

New Oriental Education & Technology Group Inc.

Form 20-F/A

February 22, 2013

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F/A**

(Amendment No. 2)

(Mark One)

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(B) OR 12(G) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended May 31, 2012.

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

..

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell company report \_\_\_\_\_

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-32993

**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**

(Exact name of Registrant as specified in its charter)

N/A

(Translation of Registrant's name into English)

Cayman Islands

(Jurisdiction of incorporation or organization)

No. 6 Hai Dian Zhong Street

Haidian District, Beijing 100080

People's Republic of China

(Address of principal executive offices)

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**No. 6 Hai Dian Zhong Street**

**Haidian District, Beijing 100080**

**People's Republic of China**

**(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Exchange on Which Registered</b>
<b>American depositary shares, each representing one common share*</b>	<b>New York Stock Exchange</b>
<b>Common shares, par value US\$0.01 per share**</b>	<b>New York Stock Exchange</b>

\* Effective August 18, 2011, the ratio of ADSs to our common shares was changed from one ADS representing four common shares to one ADS representing one common share.

\*\* Not for trading, but only in connection with the listing on New York Stock Exchange of the American depositary shares.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

**None**

**(Title of Class)**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

**None**

**(Title of Class)**

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Indicate the number of outstanding shares of each of the Issuer's classes of capital or common stock as of the close of the period covered by the annual report. **158,379,387 common shares, par value US\$0.01 per share, as of May 31, 2012.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer   
Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

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**EXPLANATORY NOTE**

This amendment No. 2 (this Amendment No. 2) to New Oriental Education & Technology Group Inc.'s annual report on Form 20-F for the fiscal year ended May 31, 2012 (the 2012 Form 20-F) hereby amends Items 3, 4, 5, 8, 18 and 19, as well as parenthetical disclosure on the face of the balance sheet and notes 1, 22 and 23 to the financial statements of New Oriental Education & Technology Group Inc. included in the 2012 Form 20-F. The 2012 Form 20-F was originally filed with the Securities and Exchange Commission on October 12, 2012 (the Original Report) and was amended on October 30, 2012 solely for the purpose of furnishing Interactive Data File disclosure. This Amendment No. 2 is prepared for the purpose of providing additional clarifying information and certain updates to the Original Report in response to the comments from the Staff of the U.S. Securities and Exchange Commission in connection with its review of the Original Report. This Amendment No. 2 is not intended to update other information disclosed in the Original Report.

This Amendment No. 2 on Form 20-F/A does not reflect events occurring after the filing of the Original Report and does not modify or update the disclosure therein in any way other than as required to reflect the amendments discussed above.

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**Table of Contents****PART I****ITEM 3. KEY INFORMATION****A. Selected Financial Data*****Our Selected Consolidated Financial Data***

The following tables present the selected consolidated financial data of our company. The selected consolidated statement of operations data for the fiscal years ended May 31, 2010, 2011 and 2012 and the consolidated balance sheet data as of May 31, 2011 and 2012 have been derived from our audited consolidated financial statements, which are included in this annual report beginning on page F-1. The selected consolidated statement of operations data for the fiscal years ended May 31, 2008 and 2009 and the selected consolidated balance sheet data as of May 31, 2008, 2009 and 2010 have been derived from our audited consolidated financial statements for the fiscal years ended May 31, 2008, 2009 and 2010, which are not included in this annual report. Our historical results do not necessarily indicate results expected for any future periods. The selected consolidated financial data should be read in conjunction with, and are qualified in their entirety by reference to, our audited consolidated financial statements and related notes included elsewhere in this annual report and Item 5 A. Operating and Financial Review and Prospects. Our audited consolidated financial statements are prepared and presented in accordance with generally accepted accounting principles in the United States, or U.S. GAAP.

At the direction of the government of the People's Republic of China in accordance with the Scheme of the Localization Restructuring of Chinese-Foreign Cooperative Accounting Firms, Deloitte Touche Tohmatsu CPA Limited has restructured to a new partnership and changed its name to Deloitte Touche Tohmatsu Certified Public Accountants LLP, effective from January 1, 2013. Deloitte Touche Tohmatsu Certified Public Accountants LLP has succeeded Deloitte Touche Tohmatsu CPA Limited for all purposes and assumed all of the obligations and rights of Deloitte Touche Tohmatsu CPA Limited with effect from January 1, 2013.

<i>(in thousands of US\$ except share, per share and per ADS data)</i>	<b>2008</b>	<b>For the Years Ended May 31,</b>			<b>2012</b>
	<b>2009</b>	<b>2010</b>	<b>2011</b>		
<b>Consolidated Statement of Operations Data:</b>					
Net revenues:					
Educational programs and services	183,917	266,389	352,857	508,439	693,712
Books and others	17,086	26,178	33,450	49,433	78,006
<b>Total net revenues</b>	<b>201,003</b>	<b>292,567</b>	<b>386,307</b>	<b>557,872</b>	<b>771,718</b>
Operating costs and expenses: <sup>(1)</sup>					
Cost of revenues	(77,219)	(112,011)	(147,261)	(222,625)	(304,027)
Selling and marketing	(25,617)	(38,947)	(58,396)	(82,797)	(115,151)
General and administrative	(52,832)	(80,689)	(103,336)	(155,412)	(235,743)
Loss on disposal of subsidiaries				(1,537)	
<b>Total operating costs and expenses</b>	<b>(155,668)</b>	<b>(231,647)</b>	<b>(308,993)</b>	<b>(462,371)</b>	<b>(654,921)</b>
<b>Operating income</b>	<b>45,335</b>	<b>60,920</b>	<b>77,314</b>	<b>95,501</b>	<b>116,797</b>
Other income (expense):					
Interest income	8,035	6,599	6,474	13,017	25,488
Interest expense					
Miscellaneous income (expense), net	(886)	590	(252)	1,257	1,175
<b>Income before provisions for income taxes and noncontrolling interest</b>	<b>52,484</b>	<b>68,109</b>	<b>83,536</b>	<b>109,775</b>	<b>143,460</b>
Provision for income taxes:					



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<i>(in thousands of US\$ except share, per share and per ADS data)</i>	For the Years Ended May 31,				
	2008	2009	2010	2011	2012
Current	(3,839)	(8,399)	(7,845)	(9,390)	(14,027)
Deferred	195	1,143	1,871	1,154	3,255
Provision for income taxes	<b>(3,644)</b>	<b>(7,256)</b>	<b>(5,974)</b>	<b>(8,236)</b>	<b>(10,772)</b>
Net income	<b>48,840</b>	<b>60,853</b>	<b>77,562</b>	<b>101,539</b>	<b>132,688</b>
Add: Net loss attributable to noncontrolling interest <sup>(2)</sup>	173	163	227	235	
Net income attributable to New Oriental Education & Technology Group Inc.	49,013	61,016	77,789	101,774	132,688
Net income per share and net income per ADS attributable to New Oriental Education & Technology Group Inc. basic <sup>(3)</sup>	0.33	0.41	0.52	0.66	0.86
Net income per share and net income per ADS attributable to New Oriental Education & Technology Group Inc. diluted <sup>(3)</sup>	0.31	0.40	0.50	0.65	0.85
Shares used in calculating basic net income per share	149,992,200	149,090,088	150,952,249	153,253,065	154,627,784
Shares used in calculating diluted net income per share	156,449,101	153,528,383	154,831,633	156,071,833	156,872,441

(1) Share-based compensation expenses are included in our operating costs and expenses as follows:

<i>(in thousands of US\$)</i>	For the years Ended May 31,				
	2008	2009	2010	2011	2012
Cost of revenues	707	316	657	900	216
Selling and marketing	226	225	117		
General and administrative	7,809	16,209	15,409	14,145	23,909
Total	8,742	16,750	16,183	15,045	24,125

(2) Amounts in relation to noncontrolling interests, formerly named minority interest, for the years ended May 31, 2008 and 2009 are reclassified in accordance with authoritative guidance regarding the noncontrolling interests, which we adopted on June 1, 2009.

(3) Each ADS represents one common share.

The following table presents our selected consolidated balance sheet data as of May 31, 2008, 2009, 2010, 2011 and 2012:

<i>(in thousands of US\$)</i>	2008	2009	2010	2011	2012
<b>Selected Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	208,440	254,772	281,104	317,260	428,261
Total assets	396,743	469,402	596,420	863,370	1,128,817
Total current liabilities	97,886	117,761	168,705	288,000	438,303
Total liabilities	97,886	117,918	168,842	289,147	438,415
Total shareholders' equity	298,680	351,246	427,567	574,223	690,402
Noncontrolling interest	177	238	11		
Total equity	298,857	351,484	427,578	574,223	690,402

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

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### **D. Risk Factors**

#### **Risks Related to Our Business**

*If we are not able to continue to attract students to enroll in our courses without a significant decrease in course fees, our revenues may decline and we may not be able to maintain profitability.*

The success of our business depends primarily on the number of student enrollments in our courses and the amount of course fees that our students are willing to pay. Therefore, our ability to continue to attract students to enroll in our courses without a significant decrease in course fees is critical to the continued success and growth of our business. This in turn will depend on several factors, including our ability to develop new programs and enhance existing programs to respond to changes in market trends and student demands, expand our geographic reach, manage our growth while maintaining the consistency of our teaching quality, effectively market our programs to a broader base of prospective students, develop and license additional high-quality educational content and respond to competitive pressures. If we are unable to continue to attract students to enroll in our courses without a significant decrease in course fees, our revenue may decline and we may not be able to maintain profitability.

*We depend on our dedicated and capable faculty, and if we are not able to continue to hire, train and retain qualified teachers, we may not be able to maintain consistent teaching quality throughout our school network and our brand, business and operating results may be materially and adversely affected.*

Our teachers are critical to maintaining the quality of our programs, services and products and maintaining our brand and reputation, as they interact with our students on a daily basis. It is critical for us to continue to attract qualified teachers who have a strong command of the subject areas to be taught and meet our qualification. We also need to hire teachers who are capable of delivering innovative and inspirational instruction. There are a limited number of teachers in China with the necessary experience and language proficiency to teach our courses and we must provide competitive compensation packages to attract and retain qualified teachers. In addition, criteria such as commitment and dedication are difficult to ascertain during the recruitment process, in particular as we continue to expand and add teachers to meet rising student enrollments. We must also provide continuous training to our teachers so that they can stay up to date with changes in student demands, admissions and assessment tests, admissions standards and other key trends necessary to effectively teach their respective courses. We may not be able to hire, train and retain enough qualified teachers to keep pace with our anticipated growth while maintaining consistent teaching quality across many different schools, learning centers and programs in different geographic locations. Shortages of qualified teachers or decreases in the quality of our instruction, whether actual or perceived, in one or more of our markets may have a material and adverse effect on our business.

*Our business depends on our New Oriental brand, and if we are not able to maintain and enhance our brand, our business and operating results may be harmed.*

We believe that market awareness of our New Oriental brand has contributed significantly to the success of our business. We also believe that maintaining and enhancing the New Oriental brand is critical to maintaining our competitive advantage. We offer a diverse set of programs, services and products to primary and middle school students, college students and other adults throughout many provinces and cities in China. As we continue to grow in size, expand our program, service and product offerings and extend our geographic reach, maintaining quality and consistency may be more difficult to achieve.

We have invested significantly in brand promotion initiatives. We cannot assure you that these or our other marketing efforts will be successful in promoting our brand to remain competitive. If we are unable to further enhance our brand recognition and increase awareness of our programs, services and products, or if we incur excessive marketing and promotion expenses, our business and results of operations may be materially and adversely affected. In addition, any negative publicity relating to our company or our programs and services, regardless of its veracity, could harm our brand image and in turn materially and adversely affect our business and operating results.

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### ***Our reputation and the trading price of our ADSs may be negatively affected by adverse publicity or other detrimental conduct against us.***

Adverse publicity concerning our failure or perceived failure to comply with legal and regulatory requirements, alleged accounting or financial reporting irregularities, regulatory scrutiny and further regulatory action or litigation could harm our reputation and cause the trading price of our ADSs to decline and fluctuate significantly. For example, after we issued a press release on July 17, 2012 disclosing that we were subject to the investigation by the U.S. Securities & Exchange Commission, or the SEC, and Muddy Waters LLC, an entity unrelated to us, issued a report containing various allegations about us on July 18, 2012, the trading price of our ADSs declined sharply and we were inundated by numerous investor inquiries. The negative publicity and the resulting decline of the trading price of our ADSs also led to the filing of shareholder class action lawsuits against us and some of our senior executive officers.

