

China Consumer

2024 Year Ahead: other than just being bears

Rating Change

Consensus vs. controversy

The market starts 2024 with a bearish outlook, light positioning and all-time low valuation for China consumer. 1) **What's the consensus?** 2024 (or 1H24 at least) will see a third round of consumption dips or be "L-shaped" at best. Weak macro, deflation, low consumer/business confidence, "Japanification" of property and behind-the-curve stimulus dominate narratives. Investors look for meaningful downside to consensus EPS. 2) **What is still controversial?** With too many moving parts and paradigm shifts, the market has little clue as to where the valuation anchor should be in the future. Bulls argue trough valuations have (more than) discounted risks, while bears highlight BABA at <10x and question earnings, regulations, geopolitics, liquidity and trend growth. With further EPS downgrades, movement in multiples will be key to near-term share-price performance.

What to do with Consumer, other than being bears?

In this market, it's hard not to be bears. To turn positive, we have to 1) look for strong alpha that can defy weak beta, or 2) make bold calls on flows and sentiment, or 3) actively gauge positioning and expectation, monitor high-frequency data, and identify the subtle discrepancy of reality vs. perception ("less bad" opportunities). In our ADR coverage universe, we upgrade **TAL** to Buy (from Neutral). We have also made EPS and PO changes for our coverage. Within our ADR universe, we prefer **EDU** and **TAL**.

Key trends and themes that we see in 2024

1) Cautious consumers now concentrate limited budgets on holiday/shopping seasons, so Lunar New Year (LNY) is critical to 1H. Expectations are low, and hope lies in the calendar shift (a late LNY). If LNY proves weak, investors may walk away in the March/April low season. 2) Supply side matters amid soft demand, and sectors with favorable supply-side can see relative resilience (eg, education). 3) Consumers become more value conscious. Companies which can deliver functional/emotional value may still enjoy trading-up. Those failing to convince consumers with value creation are vulnerable to consumption downgrade. 4) Going abroad gains importance, though most companies have limited overseas exposure. 5) The shift from growth to value is ongoing, with more attention paid to FCF/dividend yield. 6) Staples, should they continue to underperform, could become interesting in 2H24, due to likely rising yield, even cheaper valuation after rollover to 2025 and easier comps.

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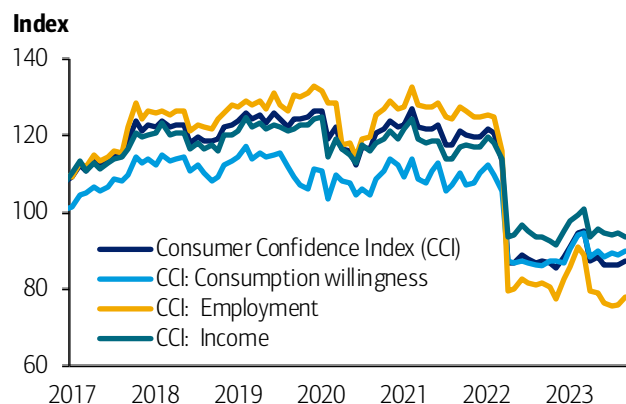
Consensus vs. controversy

What's the consensus?

China consumption has already seen two rounds of dips (April 2022/Shanghai lockdown, and April/May 2023) in the past two years. Going forward, the market in general has very low expectations for 2024 (or 1H24 at least). Investors either expect a third round of consumption dips, or an “L-shaped” trajectory at best. Weak macro, deflation, all-time low consumer & equally dull business confidence, multi-year property bubble correction (Japanification), and behind-the-curve policy stimulus dominate narratives. The current consensus EPS appears outdated, as the average forecast has remained largely unchanged now vs. 12 months ago, despite all the macro headwinds and cautious corporate commentary. As a result, the market looks for significant downside earnings risks.

Exhibit 1: Consumer confidence index

Consumer confidence still far below the pre-Covid level

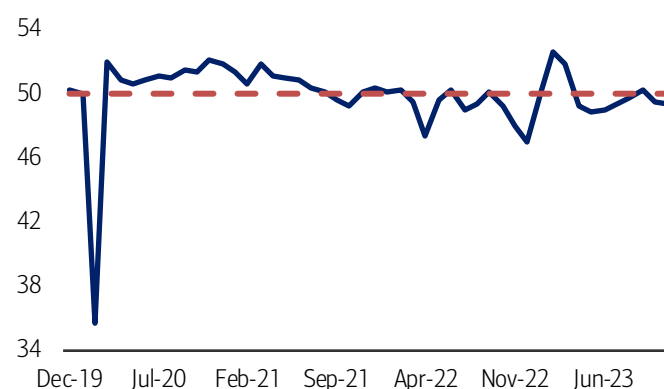


Source: NBS

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Exhibit 2: China: Manufacturing PMI

Manufacturing PMI has been below 50 for most months recently



Source: NBS

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Exhibit 3: China: CPI&PPI deflation

CPI&PPI both on deflation cycle

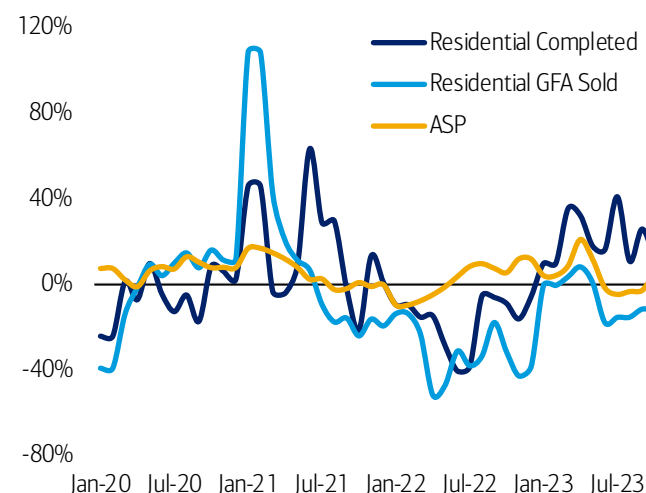


Source: NBS

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Exhibit 4: China: Residential property growth

Residential property sales continued weak trend



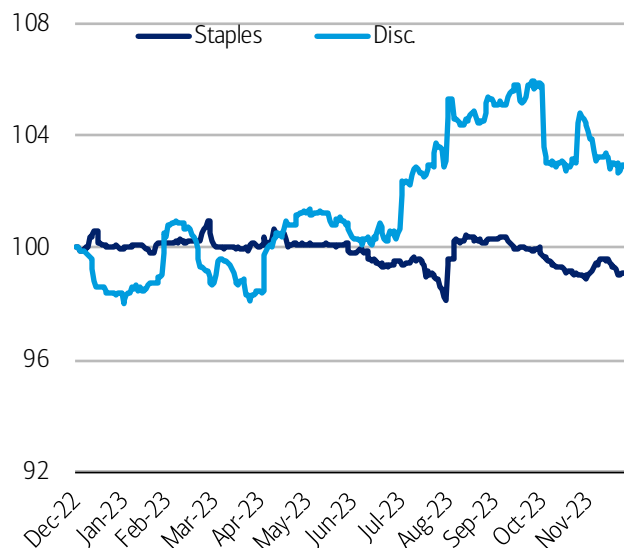
Source: NBS, BofA Global Research

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Exhibit 5: 2023 EPS consensus revision

Consumer staples have been revised down by 1% and discretionary up 3%

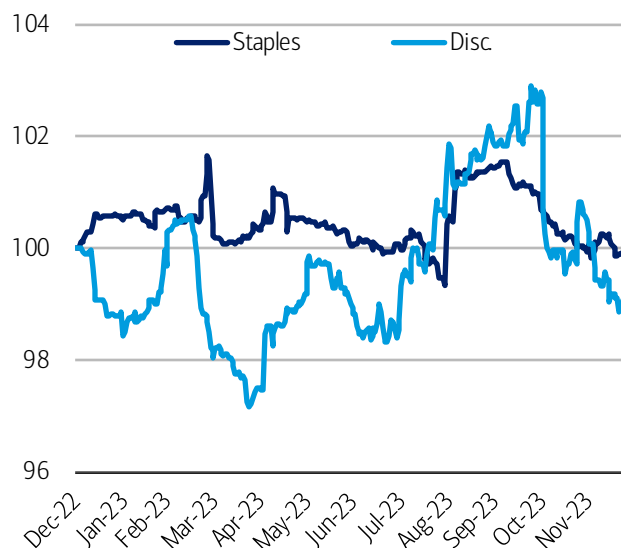


Source: Bloomberg, BofA Global Research. *Based on our covered stocks, priced as of Dec 27, 2023

