Morgan Stanley | RESEARCH

IDEA

October 17, 2016 08:01 PM GMT

China Education

Market Leaders to Benefit from Industry Consolidation

Our AlphaWise survey revealed the potential for TAL and New Oriental to quickly gain market share. Industry growth to remain strong while high acceptance level of online education bodes well for leading players' new initiatives.

Acceleration in market share gains: Our AlphaWise survey indicated that the low price course strategy is highly effective for leading players to gain market share, thanks to their strong brand name, well established systems, standardized teaching procedures, and strong teaching curriculum development capabilities. We expect the promotional environment in China's K-12 after-school tutoring market will become a new norm, and the low user stickiness in the market will benefit the leading players like TAL and New Oriental, as they're considered top providers for potential switchers. We believe New Oriental's roll out of its low price strategy to over 30 cities and TAL's acceleration in capacity expansion will accelerate their market shares in the coming quarters. Although this may bring some short-term uncertainty to revenue growth and margins when the summer course revenues are booked, we believe this strategy is value accretive to the leading players given they can manage to achieve high retention rate.

Market demand remains robust amid macro slowdown: According to our AlphaWise survey results, K-12 after school tutoring expenses are the last item to cut among major household expenses during weak financial conditions. Moreover, 24% of respondents intend to increase their spending on tutoring classes in the next 12 months. This shows that education is not only resilient during macro downturns, but also remains a structurally growing sector in China.

Good potential for online education: The survey results also show that the acceptance level of online education is very high and 43% of respondents thought online education was as good as offline, but more convenient. We believe this bodes well for future demand for the leading players' online and O2O initiatives, which could bring in incremental revenue opportunities with better operating leverage.

Reiterate Overweight on TAL and New Oriental: We raise our PT by 17% to US$81 for TAL to reflect better revenue growth and margin assumptions. We expect TAL to see rapid market share gains driven by robust demand for its high-quality services. We raise our PT by 10% to US$53 for New Oriental, mainly to reflect our more optimistic view on margin expansion and slightly better top-line growth assumptions thanks to an effective low price strategy. Although the education space has outperformed S&P500 by over 40% YTD, we remain positive given the structural industry growth and accelerating market share gains of the leading players.

ALPHAWISE α
evidence-based research

MORGAN STANLEY ASIA LIMITED+

Claire Cao
EQUITY ANALYST
Claire.Cao@morganstanley.com +852 3963-4387

Amanda Chen
EQUITY ANALYST
Amanda.G.Chen@morganstanley.com +852 2848-5456

David Sun
EQUITY ANALYST
David.Sun@morganstanley.com +852 2848-1956

Julia Zhu, CFA
EQUITY ANALYST
Julia.L.Zhu@morganstanley.com +852 2848-1993

Lavender Ng
RESEARCH ASSOCIATE
Lavender.Ng@morganstanley.com +852 3963-0029

China Internet and Other Services

Asia Pacific
IndustryView **In-Line**

Exhibit 1: Summary of Key Changes

Company Name	Ticker	Target Price (USD)		Non-GAAP NP Change (%)		
		Old	New	FY17e	FY18e	FY19e
New Oriental	EDU-N	48	53	0.9%	1.6%	5.1%
TAL	XRS-N	69	81	0.5%	6.4%	12.0%

Source: Morgan Stanley Research; e = Morgan Stanley Research estimates

Sector Initiation Report: China Internet: Asia Insight: Initiating on the Education segment; structural growth, driven mainly by K-12 (14 Apr 2016)

TAL Education Group: Good Visibility for Margin Recovery; Build Positions on Dip (28 Jul 2016)

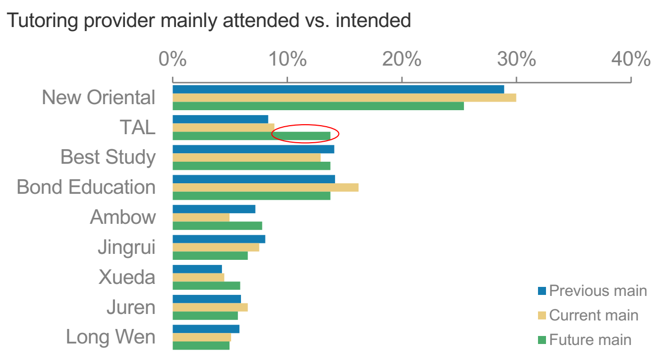
New Oriental Group (EDU.N): Robust K-12 enrollment to fuel future growth (21 Jul 2016)

Investment Summary

Reiterate OW ratings on TAL and New Oriental

Despite their strong performance, we believe TAL and New Oriental both companies are well positioned for the long-term structural growth of China's K-12 after-school tutoring services market. We believe TAL and New Oriental's ongoing investment in curriculum development, IT infrastructure, digitization of students' information, and teaching procedure standardization will increase their long-term value proposition and strengthen entry barriers.

Exhibit 2: 9% of respondents have TAL as their current major provider of after-school tutoring services while 14% intend to have TAL as the future main service provider



Source: AlphaWise, Morgan Stanley Research

We expect TAL to achieve an impressive top line growth CAGR of 43% from FY16-19e, mainly driven by a 40% CAGR over the same period in capacity, and by ASP growth and an improving utilization rate. We believe TAL's capacity add is backed by robust fundamental demand, supported by a clear jump in parents' mind share. Our survey shows that currently only 9% of respondents consider TAL to be the main provider of their children's K-12 after-school services but 14% will choose TAL in the future. We remain conservative on TAL's margin expansion given the ongoing price war in the market and minimal room for further operating efficiency improvement. We expect TAL's Non-GAAP operating margin to decline from 17.9% in FY16 to 16.8% in FY17 due to lower prices and margin dilution from new businesses and investments. We expect to see margin recovery starting from FY18 and beyond.

We expect New Oriental to record a revenue CAGR of 18% from FY16-19e, mainly driven by robust enrollment growth in its K-12 segment of 25% and K-12 ASP CAGR of 4% over the same period. Other non-K-12 segments are expected to remain flattish in the coming years. Given New Oriental's intention to have a more disciplined capacity addition plan with an annual capacity increase of only a single digit percentage, we expect to see an improving utilization rate at its learning centers in the coming years. As a result, we expect New Oriental's non-GAAP operating margin to expand from 14.6% in FY16 to 18.2% in FY19.

Valuation

Despite strong performance of China's education sector and its high valuation, we continue to see further upside driven by tailwinds from structural growth and market consolidation. We expect TAL and New Oriental to achieve calendarized non-GAAP 2016-19 earnings CAGRs of 44% and 27%, respectively, and our new target price implies a PEG of 0.9x for both companies. We select several China internet stocks under our team's coverage, which have proven profitability track records, strong revenue growth profiles, robust cash flow and high earnings visibility as comparable companies for the two K12 education players (Exhibit 3). The price targets of our selected comparables are trading at an average calendarized 2017 non-GAAP P/E of 28x with PEG of 1.2x. Given the smaller market cap and lower liquidity level, as well as a less scalable business model compared with the leading internet platforms, we believe a 25% discount to the average level for the price target implied PEG of leading internet companies is fair.

We raise our price target from US$69 to US$81 to reflect stronger assumptions on revenue growth and gross margins. We believe the recent margin pressure is temporary and see good visibility for margin recovery starting from FY18. If we apply a normalized non-GAAP operating margin of 18%, TAL is trading at 34x calendarized 2017 non-GAAP P/E and our target price implied P/E is 39x.

We raise our price target from US$48 to US$53 to reflect stronger assumptions on revenue growth. New Oriental is currently trading at 19x calendarized 2017 non-GAAP P/E and our target price implied P/E is 21x.

Exhibit 3: Selected China internet companies with proven profitability track record, strong top line growth, robust cash flow and good earnings visibility

Company	Ticker	Currency	Market Cap	Closing Price	Price Target	Rating	2017 Sales Growth	2016-19 Earnings CAGR	2016 P/E	2017 P/E	Current PEG	PT Implied PEG
			(US$ bn)	(Local $)	(Local $)		(%)	(%)	(x)	(x)	(x)	(x)
TAL	XRS.N	USD	6	71	81	OW	42%	44%	47.2	34.1	0.8	0.9
Tencent	0700.HK	HKD	256	210	225	OW	40%	23%	37.1	29.4	1.3	1.4
Alibaba	BABA.N	USD	253	102	132	OW	28%	23%	34.6	27.3	1.2	1.5
New Oriental	EDU.N	USD	7	46	53	OW	19%	27%	27.1	21.2	0.8	0.9
NetEase	NTES.O	USD	34	262	195	EW	58%	13%	20.3	18.9	1.5	1.1
Vipshop	VIPS.N	USD	7	14	14.5	EW	38%	14%	20.8	17.9	1.3	1.3
Average							**41%**		**40.9**	**27.5**	**1.1**	**1.2**

Source: Thomson Reuters, Morgan Stanley Research; Note: TAL, New Oriental and Alibaba's metrics are calendarized; share price related data as of market close on October 13th.

Summary of Key AlphaWise Survey Findings

We interviewed 1,511 parents across 18 Tier 1-2 cities in China via an online survey methodology in April 2016. Respondents must send their children to after-school tutoring classes in order to qualify for the survey. In 2012, we interviewed 498 parents across 6 cities namely Beijing, Shanghai, Guangzhou, Tianjin, Chengdu and Wuhan. The margin of error for conclusions based on the total sample is +/-2.0% in 2016 and 3.6% in 2012 at a 90% confidence level and higher for conclusions between sub-groups. By comparing our survey between 2012 and 2016, we had the following findings:

Demand to stay robust despite macro slowdown

We expect market demand for K-12 after-school tutoring services to stay robust despite the ongoing macro slowdown in China. We expect the penetration rate of after-school tutoring services in premature cities to gradually catch up with that of the mature markets like Shanghai and Beijing.

Our 2016 survey results show that 38% of respondents think there's room to increase their children's time spent on after-school tutoring services per week and there's an 18% gap between the maximum and the actual hours spent on after-school tutoring. Moreover, 24% of respondents intend to increase their spending on tutoring classes in the next 12 months.

This survey result is in-line with the recent trends we see in the K-12 after-school services market given the leading players have seen enrollment growth acceleration. TAL's offline enrollment accelerated from 32% in FY14 to 51% in FY16, while New Oriental's K12 enrollment growth jumped from 6% in FY14 to 40% in FY16.

Low price strategy to benefit national leading players most

China's K-12 after-school tutoring market has been epitomized by low price strategies for entry level students across the nation in 2016. Despite the short-term margin pressure caused by incremental teaching costs, we believe these strategies will accelerate market consolidation. We believe the leading players nationally with strong brand names, mature systems and infrastructures, and standardized procedures, like New Oriental and TAL, will benefit most given their platform enables them to achieve a good retention rate for low price courses.

We expect low price strategies to become a new norm in China's K-12 after-school tutoring market, which may lead to an ongoing decline in user stickiness in the sector. New Oriental and TAL are ranked highest as potential providers for parents that intend to switch. Moreover, we believe New Oriental and TAL have a clear edge in retaining acquired students given their brand name, strong teaching curriculum development capabilities and digitized database of students.

We believe these survey results are echoed by the recent feedback from TAL and New Oriental regarding their retention rate for summer promotion courses. TAL's retention rate was higher than 70% in Beijing, while New Oriental's retention rate was 40-50% nationwide. According to New Oriental, a low price strategy makes economic sense if the retention rate is higher than 30%. We believe both players will see refueled enrollment growth and improved utilization rates in cities where low price strategies have been rolled out.

Margin pressure caused by low price strategy is expected to be temporary

We expect to see some margin pressure for both companies when revenues for low priced summer courses are booked given little revenue contribution and the full impact of higher teaching costs. However, we expect the improving utilization rate due to robust enrollment will lead to improving margins on full-year basis.

We expect New Oriental's non-GAAP operating margin to expand from 14.6% in FY16 to 18.2% in FY19, largely thanks to the low price strategy. We expect to see non-GAAP operating income to stay flat in F1Q17 with a 1.5% negative margin impact from the low price courses in the quarter.

We estimate TAL will see its non-GAAP operating margin decline from 17.9% in FY16 to 16.8% in FY17 due to: 1) consolidation of newly acquired business with lower margins; 2) impact from low price courses; and 3) investment in online and O2O initiatives. We expect to see margin recovery to 17.9% and 18.7% in FY18 and FY19, respectively, as the margin of newly acquired business normalizes (10-20% operating margin for FirstLeap and 20-25% for Shun Shun in two to three years) and revenues of live broadcasting courses and O2O initiatives start to kick in.