We may continue to be the target of adverse publicity and other detrimental conduct against us. Such conduct includes complaints, anonymous or otherwise, to regulatory agencies regarding our operations, accounting, revenues and regulatory compliance. Additionally, allegations against us may be posted on the internet by any person or entity which identifies itself or on an anonymous basis. We may be subject to government or regulatory investigation or inquiries as a result of such third-party conduct and may be required to incur significant time and substantial costs to defend ourselves, and there is no assurance that we will be able to conclusively refute each of the allegations within a reasonable period of time, or at all. Our reputation may also be negatively affected as a result of the public dissemination of allegations or malicious statements about us, which in turn may materially and adversely affect the trading price of our ADSs.

### ***We face risks related to health epidemics and other outbreaks, which could result in reduced attendance or temporary closure of our schools, learning centers and bookstores.***

Our business could be materially and adversely affected by the outbreak of avian influenza, severe acute respiratory syndrome, or SARS, or other epidemics. In April 2009, a new strain of influenza A virus subtype H1N1, commonly referred to as swine flu, was first discovered in North America and quickly spread to other parts of the world, including China. In early June 2009, the World Health Organization declared the outbreak to be a pandemic, while noting that most of the illnesses were of moderate severity. The PRC Ministry of Health subsequently reported several hundred deaths caused by the influenza A (H1N1). The influenza A (H1N1) outbreak adversely affected our business and results of operations in the first and second fiscal quarters of 2010 as we experienced slower-than-usual student enrollment growth and large numbers of cancellations and deferments in enrollments from registered students. In addition, we had to cancel classes whenever an enrolled student was diagnosed with influenza A (H1N1), as required by applicable health regulations. Any future outbreak of avian influenza, SARS, the influenza A (H1N1) or other adverse public health developments in China may have a material and adverse effect on our business operations. These occurrences could cause cancellations or deferments of student enrollments and require the temporary closure of our schools, learning centers and bookstores while we remain obligated to pay rent and other expenses for these facilities, thus severely disrupting our business operations and materially and adversely affecting our liquidity, financial condition and results of operations.

### ***Failure to effectively and efficiently manage the expansion of our school network may materially and adversely affect our ability to capitalize on new business opportunities.***

We have increased the number of our schools in China from 25 as of May 31, 2006 to 55 as of May 31, 2012, and we increased the number of our learning centers in China from 111 as of May 31, 2006 to 609 as of May 31, 2012. We plan to continue to expand our operations in different geographic locations in China. Our expansion has resulted, and will continue to result, in substantial demands on our management, faculty and operational, technological and other resources. Our planned expansion will also place significant demands on us to maintain the consistency of our teaching quality and our culture to ensure that our brand does not suffer as a result of any decreases, whether actual or perceived, in our teaching quality. To manage and support our growth, we must continue to improve our existing operational, administrative and technological systems and our financial and management controls, and recruit, train and retain additional qualified teachers, management personnel and other administrative and sales and marketing personnel, particularly as we expand into new markets. We cannot assure you that we will be able to effectively and efficiently manage the growth of our operations, recruit and retain qualified teachers and management personnel and integrate new schools and learning centers into our operations. Any failure to effectively and efficiently manage our expansion may materially and adversely affect our ability to capitalize on new business opportunities, which in turn may have a material adverse impact on our financial condition and results of operations.

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***If we fail to successfully execute our growth strategies, we may not be able to continue to attract students to enroll in our courses without a significant decrease in course fees, and our business and prospects may be materially and adversely affected.***

Our growth strategies include expanding our program, service and product offerings and our network of schools, learning centers and bookstores, updating and expanding the content of our programs, services and products in a cost-effective and timely manner, as well as maintaining and continuing to establish strategic relationships with complementary businesses. The expansion of our programs, services and products in terms of types of offerings and geographic locations may not succeed due to competition, failure to effectively market our new programs, services and products and maintain their quality and consistency, or other factors. In addition, we may be unable to identify new cities with sufficient growth potential to expand our network, and we may fail to attract students and increase student enrollments or recruit, train and retain qualified teachers for our new schools and learning centers. Some cities in China have undergone development and expansion for several decades while others are still at an early stage of urbanization and development. In more developed cities, it may be difficult to increase the number of schools and learning centers because we and/or our competitors already have extensive operations in these cities. In recently developed and developing cities, demand for our programs, services and products may not increase as rapidly as we expect. Furthermore, we may be unable to develop or license additional content on commercially reasonable terms and in a timely manner, or at all, to keep pace with changes in market demands. If we fail to successfully execute our growth strategies, we may not be able to continue to attract students to enroll in our courses without a significant decrease in course fees, and our business and prospects may be materially and adversely affected.

***We are subject to the SEC investigation and we cannot predict the timing, outcome or consequences of the investigation.***

On July 13, 2012, we were informed that the SEC had issued a formal order of investigation captioned "In the Matter of New Oriental Education & Technology Group Inc." In that investigation the SEC's enforcement staff has requested documents and information concerning the basis for the consolidation of New Oriental China, a variable interest entity of our company, and its schools and subsidiaries, into our consolidated financial statements and other issues related to certain allegations about us contained in a report issued on July 18, 2012 by Muddy Waters LLC. We are cooperating fully with the SEC in its investigation. We cannot predict the timing, outcome or consequences of the SEC investigation.

***We have been named as a defendant in several putative shareholder class action lawsuits that could have a material adverse impact on our business, financial condition, results of operation, cash flows and reputation.***

We will have to defend against the putative shareholder class action lawsuits described in Item 8. Financial Information A. Consolidated Statements and Other Financial Information Legal and Administrative Proceedings Litigation, including any appeals of such lawsuits should our initial defense be successful. We are currently unable to estimate the possible loss or possible range of loss, if any, associated with the resolution of these lawsuits. In the event that our initial defense of these lawsuits is unsuccessful, there can be no assurance that we will prevail in any appeal. Any adverse outcome of these cases, including any plaintiff's appeal of the judgment in these lawsuits, could have a material adverse effect on our business, financial condition, results of operation, cash flows and reputation. In addition, there can be no assurance that our insurance carriers will cover all or part of the defense costs, or any liabilities that may arise from these matters. The litigation process may utilize a significant portion of our cash resources and divert management's attention from the day-to-day operations of our company, all of which could harm our business. We also may be subject to claims for indemnification related to these matters, and we cannot predict the impact that indemnification claims may have on our business or financial results.

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***We may not be able to achieve the benefits we expect from recent and future acquisitions, and recent and future acquisitions may have an adverse effect on our ability to manage our business.***

As part of our business strategy, we have pursued and intend to continue to pursue selective strategic acquisitions of businesses that complement our existing businesses. Acquisitions expose us to potential risks, including risks associated with the diversion of resources from our existing businesses, difficulties in successfully integrating the acquired businesses, failure to achieve expected growth by the acquired businesses and an inability to generate sufficient revenue to offset the costs and expenses of acquisitions. If the revenue and cost synergies that we expect to achieve from our acquisitions do not materialize, we may have to recognize impairment charges. For example, in June 2008 we acquired a 60% equity stake in Beijing Haidian Mingshitang Exam Training Education School, or Mingshitang School, a Beijing-based private school that specializes in tutoring students seeking to retake the Chinese college entrance examination, and in September 2008 we acquired Changchun Tongwen Gaokao Training Education School, or Tongwen Gaokao School, which provides services similar to those of Mingshitang School. In the fiscal year ended May 31, 2010, we recognized a goodwill impairment loss of US\$76,000 arising from the acquisitions of Mingshitang School and Tongwen Gaokao School. We disposed Mingshitang School in April 2011 and recorded a loss of US\$1.2 million on the disposal. As another example, in September 2010, we completed the acquisition of a 100% equity interest in Newave Education, a K-12 English language school in Shanghai. Due to breach of contract by the seller of Newave Education, we submitted a request for arbitration to the China International Economic and Trade Arbitration Commission for full refund of the purchase consideration which we had paid. The case was closed in December 2011, and we received the full refund by the end of the fiscal year ended May 31, 2012.

If any one or more of the aforementioned risks associated with acquisitions materialize, our acquisitions may not be beneficial to us and may have a material adverse effect on our business, financial condition and results of operations.

***Third parties have in the past brought intellectual property infringement claims against us based on the content of the books and other teaching or marketing materials that we or our teachers authored and/or distributed and may bring similar claims against us in the future.***

We may be subject to claims by educational institutions and organizations, content providers and publishers, competitors and others on the ground of intellectual property rights infringement, defamation, negligence or other legal theories based on the content of the materials that we or our teachers author and/or distribute as course materials. These types of claims have been brought, sometimes successfully, against print publications and educational institutions in the past, including ourselves. For example, in January 2001, the Graduate Management Admission Council, or GMAC, and Educational Testing Service, or ETS, filed three separate lawsuits against us in the Beijing No. 1 Intermediate People's Court, alleging that we had violated the copyrights and trademarks relating to the GMAT test owned by GMAC and relating to the GRE and TOEFL tests owned by ETS by duplicating, selling and distributing their test materials without their authorization. In September 2003, the trial court found that we had violated GMAC's and ETS's respective copyrights and trademarks in connection with those admissions tests. The trial court's judgment was partially affirmed in a final judgment issued by the Beijing Higher People's Court in December 2004. The Beijing Higher People's Court held that we had not misused the trademarks of GMAC or ETS. However, it also found that the TOEFL and GRE tests were the original works of ETS and the GMAT test was the original work of GMAC, all of which are protected under the PRC Copyright Law. The Beijing Higher People's Court held that our duplication, sale and distribution of the test materials relating to these tests without ETS's and GMAC's prior permission were not a reasonable use of the test materials under the PRC Copyright Law, and that we, therefore, had infringed upon ETS's and GMAC's respective copyrights. We were ordered to pay damages in an aggregate of approximately RMB6.5 million cease all infringing activities and destroy all copyright-infringing materials in our possession, all of which we have done. Since the Beijing Higher People's Court issued the final judgment in 2004, we have endeavored to comply with the court order and applicable PRC laws and regulations relating to intellectual property, and we have adopted policies and procedures to prohibit our employees and contractors from engaging in any copyright, trademark or trade name infringing activities. However, we cannot assure you that every teacher or other personnel will strictly comply with these policies at our schools, learning centers or other locations or media through which we provide our programs, services and products.

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We have also been involved in other claims and legal proceedings against us relating to infringement of third parties' copyrights in materials distributed by us and the unauthorized use of a third party's name in connection with the marketing and promotion of one of our programs, and may be subject to further claims in the future, particularly in light of the uncertainties in the interpretation and application of PRC intellectual property laws and regulations. Furthermore, if printed publications or other materials that we or our teachers author and/or distribute contain materials that government authorities find objectionable, these publications may have to be recalled, which could result in increased expenses, loss in revenues and adverse publicity. Any claims against us, with or without merit, could be time-consuming and costly to defend or litigate, divert our management's attention and resources or result in the loss of goodwill associated with our brand. If a lawsuit against us is successful, we may be required to pay substantial damages and/or enter into royalty or license agreements that may not be based upon commercially reasonable terms, or we may be unable to enter into such agreements at all. We may also lose, or be limited in, the rights to offer some of our programs, services and products or be required to make changes to our course materials or websites. As a result, the scope of our course materials could be reduced, which could adversely affect the effectiveness of our teaching, limit our ability to attract new students, harm our reputation and have a material adverse effect on our results of operations and financial position.

***We may lose our competitive advantage and our reputation, brand and operations may suffer if we fail to prevent the loss or misappropriation of, or disputes over, our intellectual property rights.***

We consider our trademarks and trade name invaluable to our ability to continue to develop and enhance our brand recognition. We have spent nearly 20 years building our New Oriental brand by emphasizing quality and consistency and building trust among students and parents. From time to time, our trademarks and trade name have been used by third parties for or as part of other branded programs, services and products unrelated to us. We have sent cease and desist letters to such third parties in the past and will continue to do so in the future. However, preventing trademark and trade name infringement, particularly in China, is difficult, costly and time-consuming and continued unauthorized use of our trademarks and trade name by unrelated third parties may damage our reputation and brand. In addition, we have spent significant time and expense developing or licensing and localizing the content of certain educational materials, such as books, software, CD-ROMs, magazines and other periodicals, to enrich our product offerings and meet students' needs. The measures we take to protect our trademarks, copyrights and other intellectual property rights, which presently are based upon a combination of trademark, copyright and trade secret laws, may not be adequate to prevent unauthorized use by third parties. Furthermore, the application of laws governing intellectual property rights in China and abroad is uncertain and evolving, and could involve substantial risks to us. If we are unable to adequately protect our trademarks, copyrights and other intellectual property rights, we may lose these rights, our brand name may be harmed, and our business may suffer materially.