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Exhibit 6: 2024 EPS consensus revision

Consumer staples have been largely flat and discretionary revised down 1%



Source: Bloomberg, BofA Global Research. *Based on our covered stocks, priced as of Dec 27, 2023

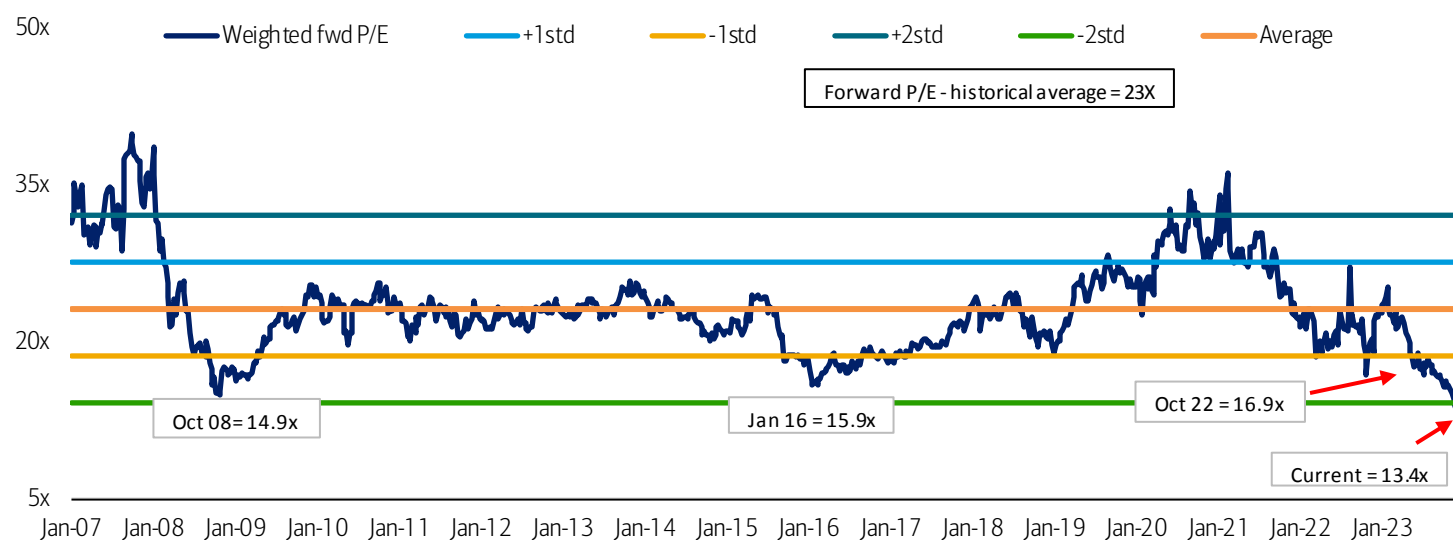
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What is still controversial?

The sector (HK & ADR) now trades at 13x forward P/E, even below the Global Financial Crisis (14.9x back in Oct-2008) and 2SD away from the historical mean, due to low EPS visibility (thus short duration) and fund outflow. All the historical experience on valuation appears irrelevant in the current environment, and the market now has no clues as to where the valuation anchor should be in the future. Bulls argue trough valuations have (more than) discounted risks, while bears highlight BABA only at <10x, and question earnings, regulations, geopolitics, liquidity and trend growth. With further EPS downgrades, movement in multiples will be key to near-term share-price performance.

Exhibit 7: China Consumer: P/E Band (1 yr forward)

Sector forward P/E already below 2008 lowest point and -2SD from historical average.



Source: Bloomberg, BofA Global Research estimates. Priced as of Dec 30, 2023

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Key trends & themes that we see in 2024

Concentrated spending, and LNY is critical to 1H

With all-time low confidence, consumers tend to concentrate their limited budgets on holiday/shopping seasons, and consumption recovery follows a wave-like pattern (normally better during holiday/shopping seasons, and lackluster in the low seasons). Thus, Lunar New Year (LNY) would be critical for setting the tone in 1H24. It is the peak season for many consumer categories, including baijiu (gifting and banquets), restaurant, and dairy (gifting demand for premium products). Investor expectations are low (partly due to tough comps from the strong 2023 LNY), and hope lies in the positive calendar shift from a late LNY. LNY in 2024 (10 Feb) will be 19 days later than 2023. As a result, the pre-LNY sell-in/shipment will happen in January (vs. in December previously). At the sell-through level, the calendar shift will also lead to a longer peak season on a YoY basis. If LNY proves weaker than expected, investors may simply walk away in the March/April low season. On the flip side, if LNY turns out to be better than expected, certain sectors might likely see some relief rally or short squeeze.

Supply-side dynamics matter amid demand uncertainties

Sectors with favorable supply-side can see relative resilience (eg, education & beer). As demand outlook turns more precarious, we believe favorable supply-side dynamics can offer better visibility. At one side of the spectrum, sectors with over-supply issues (usually with rapid capacity expansion in recent years) would likely face a rough path of re-adjusting to much slower growth. The re-balancing usually comes with inventory de-stocking, heavy promotions, intensifying competition, and other painful adjustments that cut into company profitability. On the other hand, sectors that have already gone through supply-side reforms (either driven by external shocks, like education sector in previous regulatory crackdowns; or voluntary reforms, like the beer sector through capacity rationalization) are much better positioned to weather the down-cycle, as companies can benefit from better supply-demand dynamics, or exercise pricing power or resort to SG&A cuts to achieve margin expansion despite topline softness.

Rising value consciousness: consumption upgrade vs. downgrade

Consumers become more value conscious. With a sluggish property market (and resulting negative wealth effect), rising job security risks, and cautious income outlook, Chinese shoppers are understandably turning more practical in general. However, we observe that the trading-up vs downtrend is also more nuanced. Instead of drawing arbitrary conclusions on downgrade vs upgrade, we argue consumers are more value conscious – they are still willing to pay premium for value creation, but they also turn increasingly picky about value, especially in the context of abundant supply, less information asymmetry and more careful spending patterns. Companies which can deliver functional/emotional value may still enjoy trading-up. Functional sportswear, dermatological beauty and sugar-free tea are some of the categories where consumers are still embracing trading-up trends. But those which fail to convince consumers with value creation are more vulnerable to consumption downgrade.

Growing interests in going abroad

Going abroad gains importance, as investors look for overseas opportunities to hedge sluggish domestic demand. Most names in our coverage universe are domestic-focused. Apparel OEM, select retail and white goods are just a limited number of sectors with substantial non-China businesses. Other companies are pivoting towards overseas expansion but might take time to build a more meaningful presence. ASEAN markets are usually the low-hanging fruits in terms of globalization given geographic proximity and similarities in cultures, consumer habits and routes to markets. For example, companies like Mengniu have seen some initial success in ASEAN (Mengniu is already the #1 ice-cream maker in Indonesia), though it will still take time for overseas businesses to reach a critical mass.