High acceptance level of online and O2O initiatives

Our 2016 survey results show that most parents are open minded about online education with 43% of parents indicating that they'll definitely use online classes for their children, which are seen as good as offline classes and more convenient. The acceptance level is notably higher among parents of senior high-school students given the higher level of self-discipline.

We believe this bodes well for the online and O2O initiatives of New Oriental and TAL. TAL targets to penetrate 100 cities in China with its "Double Teacher" (a hybrid model with small offline classes and live broadcasting of lectures and on-the-spot tutoring services); New Oriental launched its pilot "Double Teacher" model recently.

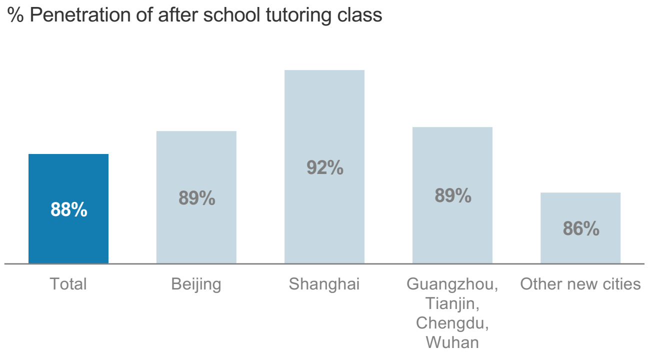
Risks

Despite strong industry fundamentals, we do see risks from: 1) slower than expected margin recovery due to an irrational price war; 2) online and O2O initiatives not as sustainable as expected; and 3) emergence of disruptive online education model.

Market Demand to Remain Robust

Room for further penetration of after-school tutoring services

Exhibit 4: Room for further penetration of after school tutoring in other new cities



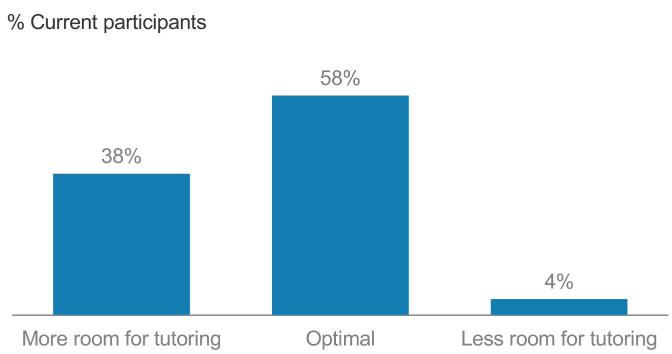
Source: AlphaWise, Morgan Stanley Research

Based on the two sets of survey results, we noted that the percentage of households sending their children to after-school tutoring classes has increased from 72% in our 2012 survey to 88% this year (90% for the six key cities).

Shanghai stood out with the highest penetration level of 92%, while Beijing, Guangzhou, Tianjin and Wuhan were at 89%. Other new cities included in the 2016 survey have an average penetration rate of 86%. We see room for further penetration for tutoring classes in other new cities, as household income continues to increase in coming years. We expect after-school tutoring service penetration in new cities to gradually approach that of Beijing and Shanghai.

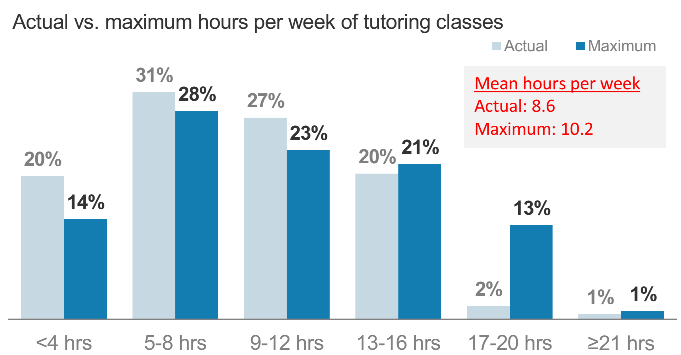
Apart from the room for further penetration of after-school tutoring services, we also see potential for the hours spent on tutoring services to grow in coming years. Among the parents that send their children to after-school tutoring classes, 38% of respondents think their children could take more tutoring classes while 58% think the current level is optimal. On average, a student spends around 8.6 hours on tutoring classes one week while the maximum level (as determined by respondents) is at 10.2 hours, indicating 18% upside potential.

Exhibit 5: 38% of respondents indicated there's room to increase their children's time spent on after-school tutoring services



Source: AlphaWise, Morgan Stanley Research

Exhibit 6: Current average weekly hours spent on tutoring services stood at 8.6 while the maximum is at 10.2

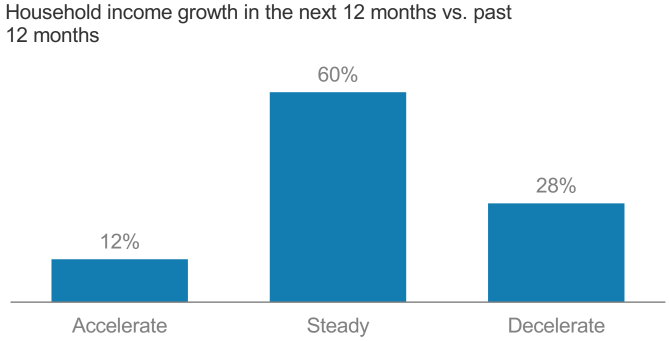


Source: AlphaWise, Morgan Stanley Research

Good resiliency amid economic downturn

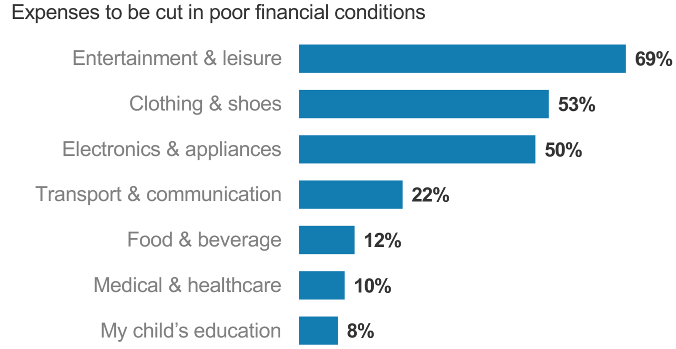
According to our survey results, 60% of respondents expect their household income growth to stay steady in the coming 12 months while 28% of them expect to see income growth deceleration, which is in line with the overall macro slowdown in China. When asked about which types of household expenses to cut in times of poor financial conditions, education spending was the most resilient segment among all consumer expenditure options presented. Only 8% of the respondents indicated they would cut their children's education spending in times of poor financial conditions.

Exhibit 7: 60% of respondents expect their income growth to be steady while 28% expected it to decelerate



Source: AlphaWise, Morgan Stanley Research

Exhibit 8: Respondents say education spending is the expense least likely to be cut during poor financial conditions



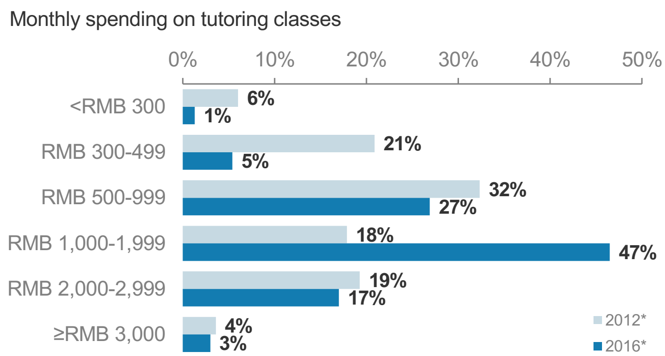
Source: AlphaWise, Morgan Stanley Research

Demand for after-school tutoring services to stay robust in coming 12 months

In terms of dollar spent on after-school tutoring services, average monthly spending on tutoring classes increased from Rmb1,193 in 2012 to Rmb1,437 in 2016, up 20% in four years, indicating robust fundamental demand in the after-school tutoring service market.

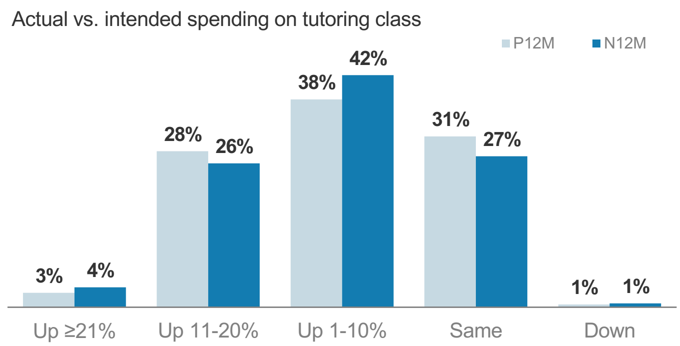
Despite the ongoing slowdown in China's macro economy, 23% of the respondents indicated they increased their spending on after-class tutoring services during the past 12 months and 24% said they will increase spending in the next 12 months. We believe this bodes well for ongoing demand growth in the K-12 after school tutoring service segment.

Exhibit 9: Monthly spending on tutoring classes has increased 20% from 2012 to 2016 for six key cities



Source: AlphaWise, Morgan Stanley Research; Note: * indicates survey results only include six cities covered in 2012 survey, which includes Beijing, Shanghai, Guangzhou, Tianjin, Chengdu and Wuhan.

Exhibit 10: 24% of respondents intend to increase their spending on tutoring classes in next 12 months

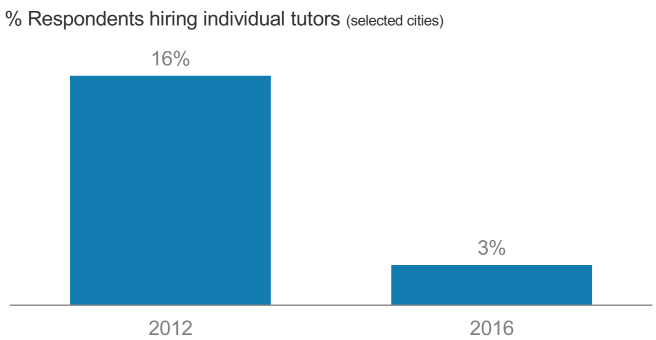


Source: AlphaWise, Morgan Stanley Research

Market Consolidation to Accelerate

Institutions are gaining share versus individual teachers

Exhibit 11: % of respondents that hire individual tutors dropped from 16% in 2012 to 3% in 2016 in six key cities



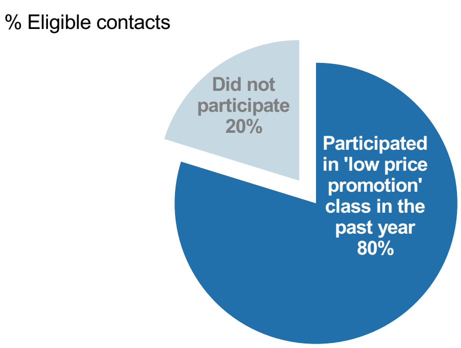
Source: AlphaWise, Morgan Stanley Research

The after-school tutoring market has become institutionalized over the past few years. Based on our survey results, the percentage of respondents hiring individual tutors shrank substantially, from 16% in 2012 to only 3% in 2016 in the six key cities.

We believe this is due to the institutions' continuous investment in curriculum development, teaching procedure standardization and digitalization, and their more reasonable pricing level. We believe institutions will continue to gain market share from individual teachers, given their better scalability.

Market consolidation to accelerate due to price war

Exhibit 12: 80% of respondents participated in "low- price promotion" classes in past year



Source: AlphaWise, Morgan Stanley Research

The after-school tutoring market in China has become promotion-driven, and 80% of respondents have sent their children to low-price promotion classes of K-12 institutions during the past year. As we mentioned in our industry initiation report (China Internet: Asia Insight: Initiating on the Education segment; structural growth, driven mainly by K-12 (14 Apr 2016)), we believe the low-price strategies initiated by New Oriental could be a good strategy for leading national institutions to consolidate the market.