***We face significant competition in each major program we offer and each geographic market in which we operate, and if we fail to compete effectively, we may lose our market share and our profitability may be adversely affected.***

The private education sector in China is rapidly evolving, highly fragmented and competitive, and we expect competition in this sector to persist and intensify. We face competition in each major program we offer and each geographic market in which we operate. For example, we face nationwide competition for our IELTS preparation courses from Global IELTS School, which offers IELTS preparation courses in many cities in China. We face regional competition for our English for children program from several competitors that focus on children's English training in specific regions, including English First. We face competition from companies that focus on providing international and/or PRC test preparation courses in specific geographic markets in China. We also face competition from companies that focus on providing after-school tutoring services, including TAL Education Group and Xueda Education Group.

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Our student enrollments may decrease due to intense competition. Some of our competitors may have more resources than we do. These competitors may be able to devote greater resources than we can to the development, promotion and sale of their programs, services and products and respond more quickly than we can to changes in student needs, testing materials, admissions standards or new technologies. In addition, we face competition from many different smaller sized organizations that focus on some of our targeted markets, and they may be able to respond more promptly to changes in student preferences in these markets. In addition, the increasing use of the Internet and advances in Internet- and computer-related technologies, such as web video conferencing and online testing simulators, are eliminating geographic and cost-entry barriers to providing private educational services. As a result, many of our international competitors that offer online test preparation and language training courses may be able to more effectively penetrate the China market. Many of these international competitors have strong education brands, and students and parents in China may be attracted to the offerings of international competitors based in the country that the student wishes to study in or in which the selected language is widely spoken. Moreover, many smaller companies are able to use the Internet to quickly and cost-effectively offer their programs, services and products to a large number of students with less capital expenditure than previously required. We may have to reduce course fees or increase spending in response to competition in order to retain or attract students or pursue new market opportunities. As a result, our revenues and profitability may decrease. We cannot assure you that we will be able to compete successfully against current or future competitors. If we are unable to maintain our competitive position or otherwise respond to competitive pressures effectively, we may lose our market share and our profitability may be adversely affected.

***Failure to adequately and promptly respond to changes in testing materials, admissions standards and technologies could cause our programs, services and products to be less attractive to students.***

Admissions and assessment tests undergo continuous change, in terms of the focus of the subjects and questions tested, the format of the tests and the manner in which the tests are administered. For example, certain admissions and assessment tests in the United States now include an essay component, which required us to hire and train teachers to be able to analyze written essays that tend to be more subjective in nature and require a higher level of English proficiency. In addition, some admissions and assessment tests that were previously offered in paper format only are now offered in a computer-based testing format. These changes require us to continually update and enhance our test preparation materials and our teaching methods. Further, the Chinese Ministry of Education, or MOE, has recently promulgated new curriculum standards for primary and secondary schools in China covering 19 subjects, including mathematics, Chinese and English. These new curriculum standards are scheduled to begin taking effect in the fall semester of 2012, and we are in the process of adapting our tutoring programs and materials to these changes in curriculum standards. Any inability to track and respond to these changes in a timely and cost-effective manner would make our programs, services and products less attractive to students, which may materially and adversely affect our reputation and ability to continue to attract students without a significant decrease in course fees.

***If colleges, universities and other higher education institutions reduce their reliance on admissions and assessment tests, we may experience a decrease in demand for our test preparation courses and our business may be materially and adversely affected.***

We provide preparation courses for both overseas and domestic admissions and assessment tests. In the fiscal year ended May 31, 2012, we derived a significant portion of our revenues from test preparation courses. The success of our test preparation courses depends on the continued use of admissions and assessment tests as a requirement for admission or graduation. However, the use of admissions tests in China may decline or fall out of favor with educational institutions and government authorities. For example, in early 2005, the PRC Ministry of Education started reforming the CET 4 and the CET 6 exams. The reform, among other things, limited these exams only to college students starting from 2007 and has effectively limited the pool of potential students for our CET 4 and CET 6 exam preparation courses to college students only. More recently, educational institutions and government authorities in China have initiated discussions and conducted early experiments in China on school admissions. Generally, these discussions and experiments exhibit a trend of basing admissions decisions less on entrance exam scores and more on a combination of other factors, such as past academic record, extracurricular activities and comprehensive aptitude evaluations. There have been certain changes in some geographic areas in the way the high school entrance exam is administered. In 2009, 76 universities and colleges were allowed to recruit up to 5% of their students through independently administered tests according to a notice promulgated by the MOE, and in 2012, the 5% threshold was raised to 8% in certain provinces, including Hubei. Students admitted through such independently administered tests still need to meet certain thresholds in the national college entrance exam. It has been reported that the number of such universities and colleges will further increase. If the use of admissions tests in China declines or falls out of favor with educational institutions and government authorities and if we fail to respond to these changes, the demand for certain of our services may decline, and our business may be materially and adversely affected.

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In the United States, there has been a continuing debate regarding the usefulness of admissions and assessment tests to assess qualifications of applicants and many people have criticized the use of admissions and assessment tests as unfairly discriminating against certain test takers. If a large number of educational institutions abandon the use of existing admissions and assessment tests as a requirement for admission, without replacing them with other admissions and assessment tests, we may experience a decrease in demand for our test preparation courses and our business may be seriously harmed.

### ***We have experienced and may continue to experience a decrease in our margins.***

Many factors may cause our gross and net margins to decline. For example, there is a recent trend that the short-term language training and test preparation markets are moving towards smaller class sizes, especially for students between the ages of five and 12. This may have resulted from discretionary income increases for families in China, which cause students to be more willing and able to pay higher course fees for the more individualized attention that smaller classes can offer. In our fiscal year ended May 31, 2012, the average class size for our short-term language training and test preparation courses was approximately 13 students per class, which decreased from approximately 15 students per class in the previous fiscal year. Although our smaller-sized classes are highly profitable, they are marginally less profitable on average than our large classes. Our net margin for our fiscal year ended May 31, 2012 was 17.2%, down from 18.2% in the previous fiscal year. This decrease was partly due to the increase in demand for our smaller-sized classes. In addition, new investments and acquisitions may cause our margins to decline before we successfully integrate the acquired businesses into our operations and realize the full benefits of these investments and acquisitions. There is a risk that our margins could continue to decline in the future due to increasing demand for our smaller-sized classes and/or other factors.

### ***New programs, services and products that we develop may compete with our current offerings.***

We are constantly developing new programs, services and products to meet changes in student demands and respond to changes in testing materials, admissions standards, market needs and trends and technological changes. While some of the programs, services and products that we develop will expand our current offerings and increase student enrollments, others may compete with or make irrelevant our existing offerings without increasing our total student enrollments. For example, our online courses may take away students from our existing classroom-based courses, and our new schools and learning centers may take away students from our existing schools and learning centers. If we are unable to expand our program, service and product offerings while increasing our total student enrollments and profitability, our business and growth may be adversely affected.

### ***Our business is subject to fluctuations caused by seasonality or other factors beyond our control, which may cause our operating results to fluctuate from quarter to quarter. This may result in volatility and adversely affect the price of our ADSs.***

We have experienced, and expect to continue to experience, seasonal fluctuations in our revenues and results of operations, primarily due to seasonal changes in student enrollments. Historically, our courses tend to have the largest student enrollments in our first fiscal quarter, which runs from June 1 to August 31 of each year, primarily because many students enroll in our courses during the summer vacation to enhance their foreign language skills and/or prepare for admissions and assessment tests in subsequent school terms. In addition, we have generally experienced larger student enrollments in our third fiscal quarter, which runs from December 1 to February 28 of each year, primarily because many students enroll in our language training and other courses during the winter school holidays. However, our expenses vary, and certain of our expenses do not necessarily correspond with changes in our student enrollments and revenues. For example, we make investments in marketing and promotion, teacher recruitment and training, and product development throughout the year and we pay rent for our facilities based on the terms of the lease agreements. In addition, other factors beyond our control, such as special events that take place during a quarter when our student enrollment would normally be high, may have a negative impact on our student enrollments. We expect quarterly fluctuations in our revenues and results of operations to continue. These fluctuations could result in volatility and adversely affect the price of our ADSs. As our revenues grow, these seasonal fluctuations may become more pronounced.

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*Our historical financial and operating results are not indicative of our future performance; and our financial and operating results are difficult to forecast.*

Our financial and operating results may not meet the expectations of public market analysts or investors, which could cause the price of our ADSs to decline. In addition to the fluctuations described above, our revenues, expenses and operating results may vary from quarter to quarter and from year to year in response to a variety of other factors beyond our control, including:

general economic conditions;

regulations or actions pertaining to the provision of private educational services in China;

detrimental negative publicity about us, our competitors or our industry;

changes in consumers' spending patterns; and

non-recurring charges incurred in connection with acquisitions or other extraordinary transactions or unexpected circumstances.

Due to these and other factors, we believe that quarter-to-quarter comparisons of our operating results may not be indicative of our future performance, and therefore you should not rely on them to predict the future performance of our ADSs. In addition, our past results may not be indicative of future performance because of new businesses developed or acquired by us.

*Our business is difficult to evaluate because we have limited experience generating net income from some of our newer services.*

Historically, our core businesses have been English language training for adults and test preparation courses for college and graduate students. We have launched many new services to expand our business and student base. For example, in 2008, we launched our New Oriental U-Can (Non-English) training program, which targets middle and high school students in China from ages 13 to 18 who are preparing for the college entrance examination in China, known as the gaokao. The gaokao is required for admission to bachelor degree programs and most associate degree programs at colleges and universities in China. In January 2010, we established a small pilot program whereby we permit third parties in certain small cities to offer our Pop Kids English program and New Oriental Star kindergarten program under a brand name cooperation model. The cooperation facilities operated by such third parties are not included in the counts of our schools and learning centers, and student enrollments from these facilities are not included as our student enrollments.

Some of these operations have not generated significant or any profit to date, and we have less experience responding quickly to changes, competing successfully and maintaining and expanding our brand in these areas without jeopardizing our brand in other areas. Consequently, there is limited operating history on which you can base your evaluation of the business and prospects of these relatively more recent operations.

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***The continuing efforts of our senior management team and other key personnel are important to our success, and our business may be harmed if we lose their services.***

It is important for us to have the continuing services of our senior management team, in particular, Michael Minhong Yu, our founder, chairman and chief executive officer, who has been our leader since our inception in 1993. If one or more of our senior executives or other key personnel are unable or unwilling to continue in their present positions, we may not be able to replace them easily, and our business may be disrupted. Competition for experienced management personnel in the private education sector is intense, the pool of qualified candidates is very limited, and we may not be able to retain the services of our senior executives or key personnel, or attract and retain high-quality senior executives or key personnel in the future. In addition, if any member of our senior management team or any of our other key personnel joins a competitor or forms a competing company, we may lose teachers, students, key professionals and staff members. Each of our executive officers and key employees is subject to the duty of confidentiality and non-competition restrictions. However, if any disputes arise between any of our senior executives or key personnel and us, it may be difficult to successfully pursue legal actions against these individuals because of the uncertainties of China's legal systems.

***We generate a significant portion of our revenues from four cities in China. Any event negatively affecting the private education industry in these cities could have a material adverse effect on our overall business and results of operations.***

We derived approximately 45.4% of our total net revenues for the fiscal year ended May 31, 2012 from our operations in Beijing, Shanghai, Wuhan and Guangzhou, and we expect these four cities to continue to constitute important sources of our revenues. If any of these cities experiences an event negatively affecting its private education industry, such as a serious economic downturn, a natural disaster or an outbreak of contagious disease, or if any of these cities adopts regulations relating to private education that place additional restrictions or burdens on us, our overall business and results of operations may be materially and adversely affected.

***If we are not able to continually enhance our online programs, services and products and adapt them to rapid technological changes and student needs, we may lose market share and our business could be adversely affected.***

The market for Internet-based educational programs, services and products is characterized by rapid technological changes and innovation, unpredictable product life cycles and user preferences. We have limited experience with generating revenues from online programs, services and products, and their results are largely uncertain. The increasing adoption of computer-based testing formats for admissions testing may lead more students to seek online test preparation courses. We must quickly modify our programs, services and products to adapt to changing student needs and preferences, technological advances and evolving Internet practices. Ongoing enhancement of our online offerings and related technology may entail significant expense and technical risk. We may fail to use new technologies effectively or adapt our online products or services and related technology on a timely and cost-effective basis. If our improvements to our online offerings and the related technology are delayed, result in systems interruptions or are not aligned with market expectations or preferences, we may lose market share and our business could be adversely affected.

