

ESF Educational Services Limited ('ESL') Accounts
for the year ended 31 August 2007

Explanatory Notes

These explanatory notes do not form part of the audited accounts and are provided to put the numbers into context with some background information. There are sections on the income and expenditure account, balance sheet and cash flow statement.

Income and expenditure

	<u>2006/07</u>		<u>2005/06</u>		<u>2004/05</u>	
	\$M	% of total income	\$M	% of total income	\$M	% of total income
Income						
Course fees	40.5	29.7	31.6	35.4	29.8	37.2
Tuition fees	88.0	64.6	53.9	60.5	48.4	60.3
Others	7.8	5.7	3.7	4.1	2.1	2.5
	<u>136.3</u>	100.0	<u>89.2</u>	100.0	<u>80.3</u>	100.0
Expenditure						
Staff cost	93.5	67.8	63.8	71.5	55.5	69.1
Depreciation	2.6	1.9	4.5	5.0	2.4	3.0
Management & administrative expenses	2.2	1.6	1.8	2.0	1.8	2.2
Rent, rates & building management fees	9.9	7.2	9.1	10.2	7.5	9.3
Other expenses	29.7	21.5	15.3	17.2	9.3	11.6
	<u>137.9</u>	100.0	<u>94.5</u>	105.9	<u>76.5</u>	95.2
(Deficit)/Surplus	<u>(1.6)</u>		<u>(5.3)</u>	(5.9)	<u>3.8</u>	4.8
Average student enrolment						
Kindergartens	695		676		701	
Renaissance College/ Phoenix International	885		426		335	
	<u>1,580</u>		<u>1,102</u>		<u>1,036</u>	

Income:

1. After a long period of slow increase in course fees, both Language Section and Sports Section have made remarkable progress in 2006/07 and achieved 16% and 40% increase in fees income respectively. The overall increase in course fees of \$8.9M represents 28% increase over previous year.
2. The increase in tuition fees of \$34.1M is mainly attributed to the opening of Renaissance College ('RCHK') in 2006/07, where the student enrolment has more than doubled when compared with its predecessor, Phoenix International School.
3. Included in the \$7.8M other income for 2006/07 were \$1.2M in registration fees charged by RCHK and Discovery College ('DC'), \$2.3M in income derived from the rental of school premises to outside parties, \$2.7M in resale of school items including uniforms and textbooks, and \$1.6M in miscellaneous items. The increase in 2006/07 relates mostly to RCHK operations.

Expenditure:

1. The \$29.7M increase in staff cost during 2006/07 is due to a) the increase in the number of staff employed at RCHK to meet its growth; b) the introduction of cash allowances for teachers at both RCHK and the Kindergartens; and c) adjustments to the Kindergartens' teaching staff and principals' salaries during the year.
2. The \$1.9M decrease in depreciation expense from 2005/06's level is due to the accelerated depreciation in leasehold improvement per the applicable Hong Kong Accounting Standard (HKAS16) introduced in 2005/06, the effect of which has tapered off in 2006/07 as most of the related assets have been fully depreciated.
3. The \$0.4M increase in management and administrative expense charged by ESF to ESL reflects the increased administrative support by ESF Centre and Education Development Centre staff due to the opening of RCHK.

4. The \$0.8M increase in rental expense is a result of higher fee income generated at Tsing Yi Kindergarten whose rent is based on 10% of its turnover.
5. Other expenses were \$14.4M higher largely due to the operations of RCHK; namely, a) \$4.1M increase in teaching materials and resources, b) \$5.9M increase in office and general expenses, c) \$0.6M in cost of goods sold related to uniform sales, and d) the \$3.9M payment to the English Schools Foundation (“ESF”) as per the Development and Operating Agreement between ESL and ESF.