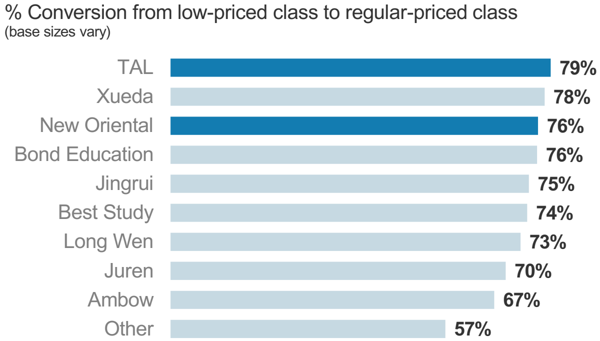
Given the highly fragmented structure of China's K-12 after-school tutoring services market, with the top two listed players, New Oriental and TAL, having a combined share of less than 5%, we see significant room for further market consolidation. According to New Oriental, which started its Rmb50 summer promotion courses back in 2010 and rolled out the program to more than 30 cities across the country this year, such strategy makes economic sense as long as the retention rate of the summer promotion courses reaches 30%.

Leading institutions have better conversion rate for their low-price classes

Based on our survey results, the conversion rate, defined as the percentage of those who have taken low-priced classes at a provider and who signed up for regular-priced classes with the same provider, varies between 57% and 79%. TAL and New Oriental achieved 79% and 76%, respectively, ranking first and third among all players.

We note that the conversion rate for regional leading players is also quite high, while the conversion rates for smaller institutions or individual teachers are substantially lower at 57%. This is a strong evidence that leading K-12 after-school tutoring

Exhibit 13: TAL, New Oriental have leading conversion rates from low- to regular-priced classes



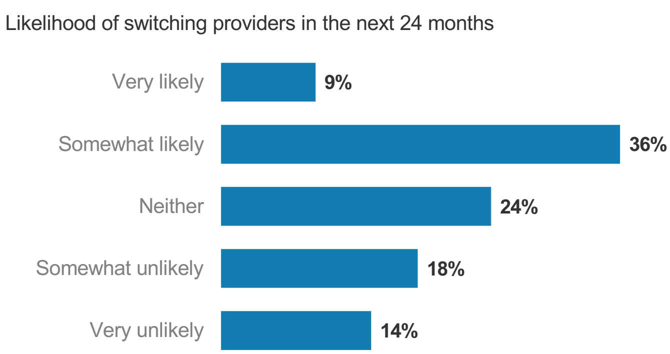
Source: AlphaWise, Morgan Stanley Research

ing share from smaller institutions / individual tutors, indicating market consolidation.

National leaders to benefit most from low user stickiness

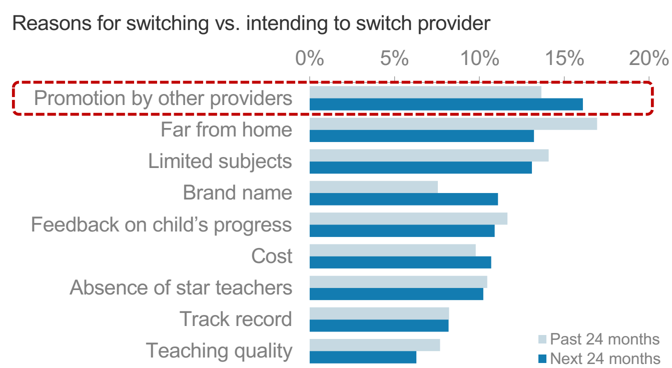
Our survey results show that user stickiness is rather low in the after-school tutoring services market, with 26% of the total respondents surveyed having switched providers in the past 24 months. We note that 45% indicated they are likely or very likely to switch providers in the next 24 months. Among all the reasons for switching, respondents cite promotions by other tutoring service providers as the top reason for the next 24 months vs. the third reason in the past 24 months.

Exhibit 14: 45% of respondents likely to switch after-school tutoring service providers in next 24 months ...



Source: AlphaWise, Morgan Stanley Research

Exhibit 15: ... and "promotion by other providers" ranks as the top reason for switching

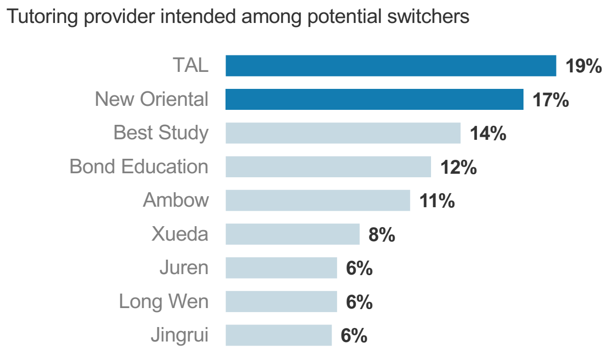


Source: AlphaWise, Morgan Stanley Research

Among parents who indicated their intention to switch tutoring service providers, 19% would choose TAL and 17% would pick New Oriental, topping the list of institutional K-12 tutoring service providers.

This echoes our view that the national leading players with stronger brand names, better platforms and more standardized teaching procedures will benefit most from the market consolidation. Medium-sized regional players should also benefit somewhat from this trend. Small institutions which used to compete on lower pricing are likely the

Exhibit 16: 19% of potential switchers prefer TAL and 17% like New Oriental



Source: AlphaWise, Morgan Stanley Research

; price war.

Given the effectiveness of the low-price summer promotion courses for entry-level students, we expect such strategy to become the norm nationally in coming years, speeding up market consolidation and benefiting the big players. For companies like TAL that have unmet demand in evolving markets, accelerating capacity expansion to attract potential students could be the most cost- effective way to gain market share without putting too much pressure on margins, we believe.

High acceptance level of online and O2O initiatives

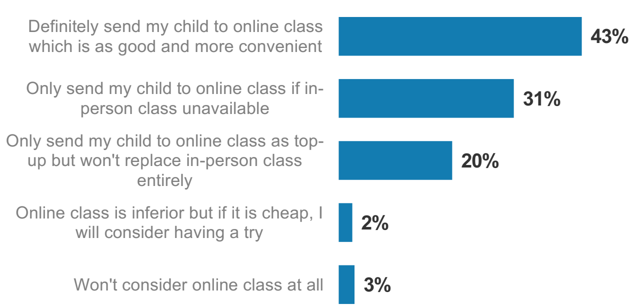
Based on our survey results, we have concluded that parents in China generally welcome the idea of online education in various formats.

Integration of digital technologies into classroom learning has already become an infrastructure upgrade widely accepted by most parents. Fully 71% of the respondents feel that is very necessary to monitor their child's learning progress in real time, especially how their child measures up against classmates in academic performance. The availability of such tool would increase their confidence in their child's tutoring provider.

The majority of respondents are open-minded about online education, and 12% are currently having their children take online class. 43% of the respondents think that apart from convenience, online classes deliver the same quality of teaching as in-person classes. The percentage of respondents saying so increases with the level of their children's education -- 56% of parents with children in senior high school prefer online education.

Exhibit 17: Acceptance level of online courses is high, ...

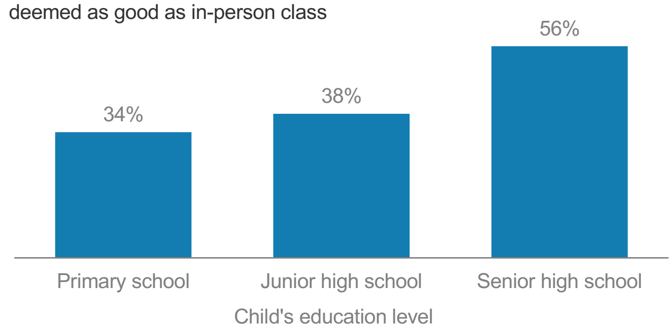
Attitude towards online class vs. in-person class



Source: AlphaWise, Morgan Stanley Research

Exhibit 18: ... especially among parents of senior high school students

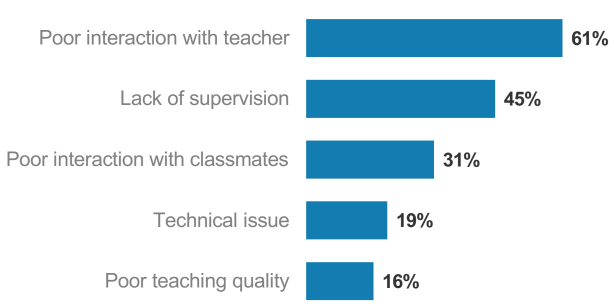
% definitely sending their child to online class which is deemed as good as in-person class



Source: AlphaWise, Morgan Stanley Research

Exhibit 19: Poor interaction with teachers and lack of supervision are key reasons parents would not send their children to O2O classes

Barriers from sending their child to O2O class



Source: AlphaWise, Morgan Stanley Research

Our concept test further reveals that 36-48% of respondents would consider sending their children to O2O classes comprising live broadcasting and tutoring services if this form of course delivery offers a significant price advantage (i.e., half the price of in-person classes).

Only 4% of the respondents opt out of this learning model, citing "lack of class interaction and supervision" as their key concerns. As shown in Exhibit 19, 61% and 45% of the respondents with negative feedback on the new learning models are concerned about poor interaction with teachers and lack of supervision, respectively.

TAL

Exhibit 20: TAL: Key Statistics and Ratios

Key Ratios & Statistics

Reuters:XRS.N / Bloomberg: XRS US China Internet and Other Services	
Price target	US$81.00
Up/downside to price target (%)	15
Shr price, close(Oct 13,2016)	US$71.01
52-Week Range	US$72.28-34.01
Shares outstanding, dil,curr (mn)	93
Mkt cap, curr (mn)	US$6,636
EV, curr (mn)	US$5,731
Avg daily trading value (mn)	US$34

Fiscal Year Ending	2/16	2/17e	2/18e	2/19e
ModelWare EPS(US$)	1.12	1.08	1.86	2.82
Prior ModelWare EPS(US$)	-	1.10	1.74	2.49
Consensus EPS(US$)§	1.34	1.47	2.21	2.98
Revenue, net (US$ mn)	620	922	1,312	1,825
EBITDA (US$ mn)	128	151	240	384
ModelWare net inc (US$ mn)	103	102	173	263
P/E	57.6	54.0	35.1	23.9
P/BV	12.4	13.7	9.9	7.1
RNOA (%)	(106.3)	(89.2)	(83.4)	(74.3)
ROE (%)	32.8	23.2	30.0	33.1
EV/EBITDA	38.2	39.7	23.6	13.5
Div yld (%)	-	-	-	-
FCF yld ratio (%)	3.5	2.6	4.3	6.3
Leverage (EOP) (%)	(119.2)	(127.3)	(135.0)	(140.0)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework

§ = Consensus data is provided by Thomson Reuters Estimates

e = Morgan Stanley Research estimates

Source: Thomson Reuters, e = Morgan Stanley Research estimate

Rapid market share gain and top-line growth acceleration: We expect TAL to see rapid market share gain in China's K-12 after-school tutoring market. Our survey results show that 14% of respondents would choose TAL as their children's future major provider of after-school services, while only 9% of respondents currently view TAL as a major service provider. We expect TAL's top-line growth to accelerate in coming years, driven by its aggressive capacity addition plan. According to the management, TAL plans to increase its capacity by 40% p.a. in the next three years to meet the growing demand in the K-12 after-school tutoring market.

Disciplined pricing strategy: Compared with New Oriental's nationwide discount pricing, TAL has a more conservative strategy which covers only summer courses for grade 7 and 10 students in Beijing. We believe this strategy is cost-effective for TAL, as it has achieved a high retention rate for such low-price courses. We view TAL's acceleration of its capacity expansion as an easy way to lock in demand without substantial margin pressure.

Good visibility of margin recovery: TAL has seen continuous margin decline since F3Q15, due to capacity increase, dilution from newly acquired business, and investment in online and O2O initiatives. We expect TAL's non-GAAP operating margin to recover from 16.8% in FY17 to 17.7% in FY18 and gradually approach 20% in the long term.

Reiterate OW with new price target of US$81: We expect TAL to see robust top-line growth driven by rapid market share gain in coming years, while its margin should slightly decline in FY17 and stabilize starting from FY18. TAL is currently trading at 34x calendarized 2017e non-GAAP P/E, and our revised price target implies a calendarized P/E of 39x with 0.9x PEG. We believe TAL's high multiple can be justified by its premium brand name, strong system and platform, high retention rate of teachers and students, as well as its strong positioning in online education.