***Failure to maintain effective internal control over financial reporting could have a material and adverse effect on the trading price of our ADSs.***

We are subject to the reporting obligations under the U.S. securities laws. Although our management concluded, and our independent registered public accounting firm reported, that we maintained effective internal control over financial reporting as of May 31, 2012, we cannot assure you that we will maintain effective internal control over financial reporting on an ongoing basis. If we fail to maintain effective internal control over financial reporting, we will not be able to conclude and our independent registered public accounting firm will not be able to report that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act of 2002 in our future annual report on Form 20-F covering the fiscal year in which this failure occurs. Effective internal control over financial reporting is necessary for us to produce reliable financial reports. Any failure to maintain effective internal control over financial reporting could result in the loss of investor confidence in the reliability of our financial statements, which in turn could have a material and adverse effect on the trading price of our ADSs. Furthermore, we may need to incur additional costs and use additional management and other resources as our business and operations further expand or in an effort to remediate any significant control deficiencies that may be identified in the future.

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***We do not have any liability or business disruption insurance, and a liability claim against us due to injuries suffered by our students or other people at our facilities could adversely affect our reputation and our financial results.***

We could be held liable for accidents that occur at our schools, learning centers and other facilities, including indoor facilities where we organize certain summer camp activities and temporary housing facilities that we lease for our students from time to time. In the event of on-site food poisoning, personal injuries, fires or other accidents suffered by students or other people, we could face claims alleging that we were negligent, provided inadequate supervision or were otherwise liable for the injuries. We currently do not have any liability insurance or business disruption insurance. A successful liability claim against us due to injuries suffered by our students or other people at our facilities could adversely affect our reputation and our financial results. Even if unsuccessful, such a claim could cause unfavorable publicity, require substantial cost to defend and divert the time and attention of our management.

***Capacity constraints or system disruptions to our computer systems or websites could damage our reputation, limit our ability to retain students and increase student enrollments and require us to expend significant resources.***

The performance and reliability of our online program infrastructure is critical to our reputation and ability to retain students and increase student enrollments. Any system error or failure, or a sudden and significant increase in traffic, could result in the difficulty of accessing our websites by our students or unavailability of our online programs. We cannot assure you that we will be able to timely expand our online program infrastructure to meet demand for such programs. Our computer systems and operations could be vulnerable to interruption or malfunction due to events beyond our control, including natural disasters and telecommunications failures. If the computer center at our headquarters is damaged by natural disaster, there could be a service delay of up to four hours until our offsite data backup center restores service on our website. We are planning to build an off-site computer center which is expected to restore service within several seconds following significant damage to our on-site computer center.

Our computer networks may also be vulnerable to unauthorized access, hacking, computer viruses and other security problems. A user who circumvents security measures could misappropriate proprietary information or cause interruptions or malfunctions in operations. Any interruption to our computer systems or operations could have a material adverse effect on our ability to retain students and increase student enrollments. Furthermore, we may be required to expend significant resources to protect against the threat of security breaches or to alleviate problems caused by these breaches.

***Terrorist attacks, geopolitical uncertainty and international conflicts involving the U.S. and elsewhere may discourage more students from studying in the United States and elsewhere outside of China, which could cause declines in the student enrollments for our courses.***

Terrorist attacks, geopolitical uncertainty and international conflicts involving the U.S. and elsewhere, such as those that took place on September 11, 2001, could have an adverse effect on our overseas test preparation courses and English language training courses. Such attacks may discourage students from studying in the United States and elsewhere outside of China and may also make it more difficult for Chinese students to obtain visas to study abroad. These factors could cause declines in the student enrollments for our test preparation and English language training courses and could have an adverse effect on our overall business and results of operations.

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### **Risks Related to Our Corporate Structure**

*If the PRC government finds that the agreements that establish the structure for operating our China business do not comply with applicable PRC laws and regulations, we could be subject to severe penalties.*

PRC laws and regulations currently require any foreign entity that invests in the education business in China to be an educational institution with relevant experience in providing educational services outside China. Our offshore holding companies are not educational institutions and do not provide educational services outside China. In addition, in the PRC, foreign ownership of high schools for students in grade ten to twelve is restricted and foreign ownership of primary and middle schools for students in grades one to nine is prohibited. As a result, our offshore holding companies are not allowed to directly own and operate schools in China. We conduct substantially all of our education business in China through a series of contractual arrangements with New Oriental China and its schools and subsidiaries and New Oriental China's shareholder. These contractual arrangements enable us to (1) have power to direct the activities that most significantly affect the economic performance of New Oriental China and its schools and subsidiaries; (2) receive substantially all of the economic benefits from New Oriental China and its schools and subsidiaries in consideration for the services provided by our wholly owned subsidiaries in China; and (3) have an exclusive option to purchase all or part of the equity interests in New Oriental China, when and to the extent permitted by PRC law, or request any existing shareholder of New Oriental China to transfer all or part of the equity interest in New Oriental China to another PRC person or entity designated by us at any time in our discretion. For a description of these contractual arrangements, see Item 4. Information on the Company C. Organizational Structure Contractual Arrangements with New Oriental China, its Schools and Subsidiaries and its Shareholder.

Tian Yuan Law Firm, our PRC legal counsel, is of the opinion that the corporate structure of New Oriental China and its schools and subsidiaries and our wholly owned subsidiaries in China are in compliance with existing PRC laws and regulations; and the contractual arrangements among our wholly owned subsidiaries in China, New Oriental China and its schools and subsidiaries and the shareholder of New Oriental China are valid, binding and enforceable under, and do not violate, PRC laws or regulations currently in effect. We have been advised by our PRC legal counsel, however, that there are substantial uncertainties regarding the interpretation and application of current and future PRC laws and regulations. Accordingly, there can be no assurance that the PRC regulatory authorities will not in the future take a view that is contrary to the above opinion of our PRC legal counsel. We have been further advised by our PRC counsel that if we, any of our wholly owned subsidiaries, New Oriental China or any of its schools or subsidiaries are found to be in violation of any existing or future PRC laws or regulations or fail to obtain or maintain any of the required permits or approvals, the relevant PRC regulatory authorities, including the Ministry of Education, which regulates the education industry, would have broad discretion in dealing with such violations, including:

revoking the business and operating licenses of our PRC subsidiaries, New Oriental China or New Oriental China's schools and subsidiaries;

discontinuing or restricting the operations of any related-party transactions among our PRC subsidiaries and New Oriental China and its schools and subsidiaries;

limiting our business expansion in China by way of entering into contractual arrangements;

imposing fines or other requirements with which we may not be able to comply;

requiring us to restructure our corporate structure or operations; or

restricting or prohibiting our use of the proceeds of our future offering to finance our business and operations in China.

The imposition of any of these penalties could result in a material and adverse effect on our ability to conduct our business and on our results of operations. If any of these penalties results in our inability to direct the activities of New Oriental China and its schools and subsidiaries that most significantly impact their economic performance, and/or our failure to receive the economic benefits from New Oriental China and its schools and subsidiaries, we may not be able to consolidate New Oriental China and its schools and subsidiaries in our consolidated financial statements in accordance with U.S. GAAP. However, we do not believe that such actions would result in the liquidation or dissolution of our

company, our wholly owned subsidiaries in China or New Oriental China or its schools or subsidiaries.

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*We rely on contractual arrangements for our operations in China, which may not be as effective in providing operational control as direct ownership.*

We have relied and expect to continue to rely on contractual arrangements with New Oriental China, its schools and subsidiaries and its shareholder to operate our education business. These contractual arrangements may not be as effective in providing us with control over New Oriental China as direct ownership. From the legal perspective, if New Oriental China, any of its schools and subsidiaries or its shareholder fails to perform its respective obligations under the contractual arrangements, we may have to incur substantial costs and spend other resources to enforce such arrangements, and rely on legal remedies under PRC law, including seeking specific performance or injunctive relief and claiming damages. For example, if Beijing Century Friendship Education Investment Co., Ltd., or Century Friendship, the sole shareholder of New Oriental China, were to refuse to transfer its equity interest in New Oriental China to us or our designee when we exercise the call option pursuant to the option agreement, or if it otherwise acts in bad faith toward us, then we may have to take legal action to compel it to fulfill its contractual obligations, which could be time consuming and costly.

These contractual arrangements are governed by PRC law and provide for the resolution of disputes through arbitration in the PRC or through the PRC courts. The legal environment in the PRC is not as developed as in some other jurisdictions, such as the United States. As a result, uncertainties in the PRC legal system could limit our ability to enforce these contractual arrangements. In the fiscal years ended May 31, 2010, 2011 and 2012, New Oriental China and its schools and subsidiaries contributed in aggregate 98.9%, 97.2% and 97.2%, respectively, of our total net revenues. In the event we are unable to enforce these contractual arrangements, we may not be able to have the power to direct the activities that most significantly affect the economic performance of New Oriental China and its schools and subsidiaries, and our ability to conduct our business may be negatively affected, and we may not be able to consolidate the financial results of New Oriental China and its schools and subsidiaries into our consolidated financial statements in accordance with U.S. GAAP.

Within the existing contractual arrangements, five of our wholly owned subsidiaries in China have entered into a series of service agreements with New Oriental China and its schools and subsidiaries to enable them to receive substantially all of the economic benefits of New Oriental China and its schools and subsidiaries. However, under certain service agreements, the renewal of the agreements requires both parties' consents, and in a number of other service agreements, the schools and subsidiaries to New Oriental China may terminate the relevant agreements according to provisions without our consent if our wholly owned subsidiaries breach the terms of the service agreements. See Item 4. Information on the Company C. Organizational Structure Contractual Arrangements with New Oriental China, its Schools and Subsidiaries and its Shareholder for more information. We believe that our exclusive option to purchase all or part of the equity interests in New Oriental China, when and to the extent permitted by PRC law, or request any existing shareholder of New Oriental China to transfer all or part of the equity interest in New Oriental China to another PRC person or entity designated by us at any time in our discretion, and the power of attorney that New Oriental China's shareholder has granted to us, effectively enable us to have the ability to cause the related service contracts to be renewed when needed. However, if we are not able to renew these service agreements when they expire or the school and subsidiaries of New Oriental China terminate these agreements according to terms and conditions thereunder, our ability to receive the economic benefits of New Oriental China and its schools and subsidiaries may be adversely affected.

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***Our ability to enforce the equity pledge agreements between us and New Oriental China's shareholder may be subject to limitations based on PRC laws and regulations.***

Pursuant to the equity pledge agreements among New Oriental China, Century Friendship and five of our wholly owned subsidiaries in China, Century Friendship, as New Oriental China's sole shareholder, agrees to pledge its equity interests in New Oriental China to our subsidiaries to secure New Oriental China's and its schools and subsidiaries' performance of their obligations under the relevant contractual arrangements. The equity pledges of Century Friendship under these equity pledge agreements have been registered with the relevant local branch of the State Administration for Industry and Commerce, or SAIC. According to the PRC Property Law and PRC Guarantee Law, the pledgee and the pledgor are prohibited from making an agreement prior to the expiration of the debt performance period to transfer the ownership of the pledged equity to the pledgee when the obligor fails to pay the debt due. However, under the PRC Property Law, when an obligor fails to pay its debt when due, the pledgee may choose to either conclude an agreement with the pledgor to obtain the pledged equity or seek payments from the proceeds of the auction or sell-off of the pledged equity. If New Oriental China or its shareholder fails to perform its obligations secured by the pledges under the equity pledge agreements, one remedy in the event of default under the agreements is to require the pledgor to sell the equity interests of New Oriental China in an auction or private sale and remit the proceeds to our wholly owned subsidiaries in China, net of related taxes and expenses. Such an auction or private sale may not result in our receipt of the full value of the equity interests in New Oriental China. We consider it very unlikely that the public auction process would be undertaken since, in an event of default, our preferred approach is to ask Shanghai Smart Words, which is one of our PRC wholly owned subsidiaries and a party to the option agreement with New Oriental China's shareholder, to designate another PRC person or entity to replace the existing shareholder of New Oriental China pursuant to the direct transfer option we have under the option agreement.

