

CMBI Credit Commentary

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

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.

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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.

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