Financial Summary

Exhibit 21: XRS Financial Summary

XRS Financial Summary | FYE FEB (US$ mn)

Income Statement	2016	2017E	2018E	2019E
Total Net Sales	**620**	**922**	**1,312**	**1,825**
Small class	788	1,150	1,633	2,172
One-on-one	92	102	110	118
Online	42	61	82	107
Gross Income	**316**	**449**	**640**	**895**
Operating Expense	(231)	(333)	(450)	(606)
Marketing (Non-GAAP)	(71)	(106)	(149)	(203)
G&A (Non-GAAP)	(138)	(192)	(262)	(354)
SBC	(26)	(39)	(43)	(54)
Operating Income	**85**	**116**	**190**	**288**
Net Income	103	102	173	263
Non-GAAP OP Income	111	154	233	342.2
Non-GAAP EBITDA	152	189	282	437.4
Non-GAAP Net Income	**129**	**140**	**216**	**316.4**
MW EPADS	1.12	1.08	1.86	2.82
Diluted Non-GAAP EPADS	1.41	1.50	2.31	3.39
Note: 1 ADS = 2 Shares				
YoY Growth (%)	**2016**	**2017E**	**2018E**	**2019E**
Total Enrollment	**55%**	**47%**	**40%**	**36%**
Total Net Sales	**43%**	**49%**	**42%**	**39%**
Small class	54%	46%	42%	33%
One-on-one	12%	10%	9%	7%
Online	60%	46%	35%	30%
Gross Income	**37%**	**42%**	**43%**	**40%**
Operating Expense	41%	44%	35%	35%
Marketing (Non-GAAP)	37%	49%	40%	36%
G&A (Non-GAAP)	47%	39%	37%	35%
SBC	40%	49%	11%	26%
Operating Income	26%	36%	64%	52%
Net Income	53%	-1%	70%	52%
Non-GAAP OP Income	**29%**	**39%**	**51%**	**47%**
Non-GAAP EBITDA	56%	25%	49%	55%
Non-GAAP Net Income	**50%**	**9%**	**54%**	**47%**
Diluted Non-GAAP EPS	37%	-4%	72%	52%
Diluted Non-GAAP ADS	34%	7%	54%	47%
As % of Revenue (%)	**2016**	**2017E**	**2018E**	**2019E**
Small class	127%	125%	124%	119%
One-on-one	15%	11%	8%	6%
Online	7%	7%	6%	6%
Gross Income	51.0%	48.7%	48.8%	49.0%
Marketing	-11.5%	-11.5%	-11.3%	-11.1%
G&A	-22.2%	-20.8%	-20.0%	-19.4%
SBC	-4.2%	-4.2%	-3.3%	-2.9%
Non-GAAP OP Profits	17.9%	16.8%	17.7%	18.7%
Non-GAAP Net Income	20.8%	15.2%	16.4%	17.3%

Key Metrics	2016	2017E	2018E	2019E
Small class enrollment ('000)	1,652	2,478	3,544	4,891
YoY (%)	*45%*	*50%*	*43%*	*38%*
One-on-one enrollment ('000)	270	313	338	361
YoY (%)	*40%*	*16%*	*8%*	*7%*
Online enrollment ('000)	388	609	887	1,210
YoY (%)	*73%*	*57%*	*46%*	*36%*
Small class ARPU (USD)	310	318	324	334
YoY (%)	*-3%*	*3%*	*2%*	*3%*
One-on-one ARPU (USD)	306	295	301	305
YoY (%)	*-18%*	*-3%*	*2%*	*2%*
Online ARPU ('000)	67	69	69	68
YoY (%)	*-3%*	*2%*	*0%*	*-1%*
Teachers' Cost as % Revenue	21%	22%	22%	22%
Rental Cost as % Revenue	14%	14%	14%	14%
Balance Sheet	**2016**	**2017E**	**2018E**	**2019E**
Cash and Cash Equivalents	452	666	1,002	1,484
Current Assets	**516**	**743**	**1,090**	**1,602**
PP&E, Net	115	162	219	256
Long-term Investments	274	274	274	274
Non-current Assets	**546**	**593**	**649**	**685**
Total Assets	**1,061**	**1,336**	**1,738**	**2,287**
Accrued expenses and others	70	70	70	70
Deferred Revenue	281	418	595	827
Current Liabilities	**383**	**517**	**705**	**937**
Total Liabilities	**621**	**755**	**942**	**1,174**
Total Equity	**441**	**581**	**796**	**1,113**
Cash Flow	**2016**	**2017E**	**2018E**	**2019E**
Net Income	103	102	173	263
D&A	41	35	50	96
Change in Working Capital	154	121	176	203
Operating Cash Flow	**324**	**296**	**442**	**615**
CAPEX	(62)	(83)	(106)	(133)
Free Cash Flow	**312**	**296**	**442**	**615**
Investing Cash Flow	(370)	(83)	(106)	(133)
Financing Cash Flow	10	0	0	0
Ratio Analysis	**2016**	**2017E**	**2018E**	**2019E**
ROA	14.0%	11.7%	14.0%	15.7%
ROE	34.1%	27.4%	31.3%	33.1%
Net Debt to Equity	1%	1%	1%	1%
Net Cash (US$ mn)	452	666	1,002	1,484
Key Valuation Metrics				
3-yr CAGR: Non-GAAP Net Profit	36%	35%	46%	37%
PE - Current Adj. Diluted EPADS	49.8	46.7	30.3	20.7
Non-GAAP EV/EBITDA	36.0	28.8	19.3	12.5
FCF Yield	5.4%	5.2%	7.7%	10.7%

Source: Company data, Morgan Stanley Research; E = Morgan Stanley Research estimates

Risk Reward

Strong market share gain to boost share price performance

Source: Thomson Reuters, Morgan Stanley Research estimates

Price Target **$81**

Base case DCF value.

Bull **$98**

42x bull case calendarized 2017e P/E

Strong demand with superior pricing power: Revenue expands at a three-year CAGR (F2016-19) of 47% (enrollment growth of 45% and offline enrollment growth of 42%), thanks to stronger enrollment demand and faster network expansion. Operating margin (non-GAAP) of ~17%.

Base **$81**

37x base case calendarized 2017e P/E

Sustained volume and ARPU growth: Revenue expands at a three-year CAGR (F2016-19) of 43%, driven by capacity expansion. Operating margin (non-GAAP) of ~16.8%.

Bear **$56**

29x bear case calendarized 2017e P/E

Slower network expansion with lower pricing power: Revenue expands at a three-year CAGR (F2016-19) of 37%, owing to slower than expected capacity expansion. Operating margin (non-GAAP) of ~16.3%.

Investment Thesis

- Rapid market share gain in China's after-school tutoring market.
- China's leading K-12 after-school service provider in terms of enrollment, with a strong brand name.
- Rapid enrollment growth in existing key markets and successful penetration.
- Accelerating consolidation in the K-12 after-class tutoring market in China, especially in tier-one cities.
- Increasing adoption of online education and Double Teacher model.

Key Value Drivers

- Offline enrollment and ARPU growth
- Online enrollment and ARPU growth
- Capacity expansion driven by demand
- Learning centers ramp up in new cities

Potential Catalysts

- Double Teacher model proves commercially feasible and is rolled out widely
- Quicker-than-expected network expansion, fostered by strong demand

Risks to Achieving Price Target

- Slower than expected ramp-up of new learning centers.
- Bigger than expected margin drag from capacity expansion and competition in F18.
- More intense price competition across the country limits TAL's top-line growth.
- Continued macro slowdown caps spending on after-school tutoring services.

Earnings Estimate Revisions

We have raised our revenue forecast by 0.6% for F2017, 1.8% for F18,and 6.5% for F19 on the back of our AlphaWise results pointing to a big jump in future demand for TAL's services. We have raised our three-year (2016-19e) revenue CAGR from 40% to 43%, mainly to reflect more optimistic assumptions on enrollment growth. We believe TAL's top-line growth is mainly driven by its capacity expansion, which management expects to reach 40% CAGR in the coming three years, and we conservatively expect a further 3% annual growth to come from an improved utilization rate and ASP growth.

We expect TAL's non-GAAP operating margin to recover in FY18 and gradually increase to 20% in the long term, reflecting: 1) its aggressive capacity addition plan and 2) its conservative pricing strategy.

As a result, we have raised our non-GAAP net income forecast by 0.5% for FY17, 6.4% for FY18 and 12% for FY19.

Exhibit 22: TAL: Old vs. New Estimates

FYE Feb	New			Old			% Change		
Income Statement (US$ mn)	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**
Net revenues	**922**	**1,312**	**1,825**	**917**	**1,289**	**1,714**	**0.6%**	**1.8%**	**6.5%**
Cost of revenues	473	672	930	470	674	904	0.6%	-0.3%	2.9%
Gross profit	**449**	**640**	**895**	**446**	**615**	**809**	**0.6%**	**4.1%**	**10.6%**
Selling and marketing	106	149	203	105	147	189	0.6%	1.3%	7.1%
General and administrative	192	262	354	191	255	322	0.6%	2.9%	9.9%
Stock-based compensation	39	43	54	38	42	50	0.6%	1.8%	6.5%
Total operating expenses	336	453	610	334	443	561	0.6%	2.2%	8.6%
Government subsidies	3	3	3	3	3	3	0.0%	0.0%	0.0%
Income from operations	**116**	**190**	**288**	**115**	**175**	**252**	**0.5%**	**8.7%**	**14.7%**
Impairment loss on long-term investment	-	-	-	-	-	-			
Gain on short-term investment	-	-	-	-	-	-			
Gain on fair value change of long-term investment	-	-	-	-	-	-			
Income before income tax and loss from equity method investments	129	214	328	129	198	289	0.5%	7.9%	13.5%
Loss from equity method investments	-	5	6	-	5	6		0.0%	0.0%
Add: Net (gain)/loss attributable to noncontrolling interest	-	-	-	-	-	-			
Total net income attributable to TAL Education Group	102	173	263	101	161	232	0.5%	7.6%	13.2%
Diluted	187	187	187	183	185	187	2.1%	1.1%	0.1%
Net earnings per share (US$)									
Basic	0.63	1.08	1.64	0.63	1.00	1.45	0.0%	8.0%	13.1%
Diluted	0.54	0.93	1.41	0.55	0.87	1.24	-1.8%	6.9%	13.7%
Net earnings per ADS (2 ordinary shares equal to 1 ADS, US$)									
Basic	1.26	2.16	3.28	1.26	2.00	2.90	0.0%	8.0%	13.1%
Diluted	1.08	1.86	2.82	1.10	1.74	2.48	-1.8%	6.9%	13.7%
Non-GAAP									
Non-GAAP Gross Profit	449	640	895	446	615	810	0.6%	4.1%	10.6%
Non-GAAP Operating Income	154	233	342	154	217	302	0.5%	7.3%	13.3%
Non-GAAP Net Income	**140**	**216**	**316**	**139**	**203**	**282**	**0.5%**	**6.4%**	**12.0%**
Non-GAAP EPADS - Basic	1.08	1.86	2.82	1.10	1.74	2.48	-1.8%	6.9%	13.7%
Non-GAAP EPADS - Diluted	1.50	2.31	3.39	1.52	2.19	3.03	-1.5%	5.3%	11.9%
Non-GAAP GPM	48.7%	48.8%	49.0%	48.7%	47.7%	47.2%	0.0%	1.1%	1.8%
Non-GAAP OPM	16.8%	17.7%	18.7%	16.8%	16.8%	17.6%	0.0%	0.9%	1.1%
Non-GAAP NPM	15.2%	16.4%	17.3%	15.2%	15.7%	16.5%	0.0%	0.7%	0.8%

Source: Company Data, Morgan Stanley Research estimates (E)

Price Target and Valuation

Methodology

Our preferred valuation methodology is discounted cash flow (DCF) – it incorporates our long-term view. We continue to apply an 11.5% discount rate (US risk-free rate 3%, beta 1.3,equity risk premium 5%, China risk premium 2%) and a 3% terminal growth rate.

Our new price target is US$81, which is our base-case DCF value: We expect a 43% three-year revenue CAGR (F2016-19e), driven by 39% offline enrollment growth and 3% ARPU expansion. We assume that TAL's non-GAAP operating margin rises from 17.9% in F16 to 18.7% by F19 as a result of rapid market share gain in the K-12 after-school tutoring market.

Bull case analysis: We assume the company successfully gains share in its existing markets and further penetrates lower-tier cities, leading to robust enrollment growth; a successful nationwide roll-out of its Double Teacher model helps mitigate margin dilution from the higher proportion of lower-margin learning centers in lower-tier cities. We assume increased operating leverage from strong word-of-mouth referrals and a lower marketing expense ratio.

Bear case analysis: We assume weaker-than-expected enrollment growth and ARPU expansion as a result of intensifying market competition; higher marketing expenditure when entering new cities, and failure of the Double Teacher model to lift operating margin meaningfully.