In addition, in the registration forms of the local branch of State Administration for Industry and Commerce for the pledges over the equity interests under the equity pledge agreements, the amount of registered equity interests pledged to our wholly owned subsidiaries was stated as RMB3,000,000, RMB18,500,000, RMB9,500,000, RMB14,000,000 and RMB5,000,000, respectively, which in aggregate represent 100% of the registered capital of New Oriental China. The equity pledge agreements with New Oriental China's shareholder provide that the pledged equity interest shall constitute continuing security for any and all of the indebtedness, obligations and liabilities under all of the principal service agreements and the scope of pledge shall not be limited by the amount of the registered capital of New Oriental China. However, it is possible that a PRC court may take the position that the amount listed on the equity pledge registration forms represents the full amount of the collateral that has been registered and perfected. If this is the case, the obligations that are supposed to be secured in the equity pledge agreements in excess of the amount listed on the equity pledge registration forms could be determined by the PRC court as unsecured debt, which takes last priority among creditors and often does not have to be paid back at all. We do not have agreements that pledge the assets of New Oriental China and its schools and subsidiaries for the benefit of us or our wholly owned subsidiaries.

***The controlling shareholder of Century Friendship, which is the sole shareholder of New Oriental China, may have potential conflicts of interest with us, and if any such conflicts of interest are not resolved in our favor, our business may be materially and adversely affected.***

New Oriental China is wholly owned by Century Friendship, a PRC domestic company which is controlled by Mr. Michael Minhong Yu, our founder, chairman and chief executive officer. The interests of Mr. Yu as the controlling shareholder of the entity which owns New Oriental China may differ from the interests of our company as a whole, since Mr. Yu is only one of the beneficial owners of our company, holding 17.8% of our total common shares issued and outstanding as of September 20, 2012. We cannot assure you that when conflicts of interest arise, Mr. Yu will act in the best interests of our company or that conflicts of interests will be resolved in our favor. In addition, Mr. Yu may breach or cause New Oriental China and its schools and subsidiaries to breach or refuse to renew the existing contractual arrangements with us. Currently, we do not have existing arrangements to address potential conflicts of interest Mr. Yu may encounter in his capacity as a beneficial owner and director of New Oriental China, on the one hand, and as a beneficial owner and director of our company, on the other hand; provided that we could, at all times, exercise our option under the option agreement with Century Friendship to cause it to transfer all of its equity ownership in New Oriental China to a PRC entity or individual designated by us, and this new shareholder of New Oriental China could then appoint a new director of New Oriental China to replace Mr. Yu. In addition, if such conflicts of interest arise, Beijing Pioneer, our wholly owned PRC subsidiary, could also, in the capacity of Century Friendship's attorney-in-fact as provided under the proxy agreement and power of attorney, directly appoint a new director of New Oriental China to replace Mr. Yu. We rely on Century Friendship and Mr. Yu to comply with the laws of China, which protect contracts, including the contractual arrangements New Oriental China and its schools and subsidiaries and its shareholder have entered into with us, which provide that directors and executive officers owe a duty of loyalty to our company and require them to avoid conflicts of interest and not to take advantage of their positions for personal gains. We also rely on Mr. Yu to abide by the laws of the Cayman Islands, which provide that directors have a duty of care and a duty of loyalty to act honestly in good faith with a view to our best interests. However, the legal frameworks of China and the Cayman Islands do not provide guidance on resolving conflicts in the event of a conflict with another corporate governance regime. If we cannot resolve any conflicts of interest or disputes between us and Century Friendship and Mr. Yu, we would have to rely on legal proceedings, which could result in disruption of our business and subject us to substantial uncertainty as to the outcome of any such legal proceedings.



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*If the custodians or authorized users of our controlling non-tangible assets, including chops and seals, fail to fulfill their responsibilities, or misappropriate or misuse these assets, our business and operations could be materially and adversely affected.*

Under PRC law, legal documents for corporate transactions, including agreements and contracts such as the leases and sales contracts that our business relies on, are executed using the chop or seal of the signing entity or with the signature of a legal representative whose designation is registered and filed with the relevant local branch of the SAIC. We generally execute legal documents by affixing chops or seals, rather than having the designated legal representatives sign the documents.

We have three major types of chops corporate chops, contract chops and finance chops. We use corporate chops generally for documents to be submitted to government agencies, such as applications for changing business scope, directors or company name, and for legal letters. We use contract chops for executing leases and commercial, contracts. We use finance chops generally for making and collecting payments, including, but not limited to issuing invoices. Use of corporate chops and contract chops must be approved by our legal department and administrative department, and use of finance chops must be approved by our finance department. The chops of our subsidiaries and New Oriental China and its schools and subsidiaries are generally held by the relevant entities so that documents can be executed locally. Although we usually utilize chops to execute contracts, the registered legal representatives of our PRC subsidiaries, New Oriental China and its schools and subsidiaries have the apparent authority to enter into contracts on behalf of such entities without chops. All designated legal representatives of our PRC subsidiaries and New Oriental China and its schools and subsidiaries are members of our senior management who have signed employment agreements with us under which they agree to abide by duties they owe to us.

In order to maintain the physical security of our chops, we generally have them stored in secured locations accessible only to the department heads of the legal, administrative or finance departments. Our designated legal representatives generally do not have access to the chops. Although we monitor our employees, including the designated legal representatives of our PRC subsidiaries and New Oriental China and its schools and subsidiaries, the procedures may not be sufficient to prevent all instances of abuse or negligence. There is a risk that our employees or designated legal representatives could abuse their authority, for example, by binding the relevant subsidiary or New Oriental China and its schools and subsidiaries with contracts against our interests, as we would be obligated to honor these contracts if the other contracting party acts in good faith in reliance on the apparent authority of our chops or signatures of our legal representatives. If any designated legal representative obtains control of the chop in an effort to obtain control over the relevant entity, we would need to have a shareholder or board resolution to designate a new legal representative and to take legal action to seek the return of the chop, apply for a new chop with the relevant authorities, or otherwise seek legal remedies for the legal representative's misconduct. If any of the designated legal representatives obtains and misuses or misappropriates our chops and seals or other controlling intangible assets for whatever reason, we could experience disruption to our normal business operations. We may have to take corporate or legal action, which could involve significant time and resources to resolve while distracting management from our operations.

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*Our ability to operate private schools may be subject to significant limitations or may otherwise be materially and adversely affected by changes in PRC laws and regulations.*

The principal regulations governing private education in China are The Law for Promoting Private Education (2003) and The Implementation Rules for the Law for Promoting Private Education (2004). Under these regulations, a private school may elect to be a school that does not require reasonable returns or a school that requires reasonable returns. As of May 31, 2012, 22 of our schools elected as schools not requiring reasonable returns, 24 of our schools elected as schools requiring reasonable returns, and the remaining schools are not classified.

At the end of each fiscal year, every private school is required to allocate a certain amount to its development fund for the construction or maintenance of the school or procurement or upgrade of educational equipment. In the case of a private school that requires reasonable returns, this amount shall be no less than 25% of annual net income of the school, while in the case of a private school that does not require reasonable returns, this amount shall be equivalent to no less than 25% of the annual increase in the net assets of the school, if any. A private school that requires reasonable returns must publicly disclose such election and additional information required under the regulations. A private school shall consider factors such as the school's tuition, ratio of the funds used for education-related activities to the course fees collected, admission standards and educational quality when determining the percentage of the school's net income that would be distributed to the investors as reasonable returns. However, none of the current PRC laws and regulations provides a formula or guidelines for determining reasonable returns. In addition, none of the current PRC laws and regulations sets forth different requirements or restrictions on a private school's ability to operate its education business based on such school's status as a school that requires reasonable returns or a school that does not require reasonable returns.

In some cities, our schools are registered as schools that require reasonable returns, while in other cities, our schools are registered as schools that do not require reasonable returns. The current PRC laws and regulations governing private education may be amended or replaced by new laws and regulations that (1) impose significant limitations on the ability of our schools to operate their business, charge course fees or make payments to related parties for services received, (2) specify the formula for calculating reasonable returns, (3) change the preferential tax treatment policies applicable to private schools, or (4) restrict a private school's ability to make payments to related parties for services. We cannot predict the timing and effects of any such amendments or new laws and regulations. Changes in PRC laws and regulations governing private education or otherwise affecting our schools' operations could materially and adversely affect our business prospects and results of operations. For example, if the PRC government imposes additional limitations on private schools' ability to operate their business or restricts private schools from making payments to related parties for services, our ability to receive service fees from our affiliated schools may be limited or we may have to reorganize our group structure.

On July 29, 2010, the PRC central government promulgated the Outline of China's National Plan for Medium- and Long-Term Education Reform and Development, which for the first time announced the policy that the government will implement a reform to divide private education entities into two categories: (1) for-profit private education entities and (2) not-for-profit private education entities. However, this outline is still new and no further law or regulation has been promulgated to implement the outline. If upon the implementation of this reform, our schools choose to be for-profit private education entities, they may be subject to income tax at the rate of 25% and other taxes as if they were enterprises. For the year ended May 31, 2012, schools that accounted for approximately 28.8% of our consolidated net revenues were subject to a 25% income tax rate. The other schools, including the Beijing school, which accounted for approximately 61.6% of our consolidated net revenues, were subject to favorable tax rates. Historically, the effective income tax rates for all our schools were 8.27%, 10.98% and 9.93% in the fiscal years ended May 31, 2010, 2011 and 2012, respectively. Additionally, if our schools choose to be not-for-profit private education entities, our contractual arrangements with New Oriental China and its schools and subsidiaries may be subject to more stringent scrutiny. As a result, implementation of this reform policy may adversely affect our results of operations.

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***Our contractual arrangements may be subject to scrutiny by the PRC tax authorities, and a finding that we owe additional taxes could substantially reduce our consolidated net income and the value of your investment.***

Under PRC laws and regulations, arrangements and transactions among related parties may be subject to audit or challenge by the PRC tax authorities. We could face material and adverse tax consequences if the PRC tax authorities determine that the contractual arrangements among our wholly owned subsidiaries in China and New Oriental China and its schools and subsidiaries do not represent an arm's-length price and adjust New Oriental China or any of its schools' or its subsidiaries' income in the form of a transfer pricing adjustment. A transfer pricing adjustment could, among other things, result in a reduction, for PRC tax purposes, of expense deductions recorded by New Oriental China or any of its schools or its subsidiaries, which could in turn increase its tax liabilities. In addition, the PRC tax authorities may impose late payment fees and other penalties to New Oriental China and its schools and subsidiaries for under-paid taxes. Our consolidated net income may be materially and adversely affected if our tax liabilities increase or if we are found to be subject to late payment fees or other penalties.

***Regulatory agencies may commence investigations of the private primary and secondary schools controlled and operated by New Oriental China. If the results of the investigations are unfavorable to us, we may be subject to fines, penalties, injunctions or other censure that could have an adverse impact on our results of operations.***

PRC laws and regulations currently prohibit foreign ownership of primary and middle schools for students in grades one to nine in China, and restrict foreign ownership of high schools for students in grades ten to twelve. New Oriental China controls and operates a private primary and secondary school in Yangzhou and a private secondary school in Beijing. As the provision of private primary and middle school services is a heavily regulated industry in China, our existing and any new primary or middle schools we establish or acquire in the future may be subject from time to time to investigations, claims of non-compliance or lawsuits by governmental agencies, which may allege statutory violations, regulatory infractions or other causes of action. If the results of the investigations are unfavorable to us, we may be subject to fines, injunctions or other penalties that could have an adverse impact on our results of operations. Even if we adequately address the issues raised by a government investigation, we may have to devote significant financial and management resources to resolve these issues, which could harm our business.

***We may rely on dividends and other distributions on equity paid by our wholly owned subsidiaries to fund any cash and financing requirements we may have, and any limitation on the ability of our subsidiaries or New Oriental China and its schools and subsidiaries to make payments to us could have a material adverse effect on our ability to conduct our business.***

We are a holding company, and we may rely on dividends from our wholly owned subsidiaries in China and service, license and other fees paid to our wholly owned subsidiaries by New Oriental China and its schools and subsidiaries for our cash requirements, including any debt we may incur. Current PRC regulations permit our subsidiaries to pay dividends to us only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. In addition, each of our subsidiaries and New Oriental China and its subsidiaries in China is required to set aside at least 10% of its after-tax profits each year, if any, to fund a statutory reserve until such reserve reaches 50% of its registered capital, and each of our subsidiaries is required to further set aside a portion of its after-tax profits to fund the employee welfare fund at the discretion of its board of directors. These reserves are not distributable as cash dividends. Furthermore, if our subsidiaries and New Oriental China and its schools and subsidiaries in China incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments to us. In addition, the PRC tax authorities may require us to adjust our taxable income under the contractual arrangements we currently have in place in a manner that would materially and adversely affect our subsidiaries' ability to pay dividends and other distributions to us. Moreover, at the end of each fiscal year, every private school in China is required to allocate a certain amount to its development fund for the construction or maintenance of the school or procurement or upgrade of educational equipment. In the case of a private school that requires reasonable returns, this amount shall be no less than 25% of the annual net income of the school, while in the case of a private school that does not require reasonable returns, this amount shall be equivalent to no less than 25% of the annual increase in the net assets of the school, if any. Any limitation on the ability of our subsidiaries to distribute dividends to us or on the ability of New Oriental China and its schools and subsidiaries to make payments to us could materially and adversely limit our ability to grow, make investments or acquisitions that could be beneficial to our businesses, pay dividends, or otherwise fund and conduct our business.