Paradigm shift from growth to value

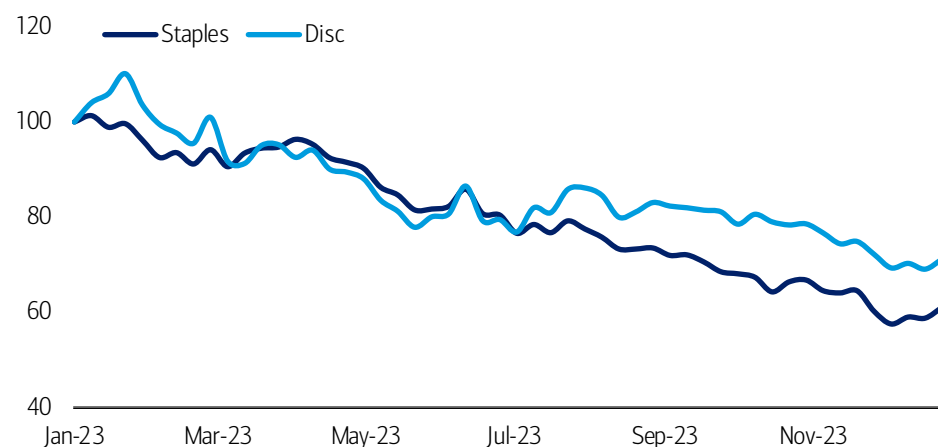
China consumer is normally viewed as a growth sector, but the shift from growth to value is ongoing, with higher emphasis on FCF/dividend yield. In an uncertain economic environment, investors are seeking quality companies with stable cash flows and good dividend yield for stable returns and share-price downside protection. Many consumer companies are placing higher emphasis on cash flow and shareholder return. They are cutting CAPEX, improving operating efficiency, raising dividend payout, and increasing share buyback. We scan through our HK/ADR coverage universe and highlight the following Buy-rated companies, with solid FCF/dividend yield, and healthy ROE and balance sheet.

Comeback of staples in 2H24?

Staples have lagged discretionary in our HK/ADR universe in 2023, as 1) staples are not as defensive as expected in the current downcycle; 2) staples are crowded among long-only investors with higher valuation, thus more vulnerable at times of fund outflow and de-rating; and 3) most large-cap staples have completed the domestic fast-expansion stage or are still new in the overseas markets, whereas select discretionary names enjoy the benefits of store expansion or overseas venture, which supports earnings upside. However, we note that leading staples enjoy established branding and routes to markets, relatively stable competitive dynamics, and strong B/S and cashflow. As the sector has de-rated significantly, many staple names may have the potential to raise dividend to bring the dividend yield to 5%+, if necessary. As such, should their underperformance continue, staples could become interesting in 2H24, especially considering likely rising yield, even cheaper valuation after rollover to 2025 and easier comps.

Exhibit 8: HK/ADR staple and discretionary share-price performance in 2023

Staples underperformed discretionary by 10% in 2023



Source: Bloomberg

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Our rating, PO & EPS change summary

In this market, it's hard not to be bears. To turn positive, we have to 1) look for strong alpha that can defy weak beta in general, or 2) make bold calls on flows and sentiment, largely driven by top-down factors, or 3) actively gauge positionings and expectation, monitor high-frequency data, and identify the subtle discrepancy of reality vs. perception ("less bad" opportunities). At the start of 2024, here are our action points.

In our ADR coverage universe, we upgrade **TAL** to Buy (from Neutral). We have also made EPS and PO changes for our coverage. We prefer **EDU** and **TAL** in our ADR coverage universe.

Exhibit 9: China consumer: estimate changes

We raise our 2024E EPS for ADR coverage on average

Company	2024			2025		
	Old	New	Chg	Old	New	Chg
New Oriental	3.69	3.96	7.2%	4.60	5.06	10.0%
TAL education	0.19	0.27	41.4%	0.33	0.53	59.0%
Yum China	2.21	2.18	-1.7%	2.61	2.56	-2.0%
Average			15.6%			22.4%

Note: EDU and TAL EPS are calculated by one year later due to fiscal year ending difference

Source: BofA Global Research estimates.

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Exhibit 10: Rating and PO change

We upgrade TAL and raise our PO for 7% on average.

	BofA ticker	Currency	Rating		PO		
			Old	New	Old	New	Chg
New Oriental - US	EDU	USD	Buy	Buy	76.9	100	30%
TAL	TAL	USD	Neutral	Buy	6.7	15.7	134%
YumC - US	YUMC	USD	Buy	Buy	63.8	53.6	-16%
Average							49%

Source: BofA Global Research

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Exhibit 11: China consumer: PO change details

PO change details summary

Company name	PO	DCF	Old		P/E	New**		P/E
						PO	DCF assumptions	
New Oriental – US*	76.9	N/A			23x	100.0	N/A	Unchanged
TAL*	6.7	N/A			18x	15.7	N/A	30x
YumC - US	63.8	9.8% WACC, 0.8x beta and 3% terminal growth			25x	53.6	Unchanged	22x

Source: BofA Global Research estimates. *Based on non-GAAP ex-cash P/E. **Based on 2024E estimates, expect for EDU (FY24E, end in May 2024) and TAL (FY26E, end in Feb 2026)

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Exhibit 12: China consumer: PO change reasons

Reasons for changes of DCF assumptions or earnings multiples

Company name	Reason
New Oriental – US*	Lift 2024-26E EPS by 7-10% to reflect higher business growth outlook and profitability.
TAL*	Apply a higher target multiple to FY26E non-GAAP ex-cash EPS, and use 17% WACC to discount valuation back to FY25 to incorporate normalized margins.
YumC - US	Factor in lower target multiple due to rising competition

Source: BofA Global Research estimates. *Based on non-GAAP ex-cash P/E

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Stock picks

TAL: upgrade to Buy from Neutral

We upgrade TAL from Neutral to Buy. We raise our FY24-26E non-GAAP EPS by 59-381%, largely due to higher assumptions of K-9 non-academic tutoring growth. We also lift PO by 134% to USD15.7, based on SOTP valuation methodology. As TAL could be still loss-making in FY24 (Feb-2024), and under-earning in FY25, we think FY26 should be a more reasonable anchor to value TAL's profitability. We use FY26 non-GAAP ex-cash EPS and 30x P/E to derive our P/E-based valuation. We believe 30x is a fair multiple (higher than EDU's 23x) given TAL's potentially faster growth near-term as it is still at early stage of accelerating top-line growth and margin recovery. We also use 17% WACC (3% risk free, 9% market premium and 1.55x beta) to discount P/E-based valuation back to FY25 (USD10.6/ADR) and add on net cash value (USD5.1/ADR) to arrive at our PO.

Favorable market dynamics

China's education sector enjoys favorable supply and demand dynamics. Supply side reform was underway after 2021's double-deduction policy. With smaller players or new entrants lacking funding source to support aggressive expansion, we believe current leaders enjoy scale, financial and brand advantages and are in a better position to grab market shares. Meanwhile, demand for offline non-academic tutoring continues to surge post reopening.

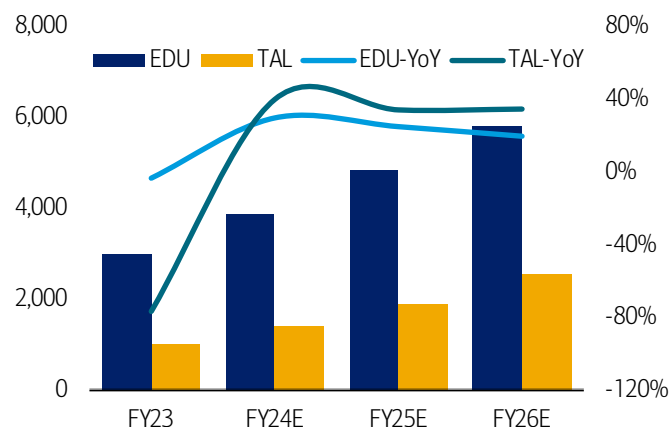
Narrowing loss in FY24 and likely to turn profitable from FY25

We expect TAL to get closer to breakeven in FY24. In contrast, we expect EDU to post 14.5% non-GAAP OPM in FY24. Smaller scale, AI investment, accounting treatment of learning devices and overseas tutoring were the key drags of TAL's profitability. We estimate FY25 to be a year of turning profitable, based on the following reasons.