New Oriental

Exhibit 23: EDU Key Statistics and Ratios

Key Ratios & Statistics

Reuters:EDU.N / Bloomberg: EDU US China Internet and Other Services	
Price target	US$53.00
Up/downside to price target (%)	15
Shr price, close(Oct 13,2016)	US$45.86
52-Week Range	US$48.41-21.73
Shares outstanding, dil,curr (mn)	157
Mkt cap, curr (mn)	US$7,218
EV, curr (mn)	US$5,508
Avg daily trading value (mn)	US$53

Fiscal Year Ending	5/16	5/17e	5/18e	5/19e
ModelWare EPS(US$)	1.43	1.70	2.26	2.90
Prior ModelWare EPS(US$)	-	1.69	2.23	2.75
Consensus EPS(US$)§	1.42	1.80	2.20	2.71
Revenue, net (US$ mn)	1,478	1,754	2,075	2,428
EBITDA (US$ mn)	283	338	394	475
ModelWare net inc (US$ mn)	225	271	363	470
P/E	34.5	29.0	22.0	17.3
P/BV	4.8	4.5	3.8	3.1
RNOA (%)	(46.4)	(37.8)	(37.4)	(34.5)
ROE (%)	18.4	19.3	22.0	23.6
EV/EBITDA	16.8	15.1	11.4	8.1
Div yld (%)	-	-	-	-
FCF yld ratio (%)	7.8	6.5	8.9	9.7
Leverage (EOP) (%)	(137.5)	(141.4)	(146.7)	(146.3)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework
§ = Consensus data is provided by Thomson Reuters Estimates
e = Morgan Stanley Research estimates

Source: Thomson Reuters, e = Morgan Stanley Research estimate

Aggressive low-price strategy to help student acquisition: New Oriental rolled out its low-price strategy to over 30 cities across China this summer and achieved total enrollment of almost 200k. With a retention rate of 40-50% (defined as number of students converted into autumn courses after taking summer promotion courses), New Oriental stands to benefit from this strategy as an effective user acquisition channel, we think.

Disciplined capacity addition should lead to improving margin: Having gone through the pain of blind capacity expansion in 2008-2012, New Oriental now has a more disciplined plan with annual capacity increases at the single- digit percentage level. We believe the strong enrollment growth together with a well-paced expansion plan will lead to improving margins in coming years. Currently, New Oriental's utilization rate is around 20%, and the company targets an optimal level of 30% in the long term. According to management, a 1% improvement in the utilization rate would translate into a 1% increase in operating margin. We conservatively expect New Oriental's non-GAAP operating margin to expand from 14.6% to 18.2% by FY19.

Reiterate OW with new price target of US$53: We expect New Oriental to achieve strong revenue growth together with margin expansion in coming years, which supports its valuation rerating. New Oriental's stock is currently trading at 21x calendarized 2017 non-GAAP P/E, and our revised price target of US$53 implies a calendarized P/E of 24x with PEG of 0.9x.

Financial Summary

Exhibit 24: EDU Financial Summary

EDU Financial Summary | FYE MAY (US$ mn)

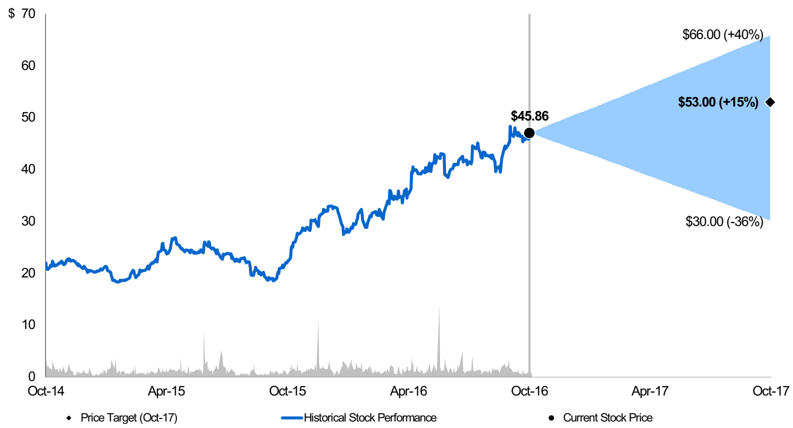
Income Statement	**2016**	**2017E**	**2018E**	**2019E**
Total Net Sales	**1,478**	**1,754**	**2,075**	**2,428**
Educational programs and services	1,309	1,552	1,836	2,148
Books and others	169	202	239	280
Gross Income	**864**	**1,040**	**1,251**	**1,476**
Operating Expense	(665)	(790)	(925)	(1,061)
Marketing	(198)	(232)	(271)	(311)
G&A	(454)	(538)	(630)	(723)
SBC	(17)	(20)	(24)	(28)
Operating Income	**199**	**250**	**326**	**415**
Net Income	225	271	363	470
Non-GAAP OP Income	216	270	350	442.3
Non-GAAP EBITDA	300	357	417	502.7
Non-GAAP Net Income	**242**	**291**	**387**	**497.9**
MW EPS	1.43	1.70	2.26	2.90
Diluted Non-GAAP ADS	1.54	1.83	2.41	3.07
Note: 1 ADS = 1 Shares				
YoY Growth (%)	**2016**	**2017E**	**2018E**	**2019E**
Total Enrollment	**26%**	**24%**	**18%**	**16%**
Total Net Sales	**19%**	**19%**	**18%**	**17%**
Educational programs and services	19%	19%	18%	17%
Books and others	18%	20%	18%	17%
Gross Income	**20%**	**20%**	**20%**	**18%**
Operating Expense	17%	19%	17%	15%
Marketing	5%	17%	17%	15%
G&A	25%	19%	17%	15%
SBC	7%	19%	18%	17%
Operating Income	30%	26%	30%	27%
Net Income	16%	20%	34%	29%
Non-GAAP OP Income	**27%**	**25%**	**29%**	**27%**
Non-GAAP EBITDA	29%	19%	17%	20%
Non-GAAP Net Income	**16%**	**20%**	**33%**	**29%**
Diluted Non-GAAP EPS	16%	19%	33%	28%
Diluted Non-GAAP ADS	16%	19%	32%	27%
As % of Revenue (%)	**2016**	**2017E**	**2018E**	**2019E**
Educational programs and services	88.6%	88.5%	88.5%	88.5%
Books and others	11.4%	11.5%	11.5%	11.5%
Gross Income	58.4%	59.3%	60.3%	60.8%
Marketing	-13.4%	-13.2%	-13.1%	-12.8%
G&A	-30.7%	-30.7%	-30.4%	-29.8%
SBC	-1.1%	-1.1%	-1.1%	-1.1%
Non-GAAP OP Profits	14.6%	15.4%	16.9%	18.2%
Non-GAAP Net Income	16.3%	16.6%	18.7%	20.5%

Key Metrics	**2016**	**2017E**	**2018E**	**2019E**
Total Enrollment ('000)	3,645	4,528	5,327	6,167
YoY (%)	*26%*	*24%*	*18%*	*16%*
Total ARPU (USD)	359	343	345	348
YoY (%)	*-6%*	*-5%*	*1%*	*1%*
K-12 Enrollment ('000)	2,693	3,574	4,389	5,241
YoY (%)	*40%*	*33%*	*23%*	*19%*
K-12 ARPU (USD)	267	273	288	300
YoY (%)	*-6%*	*2%*	*6%*	*4%*
Teachers' Cost as % Revenue	22%	23%	23%	23%
Rental Cost as % Revenue	10%	10%	9%	9%
Balance Sheet	**2016**	**2017E**	**2018E**	**2019E**
Cash and Cash Equivalents	796	1,241	1,738	2,278
Short-term Investments	819	901	991	1,090
Current Assets	**1,869**	**2,270**	**2,863**	**3,493**
PP&E, Net	238	208	201	211
Long-term Investments	179	179	179	179
Non-current Assets	**485**	**456**	**449**	**458**
Total Assets	**2,355**	**2,726**	**3,311**	**3,951**
Accrued expenses and others	217	260	308	360
Deferred Revenue	647	678	846	994
Current Liabilities	**918**	**1,039**	**1,284**	**1,481**
Total Liabilities	**920**	**1,041**	**1,286**	**1,483**
Total Equity	**1,435**	**1,685**	**2,025**	**2,468**
Cash Flow	**2016**	**2017E**	**2018E**	**2019E**
Net Income	225	271	363	470
D&A	85	87	68	60
Change in Working Capital	205	128	239	206
Operating Cash Flow	**515**	**486**	**671**	**737**
CAPEX	(190)	36	(91)	(100)
Free Cash Flow	**325**	**522**	**580**	**637**
Investing Cash Flow	(339)	(41)	(174)	(197)
Financing Cash Flow	3			
Ratio Analysis	**2016**	**2017E**	**2018E**	**2019E**
ROA	11.2%	11.4%	12.8%	13.7%
ROE	18.2%	18.6%	20.9%	22.2%
Net Debt to Equity	-47%	-67%	-80%	-87%
Net Cash (US$ mn)	796	1,241	1,738	2,278
Key Valuation Metrics				
3-yr CAGR: Non-GAAP Profit	23%	27%	28%	24%
PE - Current Adj. Diluted EPADS	30.0	25.2	19.1	15.0
EV/EBITDA	22.6	19.0	16.3	13.5
FCF Yield	4.5%	7.2%	8.0%	8.8%

Source: Company data, Morgan Stanley Research; E = Morgan Stanley Research estimates

Risk Reward

Healthy top-line growth and steady margin expansion to support share price



Source: Thomson Reuters, Morgan Stanley Research estimates

Price Target **$53**

Base case DCF value.

Bull **$66**

28x bull case calendarized 2017e EPS

Strong demand, robust enrollment growth: Three-year (F2016-19) sales CAGR of 22%, thanks to stronger demand from its K-12 programs and even sharper enrollment growth in Rmb50 courses. Operating margin to improve from 13.6% in F15 to 18.6% in F19, thanks to operating leverage.

Base **$53**

24x base case calendarized 2017e EPS

Stable top-line growth: Three-year sales CAGR (F2016-19) of 18%, driven by steady enrollment growth and pricing power as New Oriental maintains its market share in the K-12 after-class tutoring service market. Operating margin improves to 18.2% in F19, helped by operating leverage.

Bear **$30**

17x bear case calendarized 2017e EPS

Slower network expansion, weaker margins: Three-year sales CAGR (F2016-19) of 15%, subdued by intensifying competition from both nationwide and local schools. Operating margin declines to 13.1% in F19 as a result of less operating leverage.

Investment Thesis

- New Oriental, a leading private education services provider in China, is a key beneficiary of the growing, yet defensive, education industry.
- Education services target a market of over 450mn people in China, substantially more than the US population, yet education spending per capita in China is less than 10% of the US level.
- EDU differentiates itself from peers by its "success formula": a premium brand name, an extensive nationwide distribution network, and high-quality education content.

Key Value Drivers

- Rising education spending as a percentage of GDP in China.
- Higher penetration of language training market.
- Average spending per enrollment.

Potential Catalysts

- Utilization improvement in newly established learning centers.
- Better-than-expected growth for U-Can, its after-school tutoring program.
- Fast market consolidation in core markets, e.g., Beijing.

Risks to Achieving Price Target

- Continued macro slowdown caps household spending on after-school tutoring services.
- Market consolidation is slower than expected.
- The overseas test preparation business decelerates faster than expected.
- Disruptive online education model emerges, especially in language training.

Earnings Estimate Revisions

We have raised our revenue forecasts by 0% for FY17, 0.3% for FY18, and 2.0% for FY19. Our AlphaWise survey findings provide strong support, we think, for our view that New Oriental's low- price strategy is effective. As New Oriental ranks high as a potential provider to switchers, we expect to see slightly stronger top-line growth, mainly driven by more optimistic enrollment assumptions for its K-12 segment.

We expect EDU's non-GAAP operating margin to expand to 18.2% in FY19, reflecting its well-paced expansion plan, strong enrollment growth and improving utilization rate.

As a result, we have raised our non-GAAP net income forecast for F17, F18 and F19 by 0.9%, 1.6% and 5.1%, respectively.