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*PRC regulation of loans to, and direct investment in, PRC entities by offshore holding companies and governmental control of currency conversion may restrict or prevent us from making loans to our PRC subsidiaries or New Oriental China and its schools and subsidiaries or making additional capital contributions to our PRC subsidiaries, which could materially and adversely affect our liquidity and our ability to fund and expand our business.*

We are an offshore holding company conducting our operations in China through our PRC subsidiaries and New Oriental China and its schools and subsidiaries. We may need to make loans to our PRC subsidiaries or New Oriental China and its schools and subsidiaries, or we may make additional capital contributions to our PRC subsidiaries.

Any loans to our PRC subsidiaries or New Oriental China and its schools and subsidiaries are subject to PRC regulations. For example, loans by us to our wholly-owned subsidiaries in China, each of which is a foreign-invested enterprise, to finance their activities cannot exceed statutory limits and must be registered with the PRC State Administration of Foreign Exchange, or SAFE, or its local counterparts. Loans by us to New Oriental China and its schools and subsidiaries, which are domestic PRC entities, must be approved by the relevant government authorities and must also be registered with SAFE or its local counterparts.

We may also decide to finance our PRC subsidiaries by means of capital contributions. These capital contributions must be approved by the PRC Ministry of Commerce or its local counterparts. We are unlikely, however, to finance the activities of New Oriental China and its schools and subsidiaries by means of capital contributions due to regulatory issues related to foreign investment in domestic PRC entities, as well as the licensing and other regulatory issues. SAFE promulgated the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Currency Capital of Foreign Invested Enterprises, or SAFE Circular 142, on August 29, 2008 to regulate the conversion by a foreign-invested company of its capital contribution in foreign currency into RMB. SAFE Circular 142 requires that the paid-in capital of a foreign-invested company settled in RMB converted from foreign currencies shall be used only for purposes within the business scope as approved by the authorities in charge of foreign investment or by other competent authorities and as registered with the local branch of the SAIC and, unless set forth in the business scope or in other regulations, may not be used for equity investments within the PRC. In addition, SAFE strengthened its oversight of the flow and use of the paid-in capital of a foreign-invested company settled in RMB converted from foreign currencies. The use of such RMB paid-in capital may not be changed without SAFE's approval. Violations of Circular 142 will result in severe monetary or other penalties. In strengthening Circular 142, SAFE promulgated the Circular on Further Clarifying and Regulating Relevant Issues Concerning the Administration of Foreign Exchange under Capital Account, or SAFE Circular 45, on November 9, 2011, which expressly prohibits a foreign invested company from converting registered capital in foreign exchange into RMB for the purpose of equity investment, granting certain loans, repayment of inter-company loans, or repayment of bank loans which have been transferred to a third party. As a result, Circular 142 and Circular 45 may significantly limit our ability to transfer capital to New Oriental China and its schools and subsidiaries through our subsidiaries in the PRC, which may adversely affect our ability to expand our business, and we may not be able to convert capital into RMB to invest in or acquire any other PRC companies, or establish other variable interest entities in the PRC. See also Item 4. Information on the Company B. Business Overview Regulation. We cannot assure you that we will be able to obtain these government registrations or approvals on a timely basis, if at all. If we fail to receive such registrations or approvals, our ability to capitalize our PRC operations may be negatively affected, which could adversely affect our liquidity and our ability to fund and expand our business.

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*If any of New Oriental China and its schools and subsidiaries becomes the subject of a bankruptcy or liquidation proceeding, we may lose the ability to use and enjoy their assets, which could reduce the size of our operations and materially and adversely affect our business, ability to generate revenue and the market price of our ADSs.*

To comply with PRC laws and regulations relating to foreign ownership restrictions in the education business, we currently conduct substantially all of our operations in China through contractual arrangements with New Oriental China and its schools and subsidiaries as well as its shareholder. As part of these arrangements, New Oriental China and its schools and subsidiaries hold assets that are important to the operation of our business.

We do not have priority pledges and liens against New Oriental China's assets. As a contractual and property right matter, this lack of priority pledges and liens has remote risks. If New Oriental China undergoes an involuntary liquidation proceeding, third-party creditors may claim rights to some or all of its assets and we may not have priority against such third-party creditors on New Oriental China's assets. If New Oriental China liquidates, we may take part in the liquidation procedures as a general creditor under the PRC Enterprise Bankruptcy Law and recover any outstanding liabilities owed by New Oriental China to our PRC subsidiaries under the applicable service agreements. To ameliorate the risks of an involuntary liquidation proceeding initiated by a third-party creditor, we closely monitor the operations and finances of New Oriental China through carefully designed budgetary and internal controls to ensure that New Oriental China is well capitalized and is highly unlikely to trigger any third party monetary claims in excess of its assets and cash resources. Furthermore, our PRC subsidiaries have the ability, if necessary, to inject capital in Renminbi into New Oriental China to prevent such an involuntary liquidation.

If the shareholder of New Oriental China were to attempt to voluntarily liquidate New Oriental China without obtaining our prior consent, we could effectively prevent such unauthorized voluntary liquidation by exercising our right to request New Oriental China's shareholder to transfer all of its equity ownership interest to a PRC entity or individual designated by us in accordance with the option agreement with the New Oriental China shareholder. In addition, under the equity pledge agreements signed by the shareholder of New Oriental China and the PRC Property Law, the shareholder of New Oriental China does not have the right to issue dividends to itself or otherwise distribute the retained earnings or other assets of New Oriental China without our consent. Also, under the proxy agreement and power of attorney, the shareholder of New Oriental China undertakes to Beijing Pioneer, our wholly owned PRC subsidiary, that if it receives, among other things, any dividends, residual assets upon liquidation or proceeds from the transfer of its equity interest in New Oriental China, it will, to the extent permitted under applicable law, remit all such dividends, residual assets and proceeds to Beijing Pioneer without any compensation or other consideration. In the event that the shareholder of New Oriental China initiates a voluntary liquidation proceeding without our authorization or attempts to distribute the retained earnings or assets of New Oriental China without our prior consent, we may need to resort to legal proceedings to enforce the terms of the contractual agreements. Any such litigation may be costly and may divert our management's time and attention away from the operation of our business, and the outcome of such litigation would be uncertain.

## **Risks Related to Doing Business in China**

*Adverse changes in economic and political policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could adversely affect our business.*

Substantially all of our business operations are conducted in China. Accordingly, our results of operations, financial condition and prospects are subject to a significant degree to economic, political and legal developments in China. China's economy differs from the economies of most developed countries in many respects, including with respect to the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth for over three decades, growth has been uneven across different regions and among various economic sectors of China. The PRC government has implemented various measures to encourage economic development and guide the allocation of resources. While some of these measures benefit the overall PRC economy, they may also have a negative effect on us. For example, our financial condition and results of operations may be adversely affected by government control over capital investments, conversion of foreign exchange into Renminbi or changes in tax regulations that are applicable to us. In addition, future actions or policies of the PRC government to control the pace of economic growth may cause a decrease in the level of economic activity in China, which in turn could materially affect our liquidity and access to capital and our ability to operate our business.

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***Our business, financial condition and results of operations, as well as our ability to obtain financing, may be adversely affected by the downturn in the global or PRC economy.***

The global financial markets experienced significant disruptions in 2008 and the United States, Europe and other economies went into recession. The recovery from the lows of 2008 and 2009 was uneven and it is facing new challenges, including the escalation of the European sovereign debt crisis since 2011 and the slowdown of the Chinese economy in 2012. It is unclear whether the European sovereign debt crisis will be contained and when the Chinese economy will resume the high growth rate. There is considerable uncertainty over the long-term effects of the expansionary monetary and fiscal policies that have been adopted by the central banks and financial authorities of some of the world's leading economies, including China's. There have also been concerns over unrest in the Middle East and Africa, which have resulted in higher oil prices and significant market volatility, and over the possibility of a war involving Iran. There have also been concerns about the economic effect of the earthquake, tsunami and nuclear crisis in Japan and the relationship between China and Japan.

Economic conditions in China are sensitive to global economic conditions and also have their own challenges, and our business, results of operations and financial condition are sensitive to PRC and global economic conditions. Any prolonged slowdown in the PRC or global economy may have a negative impact on our business, results of operations and financial condition, and continued turbulence in the international markets may adversely affect our ability to access the capital markets to meet liquidity needs.

***Uncertainties with respect to the PRC legal system could adversely affect us.***

Our operations in China are governed by PRC laws and regulations. Our subsidiaries are generally subject to laws and regulations applicable to foreign investments in China and, in particular, laws applicable to wholly foreign-owned enterprises. The PRC legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. China has not developed a fully integrated legal system and recently enacted laws and regulations may not sufficiently cover all aspects of economic activities in China. In particular, because many of these laws and regulations are relatively new, and because of the limited volume of published decisions and their nonbinding nature, the interpretation and enforcement of these laws and regulations involve uncertainties. In addition, the PRC legal system is based in part on government policies and internal rules and interpretations (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of our violation of these policies, rules and interpretations until sometime after the violation. In addition, any litigation in China may be protracted and may result in substantial costs and diversion of resources and management attention.

***Regulation and censorship of information disseminated over the Internet in China may adversely affect our business and reputation and subject us to liability for information displayed on our websites.***

The PRC government has adopted regulations governing Internet access and the distribution of news and other information over the Internet. Under these regulations, Internet content providers and Internet publishers are prohibited from posting or displaying over the Internet content that, among other things, violates PRC laws and regulations, impairs the national dignity of China, or is reactionary, obscene, superstitious, fraudulent or defamatory. Failure to comply with these requirements may result in the revocation of licenses to provide Internet content and other licenses, and the closure of the concerned websites. In the past, failure to comply with such requirements has resulted in the closure of certain websites. The website operator may also be held liable for such censored information displayed on or linked to the websites. If any of our websites, including those used for our online education business, are found to be in violation of any such requirements, we may be penalized by relevant authorities, and our operations or reputation could be adversely affected.

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***We are required to obtain various operating licenses and permits and to make registrations and filings for our business operations in China; failure to comply with these requirements may materially adversely affect our business and results of operations.***

We are required to obtain and maintain various licenses and permits and fulfill registration and filing requirements in order to conduct and operate our business. For instance, to establish and operate a school to provide language training and test preparation services, we are required to obtain a private school operating permit and to make necessary filings for each learning center with the local counterparts of the Ministry of Education and the Ministry of Civil Affairs. Our business is also subject to various health, safety and other regulations that affect various aspects of our business in the cities in which we operate and we must obtain various licenses and permits under these regulations for our operations. We have been making efforts to ensure compliance with applicable rules and regulations in all material respects. In addition, we follow internal guidelines to make necessary registrations and filings and obtain necessary licenses and permits on a timely basis. If we fail to comply with applicable legal requirements, we may be subject to fines, confiscation of the gains derived from our noncompliant operations or the suspension of our noncompliant operations, which may materially and adversely affect our business and results of operations.

***PRC regulations relating to the establishment of offshore special purpose companies by PRC residents may subject our PRC resident shareholders to personal liability and limit our ability to inject capital into our PRC subsidiaries, limit our PRC subsidiaries' ability to distribute profits to us or otherwise adversely affect us.***

SAFE issued a public notice in October 2005 and its new implementation rules in April 2011, requiring PRC residents to register with the local SAFE branch before establishing or controlling any company outside of China for the purpose of capital financing with assets or equities of PRC companies, referred to in the notice as an offshore special purpose company. PRC residents that are shareholders of offshore special purpose companies established before November 1, 2005 were required to register with the local SAFE branch before March 31, 2006. Our beneficial owners immediately before our initial public offering who are PRC residents had registered with the local SAFE branch prior to our initial public offering as required under the SAFE notice. The failure of these beneficial owners to timely amend their SAFE registrations, if required, or the failure of future beneficial owners of our company who are PRC residents to comply with the registration procedures set forth in the SAFE notice may subject such beneficial owners to fines and legal sanctions and may also limit our ability to contribute additional capital into our PRC subsidiaries, limit our PRC subsidiaries' ability to distribute dividends or repay loans in foreign exchange to our company or otherwise adversely affect our business.