1. **Education business to enjoy operating leverage.** Post double-deduction policy, TAL has smaller residual businesses than EDU. TAL only had 150 learning centers, as of end-Nov-2022, vs 708 for EDU. TAL's revenue was only USD1bn in FY23, vs EDU's USD3bn. With TAL's accelerating learning center expansion plan, we expect TAL to gradually close its gap with EDU. On a positive note, it now takes shorter period for a new learning center to ramp up and reach optimal utilization rate, than the pre-COVID period. As a result, we are not expecting margin dilution from accelerating expansion, and we believe TAL's education segment will see strong margin improvement.
2. **Learning devices to contribute profit.** FY24 is the first year TAL started to sell learning devices. TAL plans for 400-500k units in FY24 with ASP of around RMB4.5k per unit. We note that TAL has launched bigger screen upgraded learning devices with ASP of RMB8.5k+ in Dec-2023, which may further help to support revenue. Given conservative accounting treatment (30% of sales will be amortized over the next 24 months), we expect learning devices to make loss in Year 1, but likely to turn profitable in Year 2 assuming stable sales volume.

Exhibit 13: EDU/TAL revenue comparison (USD mn)

TAL is expected to deliver faster growth than EDU in FY24-26

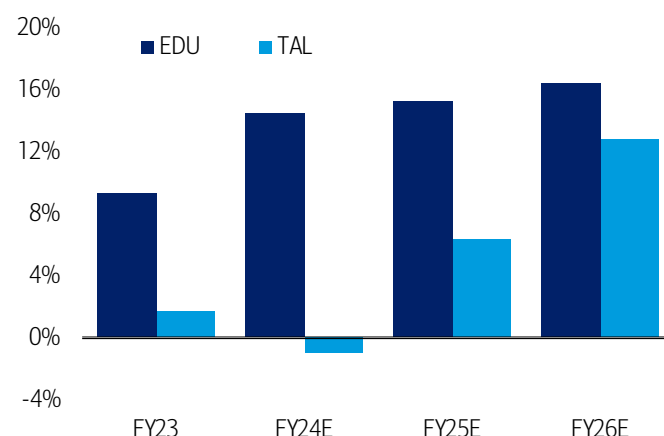


Source: BofA Global Research estimates

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Exhibit 14: EDU/TAL non-GAAP OPM comparison

We expect TAL to turn profitable in FY25E and gradually narrowing gap with EDU.



Source: BofA Global Research estimates

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Exhibit 15: TAL: Earnings revisions

We lift 2024/25E non-GAAP net profit by 442.3%/41.4%

	2024E			2025E		
	Old	New	+/-	Old	New	+/-
P&L (USDmn)						
Revenue	1,398	1,427	2.0%	1,836	1,913	4.2%
Gross profit	685	782	14.1%	932	1,071	14.9%
Operating expenses	-884	-920	4.1%	-987	-1,073	8.8%
Operating profit	-176	-115	34.4%	-31	21	NM
Non-GAAP operating profit*	-74	-13	81.9%	71	123	74.2%
Profit before tax	-96	-60	37.1%	49	111	128.4%
Net profit	-97	-76	22.1%	18	68	270.5%
SBC	-102	-102	0.0%	-102	-102	0.0%
Non-GAAP net profit*	5	26	442.3%	121	170	41.4%
Ratio Analysis (as % of revenue)						
GP margin	49.0%	54.8%	580 bps	50.8%	56.0%	520 bps
Operating Expenses	63.2%	64.5%	127 bps	53.7%	56.1%	234 bps
OP margin	-12.6%	-8.1%	450 bps	-1.7%	1.1%	281 bps
Non-GAAP OPM*	-5.3%	-0.9%	435 bps	3.8%	6.4%	258 bps
Net margin	-7.0%	-5.3%	164 bps	1.0%	3.6%	257 bps
Non-GAAP NPM*	0.3%	1.8%	150 bps	6.6%	8.9%	234 bps

Source: BofA Global Research estimates. *Excludes share-based compensation

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Exhibit 16: TAL: P&L

Resetting base in FY23

USDmn	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	4,391	1,020	1,427	1,913	2,574
COGS	-2,203	-436	-645	-842	-1,107
Gross profit	2,188	583	782	1,071	1,467
Other income/Gains	-259	-81	-35	0	0
SG&A expenses	-2,823	-697	-920	-1,073	-1,262
Operating profit	-615	-91	-115	21	227
Non-GAAP Operating Profit*	-440	18	-13	123	330
Net finance costs	95	62	90	90	90
Profit before tax	-778	-110	-60	111	317
Tax	-397	-20	-15	-43	-84
Net profit	-1,136	-136	-76	68	234
Non-GAAP Profit*	-961	-27	26	170	336
Core Non-GAAP profit**	-197	54	61	170	336

Source: BofA Global Research estimates, Company. * Excludes share-based compensation.

**Excludes other gains/losses

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Exhibit 17: TAL: Cash flow

Stable cash position

USDmn	FY22A	FY23A	FY24E	FY25E	FY26E
EBITDA	-425	-6	-29	146	372
Less Changes in WK Capital	-1,880	-60	158	289	402
Other Non-Cash Items	271	14	0	0	0
Gross Operating Cash flow	-2,033	-52	130	434	774
Less Net Interest Paid	95	62	90	90	90
Less Tax Paid	-397	-20	-15	-43	-84
Others	-248	-83	-35	0	0
Net Operating Cash flow	-2,583	-93	169	482	780
Less Capex	-246	-153	-214	-191	-257
Others	637	143	0	0	0
Free Cash flow	-1,737	-103	-45	291	523
Equity Issue	0	0	0	0	0
Other	-1	0	0	0	0
Change in Cash	-4,625	-127	-45	291	523

Source: BofA Global Research estimates, Company

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Exhibit 18: TAL: Balance Sheet

Stable cash position through FY22-26E

USDmn	FY22A	FY23A	FY24E	FY25E	FY26E
Bank Balances and Cash	3,464	3,298	3,254	3,544	4,067
Inventories	22	39	49	66	86
Others	145	131	131	131	131
Total Current Assets	3,631	3,468	3,434	3,741	4,284
Property, Plant and Equipment	281	289	416	483	595
Long term deposit	412	453	453	453	453
Goodwill	0	0	0	0	0
Others	757	514	513	513	513
Total Non-Current Assets	1,451	1,256	1,383	1,450	1,562
Total Assets	5,083	4,724	4,817	5,191	5,846
Trade Payables	90	60	81	103	139
Accrued expense	509	447	499	670	901
Deferred revenue	188	235	332	445	599
Others	116	42	42	42	42
Total Current Liabilities	903	784	955	1,260	1,682
Bond payable	0	0	0	0	0
Deferred revenue	0	2	0	0	0
Long term debt	0	0	0	0	0
Others	178	117	117	117	117
Total Non-Current Liabilities	178	120	117	117	117
Total Liabilities	1,080	903	1,072	1,377	1,799
Minority Interest	-28	-24	0	0	0
Shareholders Equity	4,002	3,821	3,745	3,814	4,047

Source: BofA Global Research estimates, Company

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Exhibit 19: TAL: Ratio Analysis

FY24E non-GAAP operating profit might still be under pressure

	FY22A	FY23A	FY24E	FY25E	FY26E
Profit & Loss					
Revenue Growth (%)	-2.3	-76.8	39.9	34.1	34.6
Earnings Growth (%)	879.5	-88.1	-44.1	NM	241.7
Non-GAAP NPAT growth (%)*	NM	-97.2	NM	547.7	97.0
Core Non-GAAP NPAT growth (%)**	NM	NM	14.6	177.9	97.0
Gross Margin (%)	49.8	57.2	54.8	56.0	57.0
Operating Margin (%)	-14.0	-8.9	-8.1	1.1	8.8
Non-GAAP Operating Margin (%)*	-10.0	1.7	-0.9	6.4	12.8
Net Margin (%)	-25.9	-13.3	-5.3	3.6	9.1
Non-GAAP Net Margin (%)*	-21.9	-2.7	1.8	8.9	13.0
Core Non-GAAP Net Margin (%)**	-4.5	5.2	4.3	8.9	13.0
Effective Tax Rate (%)	-115.3	25.2	20.0	20.0	20.0
Balance Sheet					
Net Cash (USDmn)	3,277	3,064	2,922	3,099	3,468
Net Debt/Equity (%)	-81.9	-80.2	-78.0	-81.3	-85.7
ROE (%)	-24.7	-3.5	-2.0	1.8	5.9
ROA (%)	-12.8	-0.4	-0.4	1.8	4.6

Source: BofA Global Research estimates, Company. * Excludes share-based compensation.