Exhibit 25: New Oriental: Old vs. New Estimates

FYE May	New			Old			% Change		
Income Statement (US$ mn)	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**	**2017E**	**2018E**	**2019E**
Total net revenues	**1,754**	**2,075**	**2,428**	**1,754**	**2,070**	**2,380**	**0.0%**	**0.3%**	**2.0%**
Cost of revenues (ex-SBC)	(714)	(824)	(952)	(714)	(824)	(936)	0.0%	0.0%	1.7%
Gross profit	**1,040**	**1,251**	**1,476**	**1,040**	**1,246**	**1,444**	**0.0%**	**0.4%**	**2.2%**
Selling and marketing (ex-SBC)	(232)	(271)	(311)	(235)	(274)	(312)	-1.3%	-1.0%	-0.3%
General and administrative (ex-SBC)	(538)	(630)	(723)	(538)	(629)	(716)	0.0%	0.3%	1.0%
SBC	(20)	(24)	(28)	(20)	(24)	(27)	0.0%	0.3%	2.0%
Total operating costs and expenses	(790)	(925)	(537)	(793)	(926)	(546)	-0.4%	-0.1%	-1.7%
Operating income	250	326	415	247	320	389	1.2%	2.0%	6.5%
Income before income tax and loss from equity method investments	322	430	555	319	423	528	1.0%	1.6%	5.2%
Provision for income taxes	(47)	(62)	(81)	(46)	(61)	(77)	1.0%	1.6%	5.2%
Net income	271	363	470	268	358	447	1.0%	1.6%	5.3%
Net income attributable to EDU	271	363	470	268	358	447	1.0%	1.6%	5.3%
Weighted average numbers of shares (mn)									
Basic	1.73	2.32	3.00	1.71	2.28	2.85	1.2%	1.8%	5.3%
Diluted	1.70	2.26	2.90	1.69	2.23	2.75	0.6%	1.3%	5.5%
Net earnings per ADS									
Basic	1.73	2.32	3.00	1.71	2.28	2.85	1.0%	1.6%	5.3%
Diluted	1.70	2.26	2.90	1.69	2.23	2.75	1.0%	1.6%	5.3%
Non-GAAP									
Non-GAAP Operating Income	270	350	442	267	343	416	1.1%	1.9%	6.2%
Non-GAAP Net Income	291	387	498	288	381	474	0.9%	1.6%	5.1%
Non-GAAP EPADS - Diluted	1.83	2.41	3.07	1.81	2.37	2.92	0.9%	1.6%	5.1%
Non-GAAP GPM	59.3%	60.3%	60.8%	59.3%	60.2%	60.7%	0.0%	0.1%	0.1%
Non-GAAP OPM	15.4%	16.9%	18.2%	15.2%	16.6%	17.5%	0.2%	0.3%	0.7%
Non-GAAP NPM	16.6%	18.7%	20.5%	16.4%	18.4%	19.9%	0.2%	0.2%	0.6%

Source: : Company Data, Morgan Stanley Research; E = Morgan Stanley Research estimates

Price Target and Valuation

Our preferred valuation methodology is discounted cash flow (DCF), which incorporates our long-term view. We apply a 12% discount rate (US risk-free rate of 3%, beta of 1.4, equity risk premium of 5%, China risk premium of 2%) and a 3% terminal growth rate. These assumptions are unchanged.

Our new price target is US$53, our base-case DCF value: We expect an 18% three-year revenue CAGR (F2016-19e), driven by steady enrollment growth and increasing pricing power. We have rolled this assumption forward from 16% for the F15-18e period. We assume that New Oriental's non-GAAP operating margin improves from 13.6% in F2015 to 18.2% by F2019, helped by improving operating leverage.

Bull case analysis: We assume the company becomes a market consolidator, with rising market share, especially in tier-one cities, leading to robust enrollment growth; revamped programs and O2O interactive systems that are well received by the market help improve the student retention rate, which, in turn, brings a higher utilization rate and increasing pricing power. Our scenario value here rises 10%, to US$66.

Bear case analysis: We assume that market consolidation doesn't happen, and thus enrollment growth is weaker than expected; network expansion into lower-tier cities weighs on operating margins. Our scenario value here rises 20%, to US$30. The increase in our bear case scenario value is sharper than that in the base case because, in our view, the company's capacity expansion strategy (5-7% growth p.a.) is quite disciplined, mitigating the downside risk of overly aggressive expansion that could lead to margin pressure.

Valuation Comps

Exhibit 26: China education valuation comps

Company	Thomson Reuters Ticker	Rating	Trading Currency	Closing Price 13-Oct	Mkt Cap USDmn	EV USDmn	Trading P/E (x) 16E	Trading P/E (x) 17E	Trading P/E (x) 18E	Earnings CAGR 15-18E	EV/EBITDA 16E	EV/EBITDA 17E	EV/EBITDA 18E	EV/Sales 16E	EV/Sales 17E	EV/Sales 18E	P/Sales 16E	P/Sales 17E	P/Sales 18E
China Education Companies																			
US-listed																			
New Oriental	EDU.N	OW	USD	45.9	7,410	5,822	31	26	19	22%	19	16	14	4	3	3	5	4	4
TAL Education	XRS.N	OW	USD	71.0	5,840	5,340	45	42	29	33%	35	28	20	9	6	4	9	6	5
Tarena	TEDU.O	NC	USD	14.2	833	665	19	15	12	33%	14	10	9	3	2	2	3	3	2
China Distance Education	DL.N	NC	USD	13.5	444	388	18	16	15	6%	13	11	11	3	3	3	4	3	3
China Online Education	COE.N	OW	USD	19.9	396	297	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Average							**28**	**24**	**18**	**24%**	**21**	**17**	**14**	**5**	**4**	**3**	**6**	**5**	**4**
HK-listed																			
Virscend Education Co	1565.HK	NC	HKD	4.1	1,612	1,693	40	30	17	76%	22	14	NA	11	8	NA	10	8	NA
Maple Leaf Education System	1317.HK	NC	HKD	6.3	1,080	962	26	21	16	27%	16	13	12	6	5	4	7	6	5
China E-learning Group	8055.HK	NC	HKD	0.4	149	146	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Average							**33**	**25**	**17**	**52%**	**19**	**13**	**12**	**8**	**7**	**4**	**9**	**7**	**5**
China-listed																			
Qtone Education	300359.SZ	NC	CNY	27.0	2,444	2,416	65	43	29	80%	24	NA	NA	11	7	NA	11	7	NA
Lanxum	300010.SZ	NC	CNY	19.2	2,466	2,331	58	43	32	57%	31	21	NA	8	6	NA	8	7	NA
Tangel	300148.SZ	NC	CNY	19.7	1,877	1,845	56	39	32	29%	24	15	NA	10	9	NA	10	9	NA
Xin Nan Yang Co., Ltd	600661.SH	NC	CNY	30.0	1,148	1,108	66	54	35	53%	53	37	NA	4	3	NA	4	3	NA
Average							**61**	**45**	**32**	**54%**	**33**	**24**	**NA**	**8**	**6**	**NA**	**8**	**7**	**NA**

Source: Thomson Reuters, Morgan Stanley Research;
E = Morgan Stanley Research estimates based on fiscal year end, except for Not Covered (NC) companies, which are Thomson Reuters consensus estimates; share price related data as of market close on October 13th 2016.

More on AlphaWise

ALPHAWISE α
evidence-based research

AlphaWise conducts proprietary evidence-based investment research. Click to read AlphaWise Market Research and Web Research whitepapers on evidence gathering. For further information, please contact alphawise@morganstanley.com.

Other Recent Morgan Stanley Research Based on AlphaWise Evidence

NA REITs	**Vikram Malhotra**	October 06, 2016

Sr. Housing 3Q Check-up: Construction Still Peaking; Risks Into 2017

Latest data from NIC shows senior housing construction levels remain high with upward revisions to 2Q data. We continue to see risk to the sector over the next year as new supply comes online.

NA Med Tech	**David R. Lewis**	October 05, 2016

3Q16 Hospital Survey: Environment Continues to Look Stable

Our September AlphaWise survey of 111 hospital executives supports a steady environment for medical devices. The survey provides increased confidence in the continuation of capex momentum, elevated medical acuity and stable utilization.

NA Internet	**Brian Nowak**	October 05, 2016

Prime: From 0-60 Million

AlphaWise shows continued strong Prime sub growth, now at 60mn members. We see Prime subs spending ~4.5X more than non-Prime users too, which combined with higher Prime sub forecast, leads to 4% higher '17 CSOI (even thru more investment).

EU Leisure & Hotels	**Jamie Rollo**	October 04, 2016

Cruise Chat: Slow September

Our monthly travel agents survey suggests a slow September, with weak booking volumes and generally lower prices, and our web research data shows weaker forward prices for almost all brands.

NA Software	**Melissa Gorham**	October 03, 2016

Customer Survey: A Ramping Cloud Leads to Sunshine Ahead; Reiterate OW

Our survey of 50 SPLK customers suggest a more durable growth path, stronger competitive dynamics and more positive impacts from cloud than most investors believe.

EU Leisure & Hotels	**Vaughan Lewis**	September 28, 2016

UK Online Gambling Survey: Odds On Strong Growth

Our UK survey shows a high engagement with online gambling (64% penetration of gamblers). We expect continued strong structural growth in online to be the key theme in UK gambling.

NA Retail	**Kimberly C Greenberger**	September 27, 2016

Mall Jenga Move 1: Macy's 100 Closures

We think Macy’s is the tip of the store closure iceberg. Our work suggests Class A REIT multiples may be too high relative to their Class B peers and retail tenants, supporting our below consensus numbers. Our analysis of mall exposures will be ongoing.

AP Financials	**Daniel P Toohey**	September 22, 2016

Medibank Private Ltd.: Where's my refund?

Our AlphaWise survey of 1,012 health policyholders and case studies support our view that restoring franchise momentum is a medium-term prospect, demanding reinvestment and a review of growth/retention strategies

EU Consumer	**Eileen Khoo**	September 21, 2016

The Tide Will Rise – Raise EPS ~11% on WhiteWave, PT to €80

Our detailed work and AlphaWise analysis suggest material upside potential to Danone's synergy targets, and relatively low risk of commoditization in WWAV's core business.

Disclosure Section

The information and opinions in Morgan Stanley Research were prepared or are disseminated by Morgan Stanley Asia Limited (which accepts the responsibility for its contents) and/or Morgan Stanley Asia (Singapore) Pte. (Registration number 199206298Z) and/or Morgan Stanley Asia (Singapore) Securities Pte Ltd (Registration number 200008434H), regulated by the Monetary Authority of Singapore (which accepts legal responsibility for its contents and should be contacted with respect to any matters arising from, or in connection with, Morgan Stanley Research), and/or Morgan Stanley Taiwan Limited and/or Morgan Stanley & Co International plc, Seoul Branch, and/or Morgan Stanley Australia Limited (A.B.N. 67 003 734 576, holder of Australian financial services license No. 233742, which accepts responsibility for its contents), and/or Morgan Stanley Wealth Management Australia Pty Ltd (A.B.N. 19 009 145 555, holder of Australian financial services license No. 240813, which accepts responsibility for its contents), and/or Morgan Stanley India Company Private Limited, regulated by the Securities and Exchange Board of India ("SEBI") and holder of licenses as a Research Analyst (SEBI Registration No. INH000001105); Stock Broker (BSE Registration No. INB011054237 and NSE Registration No. INB/INF231054231), Merchant Banker (SEBI Registration No. INM000011203), and depository participant with National Securities Depository Limited (SEBI Registration No. IN-DP-NSDL-372-2014) which accepts the responsibility for its contents and should be contacted with respect to any matters arising from, or in connection with, Morgan Stanley Research, and/or PT Morgan Stanley Asia Indonesia and their affiliates (collectively, "Morgan Stanley").

For important disclosures, stock price charts and equity rating histories regarding companies that are the subject of this report, please see the Morgan Stanley Research Disclosure Website at www.morganstanley.com/researchdisclosures, or contact your investment representative or Morgan Stanley Research at 1585 Broadway, (Attention: Research Management), New York, NY, 10036 USA.

For valuation methodology and risks associated with any recommendation, rating or price target referenced in this research report, please contact the Client Support Team as follows: US/Canada +1 800 303-2495; Hong Kong +852 2848-5999; Latin America +1 718 754-5444 (U.S.); London +44 (0)20-7425-8169; Singapore +65 6834-6860; Sydney +61 (0)2-9770-1505; Tokyo +81 (0)3-6836-9000. Alternatively you may contact your investment representative or Morgan Stanley Research at 1585 Broadway, (Attention: Research Management), New York, NY 10036 USA.