***We face regulatory uncertainties in China concerning our employees' participation in our share incentive plan.***

On February 15, 2012, SAFE issued the Notices on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in a Stock Incentive Plan of an Overseas Publicly-Listed Company, or Circular No. 7. According to Circular No. 7, if PRC individuals (meaning both PRC residents and non-PRC residents who reside in the PRC for a continuous period of not less than one year, excluding the foreign diplomatic personnel and representatives of international organizations) participate in any share incentive plan of an overseas listed company, a qualified PRC domestic agent, which could be the PRC subsidiaries of such overseas listed company, shall, among other things, file, on behalf of such individuals, an application with SAFE to conduct the SAFE registration with respect to such share incentive plan, and obtain approval for an annual allowance with respect to the purchase of foreign exchange in connection with the share purchase or share option exercise. Such PRC individuals' foreign exchange income received from the sale of shares and dividends distributed by the overseas listed company and any other income shall be fully remitted into a collective foreign currency account in the PRC opened and managed by the PRC domestic agent before distribution to such individuals. In addition, such PRC individuals must also retain an overseas entrusted institution to handle matters in connection with the exercise of their share options and their purchase and sale of shares.

Since Circular No. 7 is relatively new, interpretations and application of this circular involves uncertainties. We are in the process of making application on behalf of the PRC individuals who participate in our company's share incentive plan with SAFE in compliance with Circular No. 7; however, we cannot assure you that such application will be successful. If it is determined that we or the participants of our share incentive plan who are PRC individuals do not fully comply with Circular No. 7 or other applicable regulations, we and participants of our share incentive plan who are PRC individuals may be subject to fines and legal sanctions and government agencies may prevent us from further granting options under our share incentive plan to our employees who are PRC individuals. Such events could adversely affect our ability to retain talented employees.

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*The M&A rules establish complex procedures for some acquisitions of Chinese companies by foreign investors, which could make it more difficult for us to pursue growth through acquisitions in China.*

On August 8, 2006, six PRC regulatory agencies, namely the Ministry of Commerce, the State Assets Supervision and Administration Commission, the State Administration for Taxation, the State Administration for Industry and Commerce, the China Securities Regulatory Commission, or the CSRC, and SAFE, jointly adopted the Regulations on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, commonly referred to as the M&A Rules, which became effective on September 8, 2006. The M&A Rules establish procedures and requirements that could make some acquisitions of Chinese companies by foreign investors more time-consuming and complex, including requirements in some instances that the Ministry of Commerce be notified in advance of any change-of-control transaction in which a foreign investor takes control of a Chinese domestic enterprise. We may expand our business in part by acquiring complementary businesses. Complying with the requirements of the M&A Rules to complete such transactions could be time-consuming, and any required approval processes, including obtaining approval from the Ministry of Commerce, may delay or inhibit our ability to complete such transactions, which could affect our ability to expand our business or maintain our market share.

*Increases in labor costs in the PRC may adversely affect our business and our profitability.*

The economy of China has been experiencing significant growth, leading to inflation and increased labor costs. According to the National Bureau of Statistics of China, the year-over-year percent change in the consumer price index in China, the broadest measure of inflation, was 3.0% for May 2012. China's overall economy and the average wage in the PRC are expected to continue to grow. As a result, the average wage level for our employees has also increased in recent years. Continuing increases in China's inflation and material increases in the cost of labor may diminish our competitive advantage and, unless we are able pass on these increased labor costs to our students by increasing prices for our services, our profitability and results of operations could be materially and adversely affected.

*Governmental control of currency conversion may affect the value of your investment.*

The PRC government imposes controls on the convertibility between the RMB and foreign currencies and, in certain cases, the remittance of currency out of China. We receive substantially all of our revenues in RMB. Under our current corporate structure, our income at the holding company level may be primarily derived from dividend payments from our PRC subsidiaries. Shortages in the availability of foreign currency may restrict the ability of our PRC subsidiaries and New Oriental China and its schools and subsidiaries to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy their foreign currency denominated obligations. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments and expenditures from trade-related transactions, can be made in foreign currencies without prior approval from SAFE by complying with certain procedural requirements. However, approval from appropriate government authorities is required where RMB is to be converted into foreign currency and remitted out of China to pay capital expenses such as the repayment of loans denominated in foreign currencies. The PRC government may also at its discretion restrict access in the future to foreign currencies for current account transactions. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands, we may not be able to pay dividends in foreign currencies to our shareholders, including holders of our ADSs.

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### ***Fluctuation in the value of the RMB may have a material adverse effect on your investment.***

The value of the Renminbi against the U.S. dollar and other currencies is affected by, among other things, changes in China's political and economic conditions and China's foreign exchange policies. The conversion of the Renminbi into foreign currencies, including the U.S. dollar, has been based on exchange rates set by the People's Bank of China. The PRC government allowed the Renminbi to appreciate by more than 20% against the U.S. dollar between July 2005 and July 2008. Between July 2008 and June 2010, this appreciation was halted and the exchange rate between the Renminbi and the U.S. dollar remained within a narrow band. As a consequence, the RMB fluctuated significantly during that period against other freely traded currencies, in tandem with the U.S. dollar. Since June 2010, the PRC government has allowed the Renminbi to appreciate slowly against the U.S. dollar again. It is difficult to predict how market forces or PRC or U.S. government policy may impact the exchange rate between the Renminbi and the U.S. dollar in the future. In addition, there remains significant international pressure on the PRC government to adopt a substantial liberalization of its currency policy, which could result in further appreciation in the value of the RMB against the U.S. dollar.

Our revenues and costs are mostly denominated in the RMB, and a significant portion of our financial assets are also denominated in RMB. We may rely entirely on dividends and other fees paid to us by our subsidiaries and New Oriental China and its schools and subsidiaries in China. Any significant revaluation of the RMB may materially and adversely affect our cash flows, revenues, earnings and financial position, and the value of, and any dividends payable on, our ADSs in U.S. dollars. For example, a further appreciation of the RMB against the U.S. dollar would make any new RMB-denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into the RMB for such purposes. Conversely, a significant depreciation of the RMB against the U.S. dollar may significantly reduce our reported earnings in U.S. dollars, which in turn could adversely affect the price of our ADSs.

### ***The discontinuation of any preferential tax treatments currently available to us could materially and adversely affect our results of operations.***

On March 16, 2007, the National People's Congress passed the Enterprise Income Tax Law, or the EIT Law, which took effect on January 1, 2008. The EIT Law applies a uniform 25% enterprise income tax rate to both foreign-invested enterprises and domestic enterprises. The EIT Law provides that preferential tax treatments will be granted to industries and projects that are strongly supported and encouraged by the state, and that enterprises otherwise classified as high and new technology enterprises strongly supported by the state will be entitled to a preferential enterprise income tax rate. The implementation rules of the EIT Law promulgated by the State Council in December 2007 and other supplemental rules promulgated by the Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation in April 2008 and July 2008, respectively, have stipulated new criteria for such high and new technology enterprises, and all enterprises which had been granted such status before the effectiveness of the EIT Law are required to be re-examined according to such new rules before they can continue to be entitled to such preferential tax treatments.

In December 2008, two of our wholly owned subsidiaries in China, Beijing Hewstone Technology Co., Ltd. and Beijing Decision Education & Consulting Co., Ltd. were recertified as high and new technology enterprise in Beijing. Both of them are entitled to a 15% tax rate as long as they continue to qualify as a high and new technology enterprise. Enterprises that qualify as a newly established software enterprise are exempt from enterprise income tax for two years beginning in the enterprise's first profitable year followed by a tax rate of 12.5% for the succeeding three years. Beijing Pioneer Technology Co., Ltd. and Shanghai Smart Words Software Technology Co., Ltd. qualified as newly established software enterprises and were exempt from income taxes from January 2010 through December 31, 2011, and from January 2011 through December 31, 2012, respectively, and a tax rate of 12.5% through December 31, 2014, and through December 31, 2015, respectively.

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On April 21, 2010, the State Administration of Taxation issued the Circular Regarding Further Clarification on Implementation of Preferential EIT Rate during Transition Periods, or Circular 157. Circular 157 seeks to provide additional guidance on the interaction of certain preferential tax rates under the transitional rules of the EIT Law. According to Circular 157, if an enterprise is qualified as a high and new technology enterprise and is also in a tax holiday period, including 2-year exemption plus 3-year half rate, 5-year exemption plus 5-year half rate and other tax exemptions and reductions, then it would be entitled to pay tax, at its own election, at the lower of 15% or 50% of the specific tax rate set for the transitional period of preferential tax treatment (i.e., 18% in 2008, 20% in 2009, 22% in 2010, 24% in 2011 and 25% in 2012), but it is not allowed to pay tax at 50% of the 15% tax rate, i.e., 7.5%. Nonetheless, we have consulted with the relevant local tax authority, which confirmed to us that Circular 157 is not applicable to entities that qualify for 3-year exemption plus 3-year half rate tax holiday as high and new technology enterprises and are registered in the Zhongguancun High and New Technology Industrial Zones of Beijing, and that such entities will continue to pay tax at the rate of 7.5%. Our PRC subsidiaries Beijing HewStone and Beijing Decision enjoyed the preferential tax rate of 7.5% from 2008 to 2010. In light of the position taken by the relevant local tax authority, and given the fact that these subsidiaries enjoyed the 3-year exemption plus 3-year half rate as high and new technology enterprises registered in the Zhongguancun High and New Technology Industrial Zones of Beijing, we do not believe that Circular 157 has any effect on our current tax position. However, if the State Administration of Taxation took a position contrary to the position of the relevant local tax authority in its subsequent interpretation or implementation of Circular 157, the preferential tax rate of 7.5% enjoyed by Beijing Hewstone and Beijing Decision would be revoked and these subsidiaries may be required to make up the difference between the rate of 7.5% and the rate of 15%, which would negatively affect our results of operations.

According to The Implementation Rules for the Law for Promoting Private Education (2004), private schools that do not require reasonable returns enjoy the same preferential tax treatment as public schools, while the preferential tax treatment policies applicable to private schools requiring reasonable returns shall be separately formulated by the relevant authorities under the State Council. As of May 31, 2012, 22 of our schools elected as schools not requiring reasonable returns, 24 of our schools elected as requiring reasonable returns and the remaining schools were not classified. The implementing rules of the EIT Law provide certain conditions under which not-for-profit entities may be exempted from enterprise income tax. According to such conditions, our schools may not be entitled to income tax exemption. To date, however, no separate specific regulations or policies have been promulgated by the relevant authorities in this regard and whether our schools can be entitled to any preferential income tax treatment remains unclear. In practice, tax treatments for private schools vary across different cities in China. For example, private schools in certain cities are subject to a 25% standard enterprise income tax starting from January 1, 2008, while in other cities, private schools are subject to a fixed amount of enterprise income tax each year as determined by the local tax authority in lieu of the 25% standard enterprise income tax or are not required to pay enterprise income tax. If any of our schools which is currently not subject to the 25% standard enterprise income tax is required by the local tax authority to pay the 25% standard enterprise income tax instead, our results of operations may be materially and adversely affected. For more information on the income tax rates or tax exemptions applicable to our schools, please see Note 16 to our consolidated financial statements included in this annual report. Preferential tax treatments granted to us by governmental authorities are subject to review and may be adjusted or revoked at any time in the future. The discontinuation of any preferential tax treatments currently available to us, especially to those schools in major cities, will cause our effective tax rate to increase, which will increase our income tax expenses and in turn decrease our net income.