**Excludes other gains/losses

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EDU

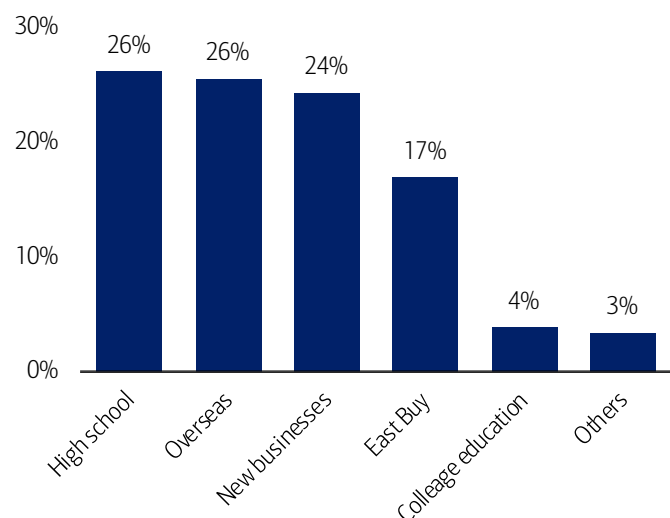
We view EDU as a key beneficiary from supply side reforms driven by regulatory changes, and solid demand also supports further growth. We raise FY24-26E non-GAAP EPS by 7-10% on higher assumptions of revenue growth. We also lift PO by 30% to USD100.0/HKD78.0, based on SOTP of net cash and ex-cash P/E. Net cash per share is USD25.1. Our P/E-derived value is USD74.9, based on 23x FY24E ex-cash P/E. The target multiple is higher than international education peers to reflect EDU's solid recovery trend and faster growth outlook.

Strong growth outlook built on multiple drivers

- New businesses (non-academic tutoring and learning devices) posted rapid growth in the past two years, and are likely to reach close to 50% of K9 academic tutoring revenue at the peak level. Offline demand has further surged post reopening. New businesses delivered 100% revenue growth in Aug-quarter 2023. We expect new businesses revenue size to surpass the pre-policy level within two years.
- Overseas test prep and consulting revenue has already surpassed the pre-COVID level, thanks to bottoming-out demand for studying abroad and market consolidation (especially for consulting).
- East Buy remains the swing factor, which is likely to contribute 17% of revenue and 11% of net profit in FY24. We note future growth uncertainty of this business, but we see gradually lower impact in the future and strong growth of its core education businesses could more than offset East Buy's possible weakness, if any.
- Margins are on the rise amid improving utilization rates of learning centers and operating leverage.
- EDU has rebuilt its track record post regulatory policy impact. The company has raised guidance for FY24 (May 2024) twice already, with future risk on the upside, in our view.

Exhibit 20: EDU: Revenue breakdown by businesses (FY24E)

Balanced and multiple revenue drivers

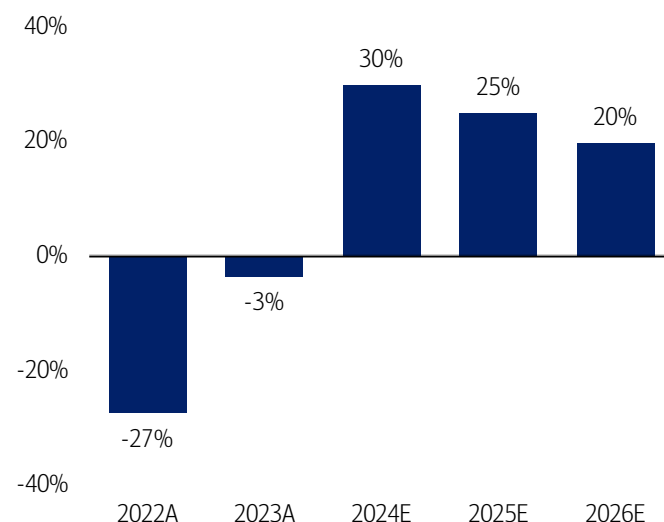


Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Exhibit 21: EDU: Revenue growth FY22-26E

Solid revenue growth outlook

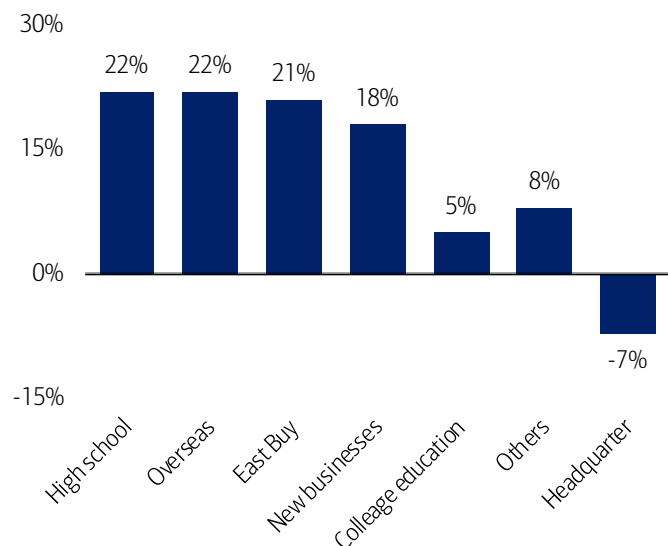


Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Exhibit 22: EDU: Non-GAAP OPM by business (FY24E)

All business lines are profitable

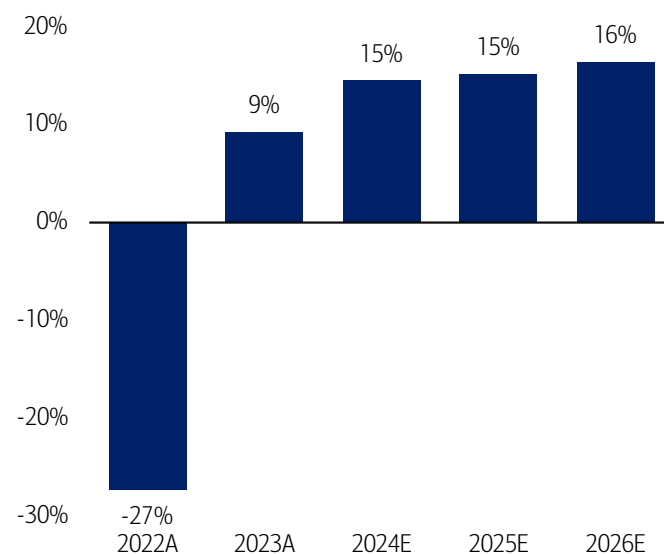


Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Exhibit 23: EDU: Non-GAAP OPM FY22-26E

Margins are on the rise amid rising utilization rate of learning centers and operating leverage.



Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Undemanding valuation with downside support

Post the recent pull-back on East Buy's talent retention issue and senior management change, we see attractive risk-reward at 18x May-25E non-GAAP P/E on top of the outlook of 30%+ EPS CAGR. Net cash of USD4bn equates to 34% of the current market cap, which also offers downside support.

EDU continues to execute its USD400mn share repurchase program. We expect future corporate measures to increase shareholder returns, including but not limited to share repurchase and dividend.

