27 Jul 2021

CMBI Credit Commentary

EDU – We suggest Buy on EDU, as we see support from its 101 repurchase term on Triggering Event

Polly Ng 吴宝玲
(852) 3657 6234
pollyng@cmbi.com.hk

Glenn Ko, CFA 高志和
(852) 3657 6235
glennko@cmbi.com.hk

Wilson Lu 路伟同
(852) 3761 8918
wilsonlu@cmbi.com.hk

James Wen 温展俊
(852) 3757 6291
jameswen@cmbi.com.hk

We recommend a Buy on EDU in view of its 101 repurchase term in OC, despite latest government policy to significantly limit tutoring hours and tuition fee. We view this policy largely restricts After School Tutoring (AST). There is a high chance EDU, an AST market leader in China, to concede and comply with this State Council's guidance, which will result in large reduction in revenue and operating loss at the onset of business transition. Upon various local government's implementation that restrict EDU to operate in public holiday and weekends, we see this constitute as one of the Triggering Events to require the issuer to purchase at 101 of its USD notes. In addition, given its high cash and short-term investment of USD 3.7bn, this should suffice 2-3 years of cash burn while EDU restructures its business model. From a fundamental basis, **we see EDU '24 at cash price 80/82 (YTM~8-9%) to largely reflect this bad-case scenario above and hence initiate a Buy.**

We see limited significant downside to EDU's bond price solely based on its VIE corporate structure risk. This is because EDU's OC has a term of **Repurchase upon Triggering Event at 101. Failure to repurchase is an event of default.**

The two Triggering Events are defined as

(1) any Change in Law that results in the Group being legally prohibited from operating substantially all of the business operations conducted by the Group as of the Issuer's consolidated financial statements for the most recent quarter.

(2) the Issuer has not furnished to trustee, 12 months after this Change in Law, an opinion from an external legal counsel stating either
   a. the Issuer is able to continue to derive substantially all of the economic benefits from the business operations conducted by the Group, or
   b. such Change in Law would not materially adversely affect the Issuer's ability to make principal, premium (if any) and interest payments on the Bonds when due.

As a result, USD bondholders' principal are protected from any Change in Law proposed by this State Council's guidance, even if it will nullify EDU's contractual rights to receive service income from its onshore companies under existing WHOFE/VIE structure.

CMBI Fixed Income
fis@cmbi.com.hk

Having said that, we observed Chinese government's regulatory approach has often been "Two steps forward, one step back". We are more inclined to think that EDU can satisfy a large part of the State Council policy objective, by greatly reducing its operating hours and tuition fee. We expect EDU will be able to strike a middle ground under regulator's scrutiny and adjust its cost-base to breakeven in 1-2 years. Although its equity financing channel is greatly hampered by this policy, EDU has sufficient cash resources on hand to adjust to this new normal, based on its net cash USD2bn as of 1QFY21, vs reported EBITDA of USD 550m in FY20. Moreover, its EDU '25 bond of USD300m is its only debt obligation, rest of USD1.5bn lease obligation should have higher flexibility of term negotiation.

CMB International Securities Limited

Fixed Income Department
Tel: 852 3761 8867/ 852 3657 6291
fis@cmbi.com.hk

Author Certification

Important Disclosures

Disclaimer

CMBIS or its affiliate(s) have investment banking relationship with the issuers covered in this report in preceding 12 months

For recipients of this document in the United Kingdom

This report has been provided only to persons (I)falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time)(“The Order”) or (II) are persons falling within Article 49(2) (a) to (d) (“High Net Worth Companies, Unincorporated Associations, etc.,) of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

CMBIS is not a registered broker-dealer in the United States. As a result, CMBIS is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority (“FINRA”). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.