Analyst Certification

The following analysts hereby certify that their views about the companies and their securities discussed in this report are accurately expressed and that they have not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report: Claire Cao; Amanda Chen; David Sun; Julia Zhu, CFA.

Unless otherwise stated, the individuals listed on the cover page of this report are research analysts.

Global Research Conflict Management Policy

Morgan Stanley Research has been published in accordance with our conflict management policy, which is available at www.morganstanley.com/institutional/research/conflictpolicies.

Important US Regulatory Disclosures on Subject Companies

As of September 30, 2016, Morgan Stanley beneficially owned 1% or more of a class of common equity securities of the following companies covered in Morgan Stanley Research: 58.com, JD.com, Inc., New Oriental Group, SouFun Holdings Limited, TAL Education Group, Vipshop Holdings.

Within the last 12 months, Morgan Stanley managed or co-managed a public offering (or 144A offering) of securities of 58.com, Alibaba Group Holding, China Online Education Group, Ctrip.com, JD.com, Inc..

Within the last 12 months, Morgan Stanley has received compensation for investment banking services from 58.com, Alibaba Group Holding, China Online Education Group, Ctrip.com, JD.com, Inc., Momo Inc., NetEase, Inc.

In the next 3 months, Morgan Stanley expects to receive or intends to seek compensation for investment banking services from 58.com, Alibaba Group Holding, Baidu Inc, Baozun Inc, Bitauto Holdings Limited, Cheetah Mobile Inc., Ctrip.com, JD.com, Inc., Leshi Internet Information & Technology, Momo Inc., NetEase, Inc, New Oriental Group, Qunar Cayman Islands Ltd, TAL Education Group, Tencent Holdings Ltd., Tuniu Corporation, Vipshop Holdings, Weibo Corp, YY Inc..

Within the last 12 months, Morgan Stanley has received compensation for products and services other than investment banking services from 58.com, Alibaba Group Holding, Baidu Inc, Cheetah Mobile Inc., Ctrip.com, NetEase, Inc, New Oriental Group, Tencent Holdings Ltd., Vipshop Holdings, YY Inc..

Within the last 12 months, Morgan Stanley has provided or is providing investment banking services to, or has an investment banking client relationship with, the following company: 58.com, Alibaba Group Holding, Baidu Inc, Baozun Inc, Bitauto Holdings Limited, Cheetah Mobile Inc., China Online Education Group, Ctrip.com, JD.com, Inc., Leshi Internet Information & Technology, Momo Inc., NetEase, Inc, New Oriental Group, Qunar Cayman Islands Ltd, TAL Education Group, Tencent Holdings Ltd., Tuniu Corporation, Vipshop Holdings, Weibo Corp, YY Inc..

Within the last 12 months, Morgan Stanley has either provided or is providing non-investment banking, securities-related services to and/or in the past has entered into an agreement to provide services or has a client relationship with the following company: 58.com, Alibaba Group Holding, Baidu Inc, Cheetah Mobile Inc., Ctrip.com, NetEase, Inc, New Oriental Group, TAL Education Group, Tencent Holdings Ltd., Vipshop Holdings, YY Inc..

Morgan Stanley & Co. LLC makes a market in the securities of 58.com, Alibaba Group Holding, Autohome Inc., Baidu Inc, Baozun Inc, Bitauto Holdings Limited, Changyou.com, Cheetah Mobile Inc., China Online Education Group, Ctrip.com, JD.com, Inc., Momo Inc., NetEase, Inc, New Oriental Group, Qunar Cayman Islands Ltd, Sohu.com Inc, SouFun Holdings Limited, TAL Education Group, Tuniu Corporation, Vipshop Holdings, Weibo Corp, YY Inc..

The equity research analysts or strategists principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors, firm revenues and overall investment banking revenues. Equity Research analysts' or strategists' compensation is not linked to investment banking or capital markets transactions performed by Morgan Stanley or the profitability or revenues of particular trading desks.

Morgan Stanley and its affiliates do business that relates to companies/instruments covered in Morgan Stanley Research, including market making, providing liquidity, fund management, commercial banking, extension of credit, investment services and investment banking. Morgan Stanley sells to and buys from customers the securities/instruments of companies covered in Morgan Stanley Research on a principal basis. Morgan Stanley may have a position in the debt of the Company or instruments discussed in this report. Morgan Stanley trades or may trade as principal in the debt securities (or in related derivatives) that are the subject of the debt research report.

Certain disclosures listed above are also for compliance with applicable regulations in non-US jurisdictions.

STOCK RATINGS

Morgan Stanley uses a relative rating system using terms such as Overweight, Equal-weight, Not-Rated or Underweight (see definitions below). Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold and sell. Investors should carefully read the definitions of all ratings used in Morgan Stanley Research. In addition, since Morgan Stanley Research contains more complete information concerning the analyst's views, investors should carefully read Morgan Stanley Research, in its entirety, and not infer the contents from the rating alone. In any case, ratings (or research) should not be used or relied upon as investment advice. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations.

Global Stock Ratings Distribution

(as of September 30, 2016)

The Stock Ratings described below apply to Morgan Stanley's Fundamental Equity Research and do not apply to Debt Research produced by the Firm.
For disclosure purposes only (in accordance with NASD and NYSE requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight, Not-Rated and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Not-Rated to hold and Underweight to sell recommendations, respectively.

	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
STOCK RATING CATEGORY	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
Overweight/Buy	**1144**	**35%**	**261**	**40%**	**23%**	**566**	**36%**
Equal-weight/Hold	**1429**	**43%**	**303**	**46%**	**21%**	**713**	**45%**
Not-Rated/Hold	**73**	**2%**	**8**	**1%**	**11%**	**10**	**1%**
Underweight/Sell	**655**	**20%**	**84**	**13%**	**13%**	**287**	**18%**
TOTAL	**3,301**		**656**			**1576**	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

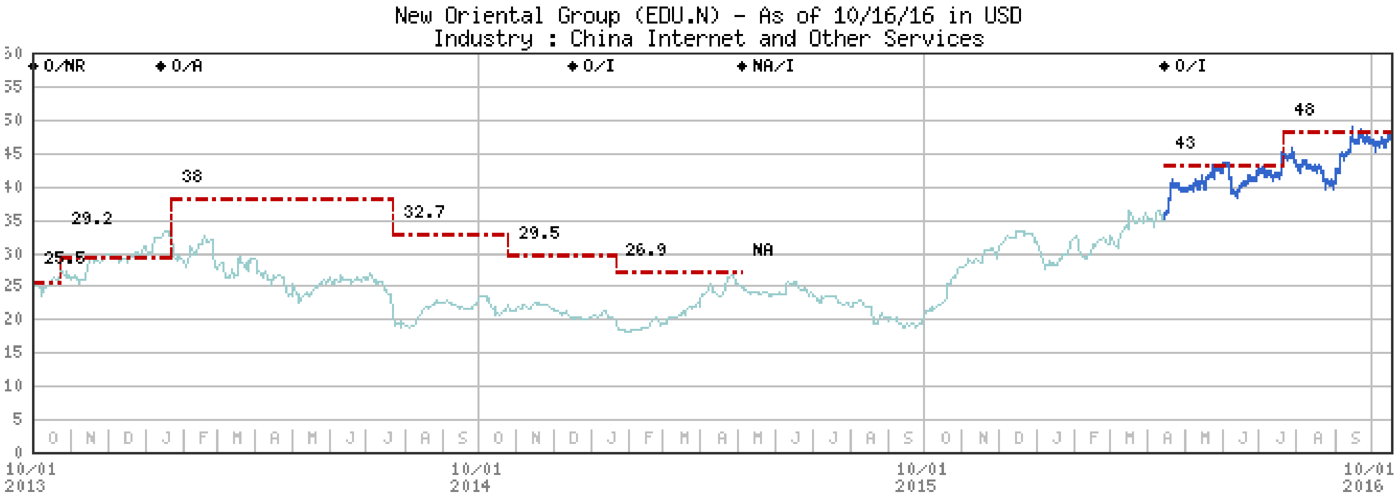
Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.
Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.
Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.
Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

Stock Price, Price Target and Rating History (See Rating Definitions)



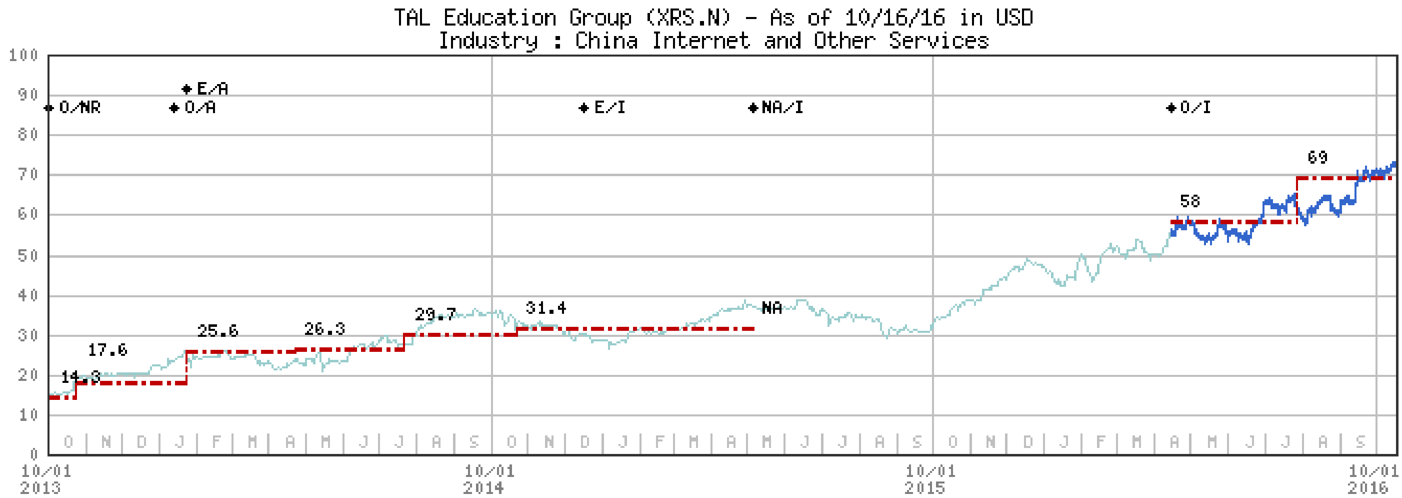
Stock Rating History: 10/1/13 : O/NR; 1/13/14 : O/A; 12/17/14 : O/I; 5/5/15 : NA/I; 4/14/16 : O/I

Price Target History: 7/24/13 : 25.5; 10/24/13 : 29.2; 1/22/14 : 38; 7/23/14 : 32.7; 10/25/14 : 29.5; 1/21/15 : 26.9; 5/5/15 : NA; 4/14/16 : 43; 7/21/16 : 48

Source: Morgan Stanley Research   Date Format : MM/DD/YY   Price Target --   No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.



Stock Rating History: 10/1/13 : 0/NR; 1/13/14 : 0/A; 1/23/14 : E/A; 12/17/14 : E/I; 5/5/15 : NA/I; 4/14/16 : 0/I

Price Target History: 7/23/13 : 14.3; 10/23/13 : 17.6; 1/23/14 : 25.6; 4/22/14 : 26.3; 7/22/14 : 29.7; 10/22/14 : 31.4; 5/5/15 : NA; 4/14/16 : 58; 7/28/16 : 69

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

Important Disclosures for Morgan Stanley Smith Barney LLC Customers

Important disclosures regarding the relationship between the companies that are the subject of Morgan Stanley Research and Morgan Stanley Smith Barney LLC or Morgan Stanley or any of their affiliates, are available on the Morgan Stanley Wealth Management disclosure website at www.morganstanley.com/online/researchdisclosures. For Morgan Stanley specific disclosures, you may refer to www.morganstanley.com/researchdisclosures.

Each Morgan Stanley Equity Research report is reviewed and approved on behalf of Morgan Stanley Smith Barney LLC. This review and approval is conducted by the same person who reviews the Equity Research report on behalf of Morgan Stanley. This could create a conflict of interest.

Other Important Disclosures

Morgan Stanley & Co. International PLC and its affiliates have a significant financial interest in the debt securities of Alibaba Group Holding, Baidu Inc, Ctrip.com, Vipshop Holdings.

Morgan Stanley Research policy is to update research reports as and when the Research Analyst and Research Management deem appropriate, based on developments with the issuer, the sector, or the market that may have a material impact on the research views or opinions stated therein. In addition, certain Research publications are intended to be updated on a regular periodic basis (weekly/monthly/quarterly/annual) and will ordinarily be updated with that frequency, unless the Research Analyst and Research Management determine that a different publication schedule is appropriate based on current conditions.