Exhibit 24: EDU: P&L

Strong earnings growth

USDmn	FY22	FY23	FY24E	FY25E	FY26E
Revenue	3,105	2,998	3,888	4,856	5,808
COGS	-1,754	-1,409	-1,765	-2,185	-2,585
Gross profit	1,351	1,588	2,123	2,671	3,224
Other income/Gains	0	0	0	0	0
SG&A expenses	-2,333	-1,398	-1,718	-2,091	-2,426
Operating profit	-983	190	405	580	798
Non-GAAP Operating profit	-850	280	565	740	958
Net finance costs	0	0	123	127	136
Profit before tax	-1,032	309	528	707	934
Tax	-136	-66	-158	-173	-219
Net profit	-1,188	177	330	494	675
Non-GAAP net profit	-1,046	259	490	654	835

Source: BofA Global Research estimates, Company

BofA GLOBAL RESEARCH

Exhibit 25: EDU: Cash flow

Healthy cash flow generating

USDmn	FY22	FY23	FY24E	FY25E	FY26E
EBITDA	-788	300	529	789	1,078
Less Changes in WK Capital	-1,358	474	442	357	413
Other Non Cash Items	-19	14	0	0	0
Gross Operating Cash flow	-2,165	788	971	1,146	1,492
Less Net Interest Paid	0	0	123	127	136
Less Tax Paid	-136	-66	-158	-173	-219
Others	0	0	0	0	0
Net Operating Cash flow	-1,280	971	936	1,100	1,409
Less Capex	-151	-143	-600	-600	-600
Others	-686	-649	0	0	0
Free Cash flow	-1,431	828	336	500	809
Equity Issue	0	-200	-200	-200	-200
Other	0	0	0	0	0
Change in Cash	-438	611	136	300	609

Source: BofA Global Research estimates, Company

BofA GLOBAL RESEARCH

Exhibit 26: EDU: Balance Sheet

Strong balance sheet to support growth

USDmn	FY22	FY23	FY24E	FY25E	FY26E
Current Assets					
Bank Balances and Cash	4,191	3,997	4,133	4,433	5,042
Inventories	28	53	44	76	66
Trade and other receivables	16	33	10	44	20
Others	239	332	373	436	498
Total Current Assets	4,474	4,414	4,559	4,988	5,626
Non-Current Assets					
Property, Plant and Equipment	403	360	888	1,310	1,648
Long term investments	438	400	400	400	400
Others	720	1,219	1,167	1,136	1,117
Total Non-Current Assets	1,561	1,979	2,454	2,845	3,165
Total Assets	6,035	6,392	7,014	7,834	8,791
Current Liabilities					
Trade Payables	22	70	46	97	72
Accrued expense	510	569	778	971	1,162
Deferred revenue	933	1,338	1,605	1,846	2,123
Others	244	274	274	274	274
Total Current Liabilities	1,710	2,251	2,702	3,188	3,630
Non-Current Liabilities					
Deferred tax liabilities	19	24	24	24	24
Bank and other borrowings	65	15	15	15	15
Total Non-Current Liabilities	531	327	327	327	327
Total Liabilities	2,241	2,578	3,029	3,515	3,957
Minority Interest	88	210	250	290	330
Shareholders' Equity	3,794	3,815	3,985	4,319	4,834

Source: BofA Global Research estimates, Company

BofA GLOBAL RESEARCH

Exhibit 27: EDU: Ratio Analysis

Healthy margin expansion

	FY22	FY23	FY24E	FY25E	FY26E
Profit & Loss					
Revenue Growth (%)	-27.4	-3.5	29.7	24.9	19.6
Earnings Growth (%)	-455.2	-114.9	86.1	49.7	36.7
Non-GAAP NPAT Growth (%)	-357.0	-124.7	89.3	33.5	27.7
Gross Margin (%)	43.5	53.0	54.6	55.0	55.5
Operating Margin (%)	-31.6	6.3	10.4	11.9	13.7
Non-GAAP Operating Margin (%)	-27.4	9.3	14.5	15.2	16.5
Net Margin (%)	-38.2	5.9	8.5	10.2	11.6
Non-GAAP Net Margin (%)	-33.7	8.6	12.6	13.5	14.4
Effective Tax Rate (%)	-15.3	16.9	23.0	20.0	20.0
Balance Sheet					
Net Cash (USDmn)	4,126	4,093	4,229	4,529	5,139
Net Debt/Equity (%)	-108.8	-107.3	-106.1	-104.9	-106.3
ROE (%)	-24.6	7.1	13.4	16.8	19.6
ROA (%)	-14.0	2.5	6.1	7.6	9.0

Source: BofA Global Research estimates, Company

BofA GLOBAL RESEARCH

Stocks mentioned

Exhibit 28: Stocks mentioned

Stocks mentioned summary

Company	BofA Ticker	Bloomberg Ticker	Price	Rating	Investment Thesis
New Oriental EDU	EDU US	EDU US	71.19	C-1-9 Buy	We rate EDU as Buy. We believe EDU's businesses are bottoming out from impact from double reduction policy. Its remaining businesses started to recover and new businesses to turn profitable. Its booming online livestreaming platform may provide additional optionality of future growth.
TAL	TAL	TAL US	11.79	C-1-9 Buy	We rate TAL as Buy for the following reason: 1) Favorable market dynamics for China education sector, with both market share gaining for leaders and demand surging post reopening. 2) We expect TA to get closer to breakeven in FY24 and turn profitable in FY25. Smaller scale, AI investment, accounting treatment of learning device and overseas tutoring were the key drags of profitability.
Yum China	YUMC	YUMC US	42.44	B-1-7 Buy	Yum China has China's largest network, solid consumer know-how, strong branding and a leading supply chain. We believe the company's solid operations and opportunities around self-help initiatives would support steady growth. Capital return could also provide downside protection. We see risk reward to the upside.

Source: BofA Global Research, Bloomberg

BofA GLOBAL RESEARCH

Investment Rationale

TAL

We rate TAL Buy for the following reasons: 1) Favorable market dynamics for China education sector, with both market share gaining for leaders and demand surging post reopening. 2) We expect TA to get closer to breakeven in FY24 and turn profitable in FY25. Smaller scale, AI investment, accounting treatment of learning device and overseas tutoring were the key drags of profitability, which have now been mitigated.

Price objective basis & risk

New Oriental Education & Technology (EDU)

Our price objective for EDU is US\$100.0/HK\$78.0 based on SOTP of net cash and ex-cash P/E. Net cash per share is USD25.1. With positive free cash flow, we believe current net cash level is sustainable. Our P/E based value is USD74.9, based on 23x FY24E ex-cash P/E. The target multiple is higher than international education peers to reflect EDU's faster growth outlook

Upside risks to our PO: Less-than-expected policy implementation, faster roll out of high-school business, faster-than-expected development of non K-12 academic business. Downside risks to our price objective: regulatory risk, VIE corporate structure risk, execution risk on expansion, recruitment and retention of quality teachers, competition, foreign currency fluctuation, expiration of preferential tax holidays, potential ban of Chinese students' US visas and higher-than-expected online investment.

TAL (TAL)

Our valuation for TAL is US\$15.7 per ADS based on SOTP of net cash and ex-cash P/E. Net cash per share as of end FY25 is USD5.1 per share. With free cash flow gradually to turn positive, we believe current net cash level is sustainable. Our P/E based value is USD10.6, calculated using 30x FY26E P/E and apply 17% WACC, and 1.55x beta to discount PE based valuation back to FY25. We believe 30x is a fair multiple given TAL's potential faster growth outlook.

Upside risks to our PO: Less-than-expected policy implementation, faster roll out of high-school business, faster-than-expected development of non K-12 academic business. Downside risks to our PO: regulatory risk, VIE corporate structure risk, execution risk on expansion, recruitment and retention of quality teachers, reputation risk, competition, foreign currency fluctuation, expiration of preferential tax holiday, higher-than-expected online losses and restatement of online customer numbers.