Business segment performance:

The operating deficit of -\$1.6M in 2006/07 can be better explained by business segment information. After allocating the cost of administration, Language Section, Sports Section and the Kindergartens each contributed \$2.3M, \$1.8M and \$1.2M surpluses to ESL’s bottomline, respectively. However, due to its first year of operation at a new school site, RCHK had experienced a loss of -\$5.6M in 2006/07 as the school is not yet at optimal capacity. The preparation for the opening of DC in 2007/08 also contributed a loss of -\$1.3M to the bottomline.

Balance sheet

ESL’s balance sheet shows:

	<u>2006/07</u>	<u>2005/06</u>	<u>2004/05</u>
	\$M	\$M	\$M
Assets employed			
Non-current assets	36.6	38.9	9.6
Current assets and other	20.2	4.6	11.1
	<u>56.8</u>	<u>43.5</u>	<u>20.7</u>
Less: current liabilities	(56.5)	(41.5)	(13.4)
Net assets employed	<u>0.3</u>	<u>2.0</u>	<u>7.3</u>
 Reserves			
Accumulated fund	0.1	1.7	7.0
Schools’ donation fund	0.2	0.3	0.3
	<u>0.3</u>	<u>2.0</u>	<u>7.3</u>

The non-current assets of \$36.6M represent mainly construction-in-progress for the DC project. These fixed assets were financed by a combination of (1) retained surplus built up by ESL over the years; and (2) the excess of current liabilities over other assets.

	<u>2006/07</u>		<u>2005/06</u>		<u>2004/05</u>	
	\$M	% of total	\$M	% of total	\$M	% of total
Reserves	0.3	0.8	2.0	5.1	7.3	76.0
Net current liabilities	<u>36.3</u>	99.2	<u>36.9</u>	94.9	<u>2.3</u>	24.0
	<u>36.6</u>		<u>38.9</u>		<u>9.6</u>	

Cashflow and capital commitments

	<u>2006/07</u>	<u>2005/06</u>	<u>2004/05</u>
	\$M	\$M	\$M
Operating activities			
(Deficit)/Surplus for the year	(1.6)	(5.3)	3.8
Depreciation	2.6	4.5	2.4
Loss on sales of fixed assets	-	-	0.2
	<u>1.0</u>	<u>(0.8)</u>	<u>6.4</u>
Change in working capital	12.8	7.6	2.8
Cash generated from operations	<u>13.8</u>	<u>6.8</u>	<u>9.2</u>
Investing activities			
Capital expenditure	(0.4)	(15.1)	(1.1)
Other	0.1	-	(0.1)
	<u>(0.3)</u>	<u>(15.1)</u>	<u>(1.2)</u>
Increase / (Decrease) in cash	<u>13.5</u>	<u>(8.3)</u>	<u>8.0</u>

Change in working capital is largely a result of setting aside the scholarship fund at RCHK in the amount of \$6.2M and fees received in advance of \$9.4M, offset by the purchase of uniforms and textbooks of -\$1.1M and prepayments of -\$0.7M, both in preparation for the new school year.

The relationship between ESF and ESL

ESL was set up in 1994 to provide kindergarten education, language classes and extra curricula activities. It also operates two Private Independent Schools and has common management with ESF although it is not a legal subsidiary of ESF.

ESL is the qualified sponsoring body to run RCHK in Ma On Shan and DC in Discovery Bay under separate service agreements with the Education Bureau.

ESF and ESL have entered into a Development and Operating Agreement such that the top-up funds made available by ESF to build the RCHK and DC school premises and other related provisions will be rewarded by fees basing on student enrolment. Such fee income has been collected by ESF from RCHK since 2006/07 (with collection from DC to commence in 2007/08) and will serve to provide a steady stream of revenue to ESF in the future.

Governance

Effective 15th February 2007, the ESF Audit Committee (“Committee”) has expanded its scope of coverage to include ESL. The Committee was formed in December 2004 and is chaired by Peter Clark with Maurice Yap and Robert Gibson as members. Prior to the ESL board meeting to discuss and approve the audited accounts, the Committee has met to discuss and monitor the preparation of ESL accounts and the work performed by external and internal auditors. The Committee reports to the ESF Executive Committee chaired by Professor Lieh Mak.

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