Morgan Stanley is not acting as a municipal advisor and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of Section 975 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Morgan Stanley produces an equity research product called a "Tactical Idea." Views contained in a "Tactical Idea" on a particular stock may be contrary to the recommendations or views expressed in research on the same stock. This may be the result of differing time horizons, methodologies, market events, or other factors. For all research available on a particular stock, please contact your sales representative or go to Matrix at http://www.morganstanley.com/matrix.

Morgan Stanley Research is provided to our clients through our proprietary research portal on Matrix and also distributed electronically by Morgan Stanley to clients. Certain, but not all, Morgan Stanley Research products are also made available to clients through third-party vendors or redistributed to clients through alternate electronic means as a convenience. For access to all available Morgan Stanley Research, please contact your sales representative or go to Matrix at http://www.morganstanley.com/matrix.

Any access and/or use of Morgan Stanley Research is subject to Morgan Stanley's Terms of Use (http://www.morganstanley.com/terms.html). By accessing and/or using Morgan Stanley Research, you are indicating that you have read and agree to be bound by our Terms of Use (http://www.morganstanley.com/terms.html). In addition you consent to Morgan Stanley processing your personal data and using cookies in accordance with our Privacy Policy and our Global Cookies Policy (http://www.morganstanley.com/privacy_pledge.html), including for the purposes of setting your preferences and to collect readership data so that we can deliver better and more personalized service and products to you. To find out more information about how Morgan Stanley processes personal data, how we use cookies and how to reject cookies see our Privacy Policy and our Global Cookies Policy (http://www.morganstanley.com/privacy_pledge.html).

If you do not agree to our Terms of Use and/or if you do not wish to provide your consent to Morgan Stanley processing your personal data or using cookies please do not access our research.

Morgan Stanley Research does not provide individually tailored investment advice. Morgan Stanley Research has been prepared without regard to the circumstances and objectives of those who receive it. Morgan Stanley recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of an investment or strategy will depend on an investor's circumstances and objectives. The securities, instruments, or strategies discussed in Morgan Stanley Research may not be suitable for all investors, and certain investors may not be eligible to purchase or participate in some or all of them. Morgan Stanley Research is not an offer to buy or sell or the solicitation of an offer to buy or sell any security/instrument or to participate in any particular trading strategy. The value of and income from your investments may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, securities/instruments prices, market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in securities/instruments transactions. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. If provided, and unless otherwise stated, the closing price on the cover page is that of the primary exchange for the subject company's securities/instruments.

The fixed income research analysts, strategists or economists principally responsible for the preparation of Morgan Stanley Research have received compensation based upon various factors, including quality, accuracy and value of research, firm profitability or revenues (which include fixed income trading and capital markets profitability or revenues), client feedback and competitive factors. Fixed Income Research analysts', strategists' or economists' compensation is not linked to investment banking or capital markets transactions performed by Morgan Stanley or the profitability or revenues of particular trading desks.

The "Important US Regulatory Disclosures on Subject Companies" section in Morgan Stanley Research lists all companies mentioned where Morgan Stanley owns 1% or more of a class of common equity securities of the companies. For all other companies mentioned in Morgan Stanley Research, Morgan Stanley may have an investment of less than 1% in securities/instruments or derivatives of securities/instruments of companies and may trade them in ways different from those discussed in Morgan Stanley Research. Employees of Morgan Stanley not involved in the preparation of Morgan Stanley Research may have investments in securities/instruments or derivatives of securities/instruments of companies mentioned and may trade them in ways different from those discussed in Morgan Stanley Research. Derivatives may be issued by Morgan Stanley or associated persons.

With the exception of information regarding Morgan Stanley, Morgan Stanley Research is based on public information. Morgan Stanley makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in Morgan Stanley Research change apart from when we intend to discontinue equity research coverage of a subject company. Facts and views presented in Morgan Stanley Research have not been reviewed by, and may not reflect information known to, professionals in other Morgan Stanley business areas, including investment banking personnel.

Morgan Stanley Research personnel may participate in company events such as site visits and are generally prohibited from accepting payment by the company of associated expenses unless pre-approved by authorized members of Research management.

Morgan Stanley may make investment decisions that are inconsistent with the recommendations or views in this report.

To our readers in Taiwan: Information on securities/instruments that trade in Taiwan is distributed by Morgan Stanley Taiwan Limited ("MSTL"). Such information is for your reference only. The reader should independently evaluate the investment risks and is solely responsible for their investment decisions. Morgan Stanley Research may not be distributed to the public media or quoted or used by the public media without the express written consent of Morgan Stanley. Information on securities/instruments that do not trade in Taiwan is for informational purposes only and is not to be construed as a recommendation or a solicitation to trade in such securities/instruments. MSTL may not execute transactions for clients in these securities/instruments. To our readers in Hong Kong: Information is distributed in Hong Kong by and on behalf of, and is attributable to, Morgan Stanley Asia Limited as part of its regulated activities in Hong Kong. If you have any queries concerning Morgan Stanley Research, please contact our Hong Kong sales representatives.

Certain information in Morgan Stanley Research was sourced by employees of the Shanghai Representative Office of Morgan Stanley Asia Limited for the use of Morgan Stanley Asia Limited.

Morgan Stanley is not incorporated under PRC law and the research in relation to this report is conducted outside the PRC. Morgan Stanley Research does not constitute an offer to sell or the solicitation of an offer to buy any securities in the PRC. PRC investors shall have the relevant qualifications to invest in such securities and shall be responsible for obtaining all relevant approvals, licenses, verifications and/or registrations from the relevant governmental authorities themselves. Neither this report nor any part of it is intended as, or shall constitute, provision of any consultancy or advisory service of securities investment as defined under PRC law. Such information is provided for your reference only.

Morgan Stanley Research is disseminated in Brazil by Morgan Stanley C.T.V.M. S.A.; in Mexico by Morgan Stanley México, Casa de Bolsa, S.A. de C.V which is regulated by Comision Nacional Bancaria y de Valores. Paseo de los Tamarindos 90, Torre 1, Col. Bosques de las Lomas Floor 29, 05120 Mexico City; in Japan by Morgan Stanley MUFG Securities Co., Ltd. and, for Commodities related research reports only, Morgan Stanley Capital Group Japan Co., Ltd; in Hong Kong by Morgan Stanley Asia Limited (which accepts responsibility for its contents) and by Morgan Stanley Asia International Limited, Hong Kong Branch; in Singapore by Morgan Stanley Asia (Singapore) Pte. (Registration number 199206298Z) and/or Morgan Stanley Asia (Singapore) Securities Pte Ltd (Registration number 200008434H), regulated by the Monetary Authority of Singapore (which accepts legal responsibility for its contents and should be contacted with respect to any matters arising from, or in connection with, Morgan Stanley Research) and by Morgan Stanley Asia International Limited, Singapore Branch (Registration number T11FC0207F); in Australia to "wholesale clients" within the meaning of the Australian Corporations Act by Morgan Stanley Australia Limited A.B.N. 67 003 734 576, holder of Australian financial services license No. 233742, which accepts responsibility for its contents; in Australia to "wholesale clients" and "retail clients" within the meaning of the Australian Corporations Act by Morgan Stanley Wealth Management Australia Pty Ltd (A.B.N. 19 009 145 555, holder of Australian financial services license No. 240813, which accepts responsibility for its contents; in Korea by Morgan Stanley & Co International plc, Seoul Branch; in India by Morgan Stanley India Company Private Limited; in Indonesia by PT Morgan Stanley Asia Indonesia; in Canada by Morgan Stanley Canada Limited, which has approved of and takes responsibility for its contents in Canada; in Germany by Morgan Stanley Bank AG, Frankfurt am Main and Morgan Stanley Private Wealth Management Limited, Niederlassung Deutschland, regulated by Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin); in Spain by Morgan Stanley, S.V., S.A., a Morgan Stanley group company, which is supervised by the Spanish Securities Markets Commission (CNMV) and states that Morgan Stanley Research has been written and distributed in accordance with the rules of conduct applicable to financial research as established under Spanish regulations; in the US by Morgan Stanley & Co. LLC, which accepts responsibility for its contents. Morgan Stanley & Co. International plc, authorized by the Prudential Regulatory Authority and regulated by the Financial Conduct Authority and the Prudential Regulatory Authority, disseminates in the UK research that it has prepared, and approves solely for the purposes of section 21 of the Financial Services and Markets Act 2000, research which has been prepared by any of its affiliates. RMB Morgan Stanley (Proprietary) Limited is a member of the JSE Limited and regulated by the Financial Services Board in South Africa. RMB Morgan Stanley (Proprietary) Limited is a joint venture owned equally by Morgan Stanley International Holdings Inc. and RMB Investment Advisory (Proprietary) Limited, which is wholly owned by FirstRand Limited. The information in Morgan Stanley Research is being disseminated by Morgan Stanley Saudi Arabia, regulated by the Capital Market Authority in the Kingdom of Saudi Arabia , and is directed at Sophisticated investors only.

Morgan Stanley Hong Kong Securities Limited is the liquidity provider/market maker for securities of Tencent Holdings Ltd. listed on the Stock Exchange of Hong Kong Limited. An updated list can be found on HKEx website: http://www.hkex.com.hk.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (DIFC Branch), regulated by the Dubai Financial Services Authority (the DFSA), and is directed at Professional Clients only, as defined by the DFSA. The financial products or financial services to which this research relates will only be made available to a customer who we are satisfied meets the regulatory criteria to be a Professional Client.

The information in Morgan Stanley Research is being communicated by Morgan Stanley & Co. International plc (QFC Branch), regulated by the Qatar Financial Centre Regulatory Authority (the QFCRA), and is directed at business customers and market counterparties only and is not intended for Retail Customers as defined by the QFCRA.

As required by the Capital Markets Board of Turkey, investment information, comments and recommendations stated here, are not within the scope of investment advisory activity. Investment advisory service is provided exclusively to persons based on their risk and income preferences by the authorized firms.

INDUSTRY COVERAGE: China Internet and Other Services

COMPANY (TICKER)	RATING (AS OF)	PRICE* (10/14/2016)
Amanda Chen		
58.com (WUBA.N)	O (08/21/2015)	US$45.62
Autohome Inc. (ATHM.N)	O (11/24/2014)	US$25.73
Bitauto Holdings Limited (BITA.N)	E (09/20/2016)	US$27.48
Ctrip.com (CTRP.O)	O (08/05/2015)	US$46.57
Leshi Internet Information & Technology (300104.SZ)	E (11/26/2015)	Rmb44.05
Qunar Cayman Islands Ltd (QUNR.O)	E (04/26/2016)	US$28.80
Shanghai Oriental Pearl Media (600637.SS)	O (11/26/2015)	Rmb24.26
SouFun Holdings Limited (SFUN.N)	O (03/21/2016)	US$3.71
Tuniu Corporation (TOUR.O)	E (04/26/2016)	US$9.89
Claire Cao		
China Online Education Group (COE.N)	O (07/05/2016)	US$19.91
Momo Inc. (MOMO.O)	E (09/06/2016)	US$23.50
New Oriental Group (EDU.N)	O (04/14/2016)	US$47.05
TAL Education Group (XRS.N)	O (04/14/2016)	US$72.25
Weibo Corp (WB.O)	O (12/17/2015)	US$53.08
YY Inc. (YY.O)	E (08/17/2015)	US$53.35
David Sun		
Baidu Inc (BIDU.O)	O (07/21/2014)	US$175.51
Changyou.com (CYOU.O)	U (09/24/2015)	US$26.98
Cheetah Mobile Inc. (CMCM.N)	U (05/23/2016)	US$11.89
NetEase, Inc (NTES.O)	E (09/24/2015)	US$261.37
Sohu.com Inc (SOHU.O)	U (09/24/2015)	US$43.42
Tencent Holdings Ltd. (0700.HK)	O (11/11/2015)	HK$208.80
Julia Zhu, CFA		
Alibaba Group Holding (BABA.N)	O (10/29/2014)	US$101.85
Baozun Inc (BZUN.O)	O (06/15/2015)	US$14.96
JD.com, Inc. (JD.O)	O (12/17/2015)	US$26.50
Vipshop Holdings (VIPS.N)	E (02/29/2016)	US$14.33

Stock Ratings are subject to change. Please see latest research for each company.
* Historical prices are not split adjusted.