Yum China (YUMC)

Our PO is US\$53.6/share (HK\$416/share), based on an equal blend of P/E, DCF and EV/EBITDA. Our DCF value for YUMC is US\$57.9/share, derived from a 9.8% WACC, 0.8x beta and 3% terminal growth rate. Our P/E-based valuation is US\$47.9/share, based on a 22x 2024E P/E, 20% below its historical average giving rising competition. Our EV/EBITDA value is US\$55/share, based on 10x 2024E EV/EBITDA, also 20% below its historical average giving rising competition. We assume US\$/HK\$ exchange rate at 7.76. Upside risks: better-than-expected SSSG, better than expected macro, lower than expected cost inflation, less competition amid industry consolidation trend. Downside risks: weaker than expected SSSG, weaker than expected macro, higher than expected cost inflation, rising competition, new waves of pandemic outbreak.

Analyst Certification

We, Chen Luo, CFA and Lucy Yu, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

APR - Consumer Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	ABC-MART	AMKYF	2670 JP	Arashi Nishizawa
	Adastria	PNMOF	2685 JP	Arashi Nishizawa
	AmorePacific Corp	AMRPF	090430 KS	Ahyung Cho
	Anta Sports	ANPDF	2020 HK	Lucy Yu
	Asahi Group Holdings	ASBRF	2502 JP	Haruka Ono
	Avenue Supermarts	XWCVF	DMART IN	Aditya Mathur
	BGF Retail	XWAHF	282330 KS	Ahyung Cho
	Bosideng	BSDGF	3998 HK	Lucy Yu
	Britannia Industries	XJNDF	BRIT IN	Aditya Mathur
	BUD APAC	BDWBF	1876 HK	Chen Luo, CFA
	China Resources Beer (Holdings) Co Ltd	CRHKF	291 HK	Chen Luo, CFA
	Cosmos Pharmaceutical	CSMYF	3349 JP	Arashi Nishizawa
	Dabur India	DBUIF	DABUR IN	Aditya Mathur
	DESCENTE	DESLF	8114 JP	Arashi Nishizawa
	DPC Dash Ltd	DPCDF	1405 HK	Lucy Yu
	Eastroc	XEBSF	605499 CH	Jack Chen
	Eclat	ECLAF	1476 TT	Ronald Leung, CFA
	E-Mart	EMRTF	139480 KS	Ahyung Cho
	GOLDWIN	GWNCF	8111 JP	Arashi Nishizawa
	H&H International Holdings	BTSDF	1112 HK	Lynn Wu
	Haier Smart Home Co Ltd	TTHEF	600690 CH	Lucy Yu
	Haier Smart Home Co Ltd	HRSHF	6690 HK	Lucy Yu
	Henan Shuanghui Investment & Dev	HSUIF	000895 CH	Chen Luo, CFA
	Hindustan Unilever	HINLF	HUVR IN	Aditya Mathur
	Hisense Home Appliance	XMBQF	000921 CH	Lucy Yu
	Hisense Home Appliance	HISEF	921 HK	Lucy Yu
	Hotel Shilla	HSLLF	008770 KS	Ahyung Cho
	ITC	ITCTF	ITC IN	Aditya Mathur
	JINS HOLDINGS	JNDOF	3046 JP	Arashi Nishizawa
	Jubilant FoodWorks	XJUBF	JUBI IN	Aditya Mathur
	Kobe Bussan	KOBNF	3038 JP	Arashi Nishizawa
	KT&G	KTCIF	033780 KS	Ahyung Cho
	Kweichow Moutai Co. Ltd.	XHJBF	600519 CH	Chen Luo, CFA
	Lawson	LWSOF	2651 JP	Arashi Nishizawa
	Li Ning Co Ltd	LNNGF	2331 HK	Lucy Yu
	Ligao Foods	XLFLF	300973 CH	Jack Chen
	Luzhou Laojiao	XMBBF	000568 CH	Lynn Wu
	Makalot Industrial	MAKAF	1477 TT	Ronald Leung, CFA
	Man Wah Holdings	MAWHF	1999 HK	Yoyo Pang
	MatsukiyoCocokara & Co	MSMKF	3088 JP	Arashi Nishizawa
	Mengniu Dairy	CIADF	2319 HK	Chen Luo, CFA
	Merida Industry Co Ltd	MIUYF	9914 TT	Ronald Leung, CFA
	MINISO Group Holdings	MNSO	MNSO US	Lucy Yu
	MINISO Group Holdings	XKTAF	9896 HK	Lucy Yu
	New Oriental Education & Technology	EDU	EDU US	Lucy Yu
	New Oriental Education & Technology	NWOEF	9901 HK	Lucy Yu
	Nitori Holdings	NCLTF	9843 JP	Arashi Nishizawa
	Proya Cosmetics	XPXCF	603605 CH	Lynn Wu
	Ryohin Keikaku	RYKKF	7453 JP	Arashi Nishizawa
	Ryohin Keikaku	RYKKY	RYKKY US	Arashi Nishizawa
	Samsonite International	SMSOF	1910 HK	Jack Chen
	Seven & i Holdings	SVNDF	3382 JP	Arashi Nishizawa
	Shenzhou International	SZHIF	2313 HK	Chen Luo, CFA
	Sun Art Retail Group	SURRF	6808 HK	Chen Luo, CFA
	Sundrug	SDGCF	9989 JP	Arashi Nishizawa
	TAL	TAL	TAL US	Lucy Yu
	Tata Consumer Products	XTCUF	TATACONS IN	Aditya Mathur
	Tingyi	TCYMF	322 HK	Jack Chen
	Titan Company	XNXAF	TTAN IN	Aditya Mathur
	Topsports International Holding Ltd.	TPSRF	6110 HK	Lucy Yu
	Tsingtao Brewery	TSGTF	168 HK	Lynn Wu
	Tsingtao Brewery	XTSOF	600600 CH	Lynn Wu
	Uni-president China	UNPSF	220 HK	Jack Chen
	UNITED ARROWS	UARWF	7606 JP	Arashi Nishizawa

APR - Consumer Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	United Breweries	UBWRF	UBBL IN	Aditya Mathur
	Varun Beverages	XMKDF	VBL IN	Aditya Mathur
	WH Group Limited	WHGRF	288 HK	Chen Luo, CFA
	Wuliangye Yibin	YBWUF	000858 CH	Chen Luo, CFA
	Yili Industrial Group	XIDRF	600887 CH	Chen Luo, CFA
	Yum China	YUMC	YUMC US	Chen Luo, CFA
	Yum China	XYUMF	9987 HK	Chen Luo, CFA

NEUTRAL

	Anjoy Foods	XSWCF	603345 CH	Jack Chen
	Asian Paints	XSAFF	APNT IN	Aditya Mathur
	China Feihe	CHFLF	6186 HK	Lynn Wu
	Chow Tai Fook Jewellery	CJWF	1929 HK	Ronald Leung, CFA
	Colgate-Palmolive India	CPIYF	CLGT IN	Aditya Mathur
	Fast Retailing	FRCOF	9983 JP	Arashi Nishizawa
	Fast Retailing	FRCOY	FRCOY US	Arashi Nishizawa
	Fenbi Ltd	XFTTF	2469 HK	Lucy Yu
	Giant Manufacturing	GTMUF	9921 TT	Ronald Leung, CFA
	Godrej Consumer Products	XGOCF	GCPL IN	Aditya Mathur
	Gree Electric Appliances	ZHUHF	000651 CH	Chen Luo, CFA
	GS Retail	XGLTF	007070 KS	Ahyung Cho
	Haidilao International Holding Ltd.	HDALF	6862 HK	Lucy Yu
	Hengan Intl	HEGIF	1044 HK	Jack Chen
	Hyundai Dept Store	HDTSF	069960 KS	Ahyung Cho
	Jason Furniture	XVZDF	603816 CH	Yoyo Pang
	Kirin Holdings	KNBWF	2503 JP	Haruka Ono
	Kirin Holdings	KNBWY	KNBWY US	Haruka Ono
	LG H&H	LGHMF	051900 KS	Ahyung Cho
	L'Occitane International S.A.	LCCTF	973 HK	Lynn Wu
	Nestle India	XNTEF	NEST IN	Aditya Mathur
	Nongfu Spring	NNFSF	9633 HK	Jack Chen
	Pan Pacific International HD	DQJCF	7532 JP	Arashi Nishizawa
	Robam Appliance	XVPDF	002508 CH	Lucy Yu
	Sapphire Foods	XLQLF	SAPPHIRE IN	Aditya Mathur
	Shinsegae	SDKLF	004170 KS	Ahyung Cho
	Suofeiya Home Collection Co Ltd	XGUZF	002572 CH	Yoyo Pang
	Yamada Holdings	YMDAF	9831 JP	Arashi Nishizawa
	Yankershop Food	XYNKF	002847 CH	Jack Chen

