it is just one of our major strategy forward to expand into the operation of vocational schools. Further details will be released once available.

So this concludes the highlight section of the day, and now I will go through line-by-line financial details of the first quarter of 2022. Again, please note that all numbers presented are in RMB unless otherwise stated. All percentage changes are on a year-over-year basis unless otherwise specified. Detailed analysis is contained in our earning press release, which is already available on our IR website.

The total revenue was 211.4 million, an increase of 20.9% from 174.8 million in the first half of 2021. The increase was primarily driven by greater student enrollment due to the opening new school programs, and the increased number of students enrolled in our existing schools. Revenue from customers was 180.2 million, an increase of 7.7% from 167.4 million in the first half of 2021. The increase was primarily driven by greater student enrollment in our existing schools.

Revenues from government cooperative agreements were 31.2 million, an increase of 318.9% from 7.5 million in the first half of 2021. In the first half of 2021, taking into consideration the uncertainties of receiving government grants for students as a result of the pandemic, the only funds that were actually received were recognized as government grants. Government grants in the first half of 2022 were released more consistently by the government, resulting in an increase in revenues from government cooperative contracts.

Cost of revenue were 121.5 million, an increase of 13.5% from 107.0 million in the first half of 2021. The increase was primarily due to the increase in cost of teaching materials, repairs, utilities and staffing in relation with increased student enrollment.

Gross profit was 90.0 million, an increase of 32.6% from 67.9 million in the first half of 2021. Gross margin was 42.5%, compared with 38.8% in the first half of 2021, increase about 4%. The increase of gross margin was primarily due to the improved cost control measures, resulting, one, improving school operating efficiencies, tighter utility use limits and stricter budget control; and two, revised compensation structure for teachers and supporting staff for a more efficient system tying pay to performance.

Net operating expense were 36.1 million, a decrease of 35.3% from 55.9 million in the first half of 2021. Selling and marketing expense were 2.5 million, a decrease of 3% from 2.5 million in the first half of 2021. It's pretty much the same, but the decrease was primarily due to the decreased expense in brand promotion and marketing activities for our relatively-mature school operation. General and administrative expenses were 35.7 million, a decrease of 36.6% from 56.3 million in the first half of 2021. The decrease was primarily due to the improved cost control and non-recurring expenses in relation to the company's IPO in March 2021.

Government grants were 2.1 million, a decrease of 30.6% from 3 million in the first half of 2021. The decrease was primarily due to the government's tight fiscal budget, resulting in delayed payments made by the government.

Income from operations was 53.8 million, an increase of 348.6% from 12 million in the first half of 2021. Net income for continuing operations was 49.9 million, an increase of 1,102% from 4.2 million in the first half of 2021. Net loss from discontinued operation was 7.2 million, a decrease of 8.9% of 7.9 million in the first half of 2021. Net income was 42.7 million compared with a net loss of 3.8 million in the first half of 2021. Adjusted net income, a non-GAAP measure, was 42.7 million, an increase of 282.1% from 11.2 million in the first half of 2021.

For business outlook for the entire fiscal year of 2022, the company expects a total revenue of continuing operations to be between 440 million to 460 million, representing an increase of 10% to 15% on a year-over-year basis. This outlook reflects the company's current and preliminary reviews on the market and operational conditions. And the outlook ranges for the fiscal year 2022 reflects a number of assumptions that are subject to change based on uncertainties.

So the above is my financial highlight briefing. Both CEO Mr. Zhang and myself wish to thank everyone for your time in participating today. We do plan to host another small group Chinese conference tomorrow at lunchtime Chinese time. So feel free to reach out to me and I can

organize. In the Chinese call, our CEO Mr. Zhang will communicate directly in Chinese to help everyone explain anything they wish to inquire.

Now I will open the line up for questions. So operator, please go ahead and we can proceed to Q&A.

Questions and Answers

Operator: And we will now begin the question-and-answer session. (Operator Instructions). It appears that there are currently no questions.

Oh, pardon me, there is one question from [Zu Chou], a private investor.

Tommy Zhou: Okay. Yes, please.

Operator: You may now go ahead.

Zu Chou: Hello, CFO, so my question is I want to make sure we don't have any plan to go private because some of us, we are pretty concerned about this possibility.

Tommy Zhou: Yes, Mr. Chou, thank you for your question. The company officially have no plan to go private at the moment for maybe two reasons, from my own perspective. For one thing, we are a mature company from an education perspective, but from a public company perspective, we're actually a young company. We've only been trading for a year and a half, and we wish to reward all those investors who's been with us since the beginning.

Our valuation is at a very low point right now. So, the company will do our effort try to increase dividends or share purchase buyback plans to make sure that we can do as much as we can from our own perspective. But sometimes, the market is out of our control, but that's something we will also try to engage. But from the company's perspective, we want to keep the public company standing, and we want to make sure our dividend and buybacks are put in place.

Secondly, I think like I said earlier, after we're being public, our internal control and also our partners' credibility to us, has increased dramatically. If there's no other great incentive for us to go private -- incentive meaning something that benefits all shareholders -- as of now, the management has no plan to go private at the moment.

Zu Chou: That's good news, thank you.

Tommy Zhou: Yes, for us, the --

Zu Chou: Okay. The second -- can I ask a second question?

Tommy Zhou: Of course, yes.

Zu Chou: So when do we plan to pay dividends to the shareholders, is there any date?

Tommy Zhou: Yes, that's a great question. So earlier in January, we said if we do make a profit this year, we will pay dividend. As of, I think in May, we published we had a profit around 5,200 -- how do you say -- in RMB, so we do plan to pay dividend. So I've already talked with regulators, tax agencies, banks and also our depository in the U.S. As soon as our money is deposited in the offshore bank account, our legal team will allow us to disclose our dividend plan.

If you ask me a specific date, I want to say it will be before October. It will be in the next 2 weeks --

Zu Chou: That's great.

Tommy Zhou: -- unless the regulators back out what they have already promised. They already promised me that the amount that I requested will be -- how do you say -- forex, translated into the U.S. dollar. So I'm still waiting for the account to be approved. I just had a talk with them this morning. So if everything goes smooth, it will be within the next 2 weeks or 3 weeks. I will keep you updated on that.

Operator: (Operator Instructions). There appears to be no further questions. This concludes our question-and-answer session. I'd like to turn it back over to Tommy Zhou for any closing remarks.

Tommy Zhou: Yes, I think those are good questions. It's probably what most investors would want to ask. And similarly, I also want to say that the company works very hard to make sure that investors' interest is met.

So with that, I want to thank you, the operator, and also thank everyone again for participating on our today's call and for your further support. We appreciate everyone's interest, and we really want to make sure that interest is paid back with the company's hard work and dividend. So we look forward to reporting to you again next quarter on our progress. And thank you again, operator.

Operator: Thank you all again. This concludes the call. You may now disconnect.