UNDERPERFORM

	Bairun	XSBZF	002568 CH	Jack Chen
	Blue Moon	XBMGF	6993 HK	Jack Chen
	Feng Tay	FTGYF	9910 TT	Ronald Leung, CFA
	Foshan Haitian Flavouring & Food Co Ltd	XCJMF	603288 CH	Lynn Wu
	Fuling Zhacai	XSRTF	002507 CH	Lynn Wu
	Heilan Home Co Ltd	XYWDF	600398 CH	Lucy Yu
	Jiangsu Yanghe Brewery	XJBTF	002304 CH	Chen Luo, CFA
	Lotte Shopping	LOSPF	023530 KS	Ahyung Cho
	Marico	MAIOF	MRCO IN	Aditya Mathur
	Oppein Home Group	XKXRF	603833 CH	Yoyo Pang
	Pidilite Industries	PDLFF	PIDI IN	Aditya Mathur
	Seria	SAOGF	2782 JP	Arashi Nishizawa
	Shanghai Jahwa	SNJUF	600315 CH	Lynn Wu
	Shanghai M&G Stationery	XBHUF	603899 CH	Yoyo Pang
	Shanxi Fen Wine	XCKZF	600809 CH	Lynn Wu
	SHIMAMURA	SHAOF	8227 JP	Arashi Nishizawa
	Smoore	SMORF	6969 HK	Jack Chen
	Snow Peak	XZNCF	7816 JP	Arashi Nishizawa
	United Spirits	XUNIF	UNSP IN	Aditya Mathur
	Want Want China	WWNTF	151 HK	Chen Luo, CFA
	WORKMAN	WKISF	7564 JP	Arashi Nishizawa
	Xiabu Xiabu	XIAXF	520 HK	Lucy Yu
	Yihai Intl	YNNHF	1579 HK	Lucy Yu
	Yihai Kerry Arawana	XYIHF	300999 CH	Lynn Wu
	Yonghui Superstores Co Ltd	XQYXF	601933 CH	Lucy Yu
	Zhejiang Semir Garment Co Ltd	XARGF	002563 CH	Lucy Yu

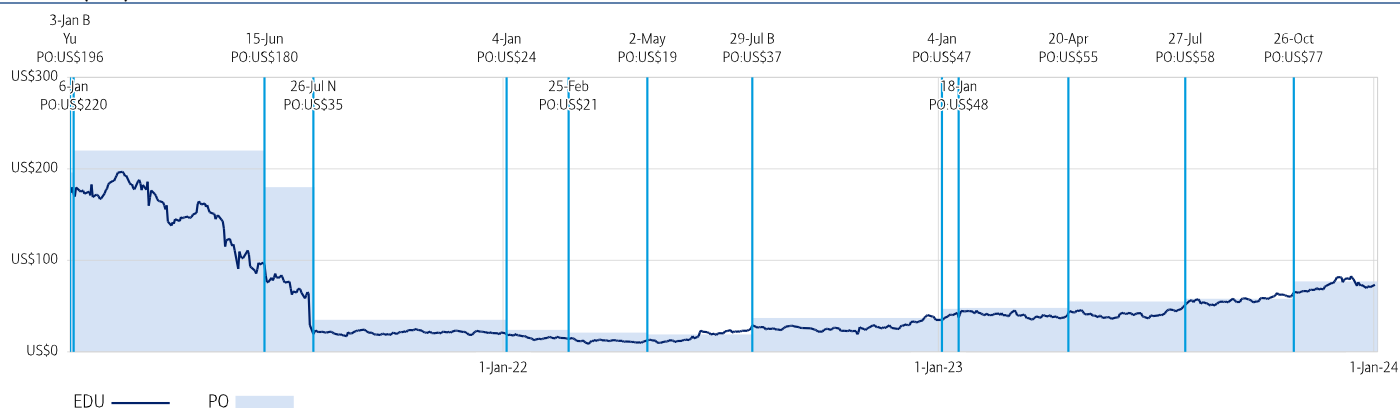
APR - Consumer Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
RSTR	Midea Group Co Ltd	XMGEF	000333 CH	Chen Luo, CFA
RVW	Adani Wilmar	XWMAF	AWLTD IN	Aditya Mathur
	Fancl	FACYF	4921 JP	Yuri Nishizaki
	Kose	KOSCF	4922 JP	Yuri Nishizaki
	Pola Orbis HD	PORBF	4927 JP	Yuri Nishizaki
	Shimano	SHMDF	7309 JP	Yuri Nishizaki
	Shiseido	SSDOF	4911 JP	Yuri Nishizaki
	Shiseido	SSDOY	SSDOY US	Yuri Nishizaki

Disclosures

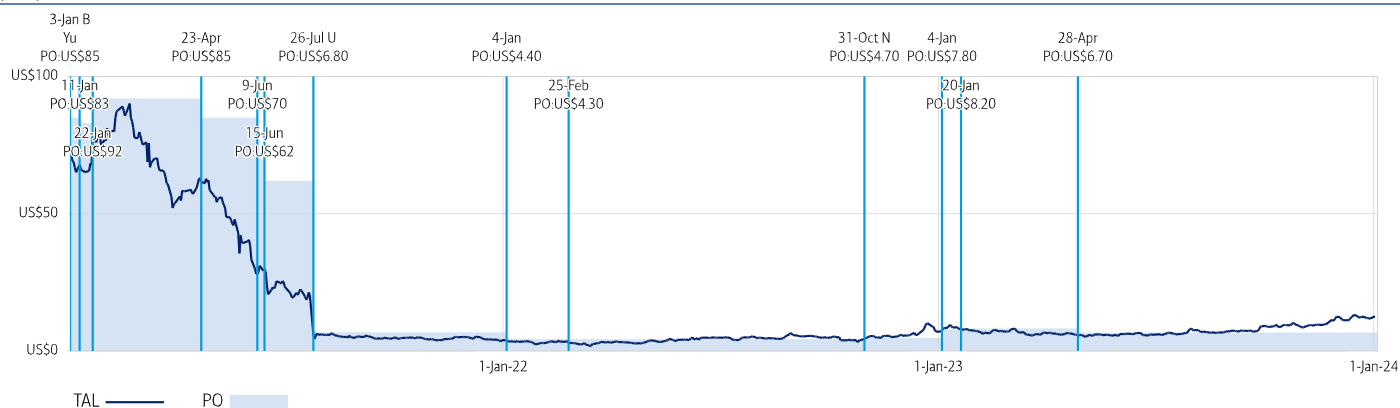
Important Disclosures

New Oriental (EDU) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

TAL (TAL) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Yum China (YUMC) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Consumer Products Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	32	50.00%	Buy	16	50.00%
Hold	19	29.69%	Hold	8	42.11%
Sell	13	20.31%	Sell	7	53.85%

Equity Investment Rating Distribution: Education & Training Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	8	53.33%	Buy	2	25.00%
Hold	4	26.67%	Hold	1	25.00%
Sell	3	20.00%	Sell	0	0.00%

Equity Investment Rating Distribution: Restaurants Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	21	58.33%	Buy	10	47.62%
Hold	10	27.78%	Hold	3	30.00%
Sell	5	13.89%	Sell	4	80.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of both a stock's absolute total return potential as well as its attractiveness for investment relative to other stocks within its Coverage Cluster (defined below). Our investment ratings are: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. An investment rating of 6 (No Rating) indicates that a stock is no longer trading on the basis of fundamentals. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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