***We may be treated as a resident enterprise for PRC tax purposes under the EIT Law, which may subject us to PRC income tax for our global income and withholding for any dividends we pay to our non-PRC shareholders and ADS holders.***

Under the EIT Law, enterprises established outside of China whose de facto management bodies are located in China are considered resident enterprises, and will generally be subject to the uniform 25% enterprise income tax rate for their global income. Although the term de facto management bodies is defined as management bodies which has substantial and overall management and control power on the operation, human resources, accounting and assets of the enterprise, the circumstances under which an enterprise's de facto management body would be considered to be located in China are currently unclear. A circular issued by the State Administration of Taxation on April 22, 2009 provides that a foreign enterprise controlled by a PRC company or a PRC company group will be classified as a resident enterprise with its de facto management bodies located within China if the following requirements are satisfied: (1) the senior management and core management departments in charge of its daily operations function mainly in the PRC; (2) its financial and human resources decisions are subject to determination or approval by persons or bodies in the PRC; (3) its major assets, accounting books, company seals, and minutes and files of its board and shareholders meetings are located or kept in the PRC; and (4) at least half of the enterprise's directors or senior management with voting rights reside in the PRC. In addition, the State Administration of Taxation recently promulgated the Interim Provisions on Administration of Income Tax of Chinese-Controlled Resident Enterprise Registered Overseas, effective from September 1, 2011, which clarified certain matters concerning the determination of resident status, administrative matters following this determination, and competent tax authorities. These interim provisions also specify that when an enterprise which is both Chinese-controlled and incorporated outside of mainland China receives PRC-sourced incomes such as dividends and interests, no PRC withholding tax is applicable if such enterprise has obtained a certificate evidencing its status as a PRC resident enterprise which is registered overseas and controlled by Chinese.



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Most members of our management team are based in China and are expected to remain in China. Although our offshore holding companies are not controlled by any PRC company or company group, we cannot assure you that we will not be deemed to be a PRC resident enterprise under the EIT Law and its implementation rules. If we are deemed to be a PRC resident enterprise, we will be subject to PRC enterprise income tax at the rate of 25% on our global income. In that case, however, dividend income we receive from our PRC subsidiaries may be exempt from PRC enterprise income tax because the EIT Law and its implementation rules generally provide that dividends received by a PRC resident enterprise from its directly invested entity that is also a PRC resident enterprise is exempt from enterprise income tax. Accordingly, if we are deemed to be a PRC resident enterprise and earn income other than dividends from our PRC subsidiaries, a 25% enterprise income tax on our global income could significantly increase our tax burden and materially and adversely affect our cash flow and profitability.

In addition, the EIT Law and its implementation rules are relatively new and ambiguities exist with respect to the interpretation of the provisions relating to identification of PRC-sourced income. If we are deemed to be a PRC resident enterprise, dividends distributed to our non-PRC entity investors by us, or the gain our non-PRC entity investors may realize from the transfer of our common shares or ADSs, may be treated as PRC-sourced income and therefore be subject to a 10% PRC withholding tax pursuant to the EIT Law and, as a result, the value of your investment may be materially and adversely affected.

### ***Dividends we receive from our subsidiaries located in the PRC are subject to the PRC withholding tax.***

The EIT Law provides that a maximum income tax rate of 20% may apply to dividends payable to non-PRC investors that are non-resident enterprises, to the extent such dividends are derived from sources within the PRC. The State Council has reduced such rate to 10%, in the absence of any applicable tax treaties that may reduce such rate. We are a Cayman Islands holding company and may derive our income from dividends we receive from our operating subsidiaries located in the PRC. If we are required under the EIT Law to pay income tax for any dividends we receive from our PRC subsidiaries, the amount of dividends, if any, we may pay to our shareholders and ADS holders may be materially and adversely affected.

According to The Arrangement between the PRC and the Hong Kong Special Administrative Region on the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income, or the Double Taxation Arrangement (Hong Kong), which became effective on January 1, 2007, The Notice of the State Administration of Taxation on Negotiated Reduction of Dividends and Interest Rates, which was issued on January 29, 2008, and The Notice of the State Administration of Taxation Regarding Interpretation and Recognition of Beneficial Owners under Tax Treaties, which became effective on October 27, 2009, dividends paid to enterprises incorporated in Hong Kong are subject to a withholding tax of 5% provided that a Hong Kong resident enterprise owns over 25% of the PRC enterprise distributing the dividend and can be considered as a beneficial owner and entitled to treaty benefits under the Double Taxation Arrangement (Hong Kong). Elite Concept Holdings Limited, Winner Park Limited and Smart Shine International Limited, our Hong Kong wholly owned subsidiaries, own 100% of our PRC subsidiaries. Thus, dividends paid by our PRC subsidiaries to us through our Hong Kong wholly owned subsidiaries may be subject to the 5% withholding tax if we and our Hong Kong subsidiaries are considered as non-resident enterprises under the EIT Law and our Hong Kong subsidiaries are considered as beneficial owners and entitled to treaty benefits under the Double Taxation Arrangement (Hong Kong). If our Hong Kong subsidiaries are not regarded as the beneficial owners of any such dividends, they will not be entitled to the treaty benefits under the Double Taxation Arrangement (Hong Kong). As a result, such dividends would be subject to regular withholding tax of 10% as provided by the PRC domestic law rather than the favorable rate of 5% applicable under the Double Taxation Arrangement (Hong Kong).

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### ***We face uncertainties with respect to indirect transfers of equity interests in PRC resident enterprises by their non-PRC holding companies.***

Pursuant to the Notice on Strengthening Administration of Enterprise Income Tax for Share Transfers by Non-PRC Resident Enterprises, or Circular 698, issued by the State Administration of Taxation on December 10, 2009, where a foreign investor transfers the equity interests in a PRC resident enterprise indirectly via disposition of the equity interests of an overseas holding company, or an Indirect Transfer, and such overseas holding company is located in a tax jurisdiction that (1) has an effective tax rate less than 12.5% or (2) does not tax foreign income of its residents, the foreign investor shall report the Indirect Transfer to the competent PRC tax authority. The PRC tax authority will examine the nature of such Indirect Transfer, and if the tax authority considers that the foreign investor has adopted an abusive arrangement in order to reduce, avoid or defer PRC taxes, it may disregard the existence of the overseas holding company and re-characterize the Indirect Transfer such that gains derived from such Indirect Transfer may be subject to PRC withholding tax at a rate of up to 10%. Circular 698 also provides that, where a non-PRC resident enterprise transfers its equity interests in a PRC resident enterprise to its related parties at a price lower than the fair market value, the competent tax authority has the power to make a reasonable adjustment to the taxable income of the transaction. Circular 698 is retroactively effective from January 1, 2008. There is uncertainty as to the application of Circular 698. For example, while the term Indirect Transfer is not clearly defined, it is understood that the relevant PRC tax authorities have jurisdiction regarding requests for information over a wide range of foreign entities having no direct contact with China. Moreover, the relevant authority has not yet promulgated any formal provisions or formally declared or stated how to calculate the effective tax rates in foreign tax jurisdictions, and the process and format of the reporting of an Indirect Transfer to the competent tax authority of the relevant PRC resident enterprise remain unclear. In addition, there are not formal declarations with regard to how to determine whether a foreign investor has adopted an abusive arrangement in order to reduce, avoid or defer PRC tax. As a result, we and our non-resident investors may have the risk of being taxed under Circular 698 and may be required to spend valuable resources to comply with Circular 698 or to establish that we or our non-resident investors should not be taxed under Circular 698, which may have a material adverse effect on our financial condition and results of operations or such non-resident investors' investments in us.

### ***Our auditor, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by the Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection.***

Our independent registered public accounting firm that issues the audit reports included in our annual reports filed with the US Securities and Exchange Commission, as auditors of companies that are traded publicly in the United States and a firm registered with the US Public Company Accounting Oversight Board (United States) (the PCAOB), is required by the laws of the United States to undergo regular inspections by the PCAOB to assess its compliance with the laws of the United States and professional standards. Because our auditors are located in the Peoples Republic of China, a jurisdiction where the PCAOB is currently unable to conduct inspections without the approval of the Chinese authorities, our auditors are not currently inspected by the PCAOB.

Inspections of other firms that the PCAOB has conducted outside China have identified deficiencies in those firms' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. This lack of PCAOB inspections in China prevents the PCAOB from regularly evaluating our auditor's audits and its quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

The inability of the PCAOB to conduct inspections of auditors in China makes it more difficult to evaluate the effectiveness of our auditor's audit procedures or quality control procedures as compared to auditors outside of China that are subject to PCAOB inspections. Investors may lose confidence in our reported financial information and procedures and the quality of our financial statements.

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### **Risks Related to Our ADSs**

#### *The market price for our ADSs may be volatile.*

The market price for our ADSs has fluctuated significantly since our ADSs became listed on the New York Stock Exchange, or the NYSE, on September 7, 2006. See Item 9. The Offer and Listing C. Markets for more information. The market price for our ADSs is likely to be highly volatile and subject to wide fluctuations in response to factors such as:

actual or anticipated fluctuations in our operating results,

changes in financial estimates by securities research analysts,

changes in the economic performance or market valuation of other education companies,

announcements by us or our competitors of material acquisitions, strategic partnerships, joint ventures or capital commitments,

addition or departure of our executive officers,

detrimental negative publicity about us, our competitors or our industry,

regulatory investigation or other governmental proceedings against us,

substantial sales or perception of sales of our ADSs in the public market, and

general economic, regulatory or political conditions in China and the U.S.

In addition, the stock market in general, and the market prices for companies with operations in China in particular, have experienced volatility that often has been unrelated to the operating performance of such companies. In addition, any negative news or perceptions about inadequate corporate governance practices or fraudulent accounting, corporate structure or other matters of other Chinese companies may also negatively affect the attitudes of investors towards Chinese companies in general, including us, regardless of whether we have conducted any inappropriate activities. Further, the global financial crisis and the ensuing economic recessions in many countries and the slowing Chinese economy have contributed and may continue to contribute to extreme volatility in the U.S. stock market. These broad market and industry fluctuations may adversely affect our operating performance. Volatility or a lack of positive performance in our ADS price may also adversely affect our ability to retain key employees, some of whom have been granted options and other share incentives under our share incentive plan.

#### ***We may need additional capital, and the sale of additional ADSs or other equity securities could result in additional dilution to our shareholders.***

We believe that our current cash and cash equivalents and anticipated cash flow from operations will be sufficient to meet our anticipated cash needs for the near future. We may, however, require additional cash resources to finance our continued growth or other future developments, including any investments or acquisitions we may decide to pursue. The amount and timing of such additional financing needs will vary principally depending on the timing of new school and learning center openings, investments and/or acquisitions, and the amount of cash flow from our operations. If our existing cash resources are insufficient to satisfy our cash requirements, we may seek to sell additional equity or debt

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securities or obtain a credit facility. The sale of additional equity securities could result in additional dilution to our shareholders. The incurrence of indebtedness would result in increased debt service obligations and could result in operating and financing covenants that would restrict our operations.

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Our ability to obtain additional capital on acceptable terms is subject to a variety of uncertainties, including:

investors' perception of, and demand for, securities of educational service providers;

conditions of the U.S. and other capital markets in which we may seek to raise funds;

our future results of operations, financial condition and cash flows;

PRC governmental regulation of foreign investment in education in China;

economic, political and other conditions in China; and

PRC governmental policies relating to foreign currency borrowings.

We cannot assure you that financing will be available in amounts or on terms acceptable to us, if at all, especially in the event of a severe and prolonged global economic recession. If we fail to raise additional funds, we may need to reduce our growth to a level that can be supported by our cash flow. Without additional capital, we may not be able to open additional schools and learning centers, acquire necessary technologies, products or businesses, hire, train and retain teachers and other employees, market our programs, services and products, or respond to competitive pressures or unanticipated capital requirements.

***If securities or industry analysts publish negative reports about our business, the price and trading volume of our ADSs securities could decline.***

The trading market for our ADSs is influenced by the research reports and ratings that securities or industry analysts or ratings agencies publish about us, our business and the private education market in China in general. We do not have any control over these analysts or agencies. If one or more of the analysts or agencies who cover us downgrades us or our securities, the price of our ADSs may decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause the price of our ADSs or trading volume to decline.

***You may not have the same voting rights as the holders of our common shares and may not receive voting materials in time to be able to exercise your right to vote.***

Except as described in the deposit agreement, holders of our ADSs will not be able to exercise voting rights attaching to the common shares evidenced by our ADSs on an individual basis. Holders of our ADSs will appoint the depositary or its nominee as their representative to exercise the voting rights attaching to the common shares represented by the ADSs. You may not receive voting materials in time to instruct the depositary to vote, and it is possible that you, or persons who hold their ADSs through brokers, dealers or other third parties, will not have the opportunity to exercise a right to vote. Upon our written request, the depositary will mail to you a shareholder meeting notice which contains, among other things, a statement as to the manner in which your voting instructions may be given, including an express indication that such instructions may be given or deemed given to the depositary to give a discretionary proxy to a person designated by us if no instructions are received by the depositary from you on or before the response date established by the depositary. However, no voting instruction shall be deemed given and no such discretionary proxy shall be given with respect to any matter as to which we inform the depositary that (1) we do not wish such proxy given, (2) substantial opposition exists or (3) such matter materially and adversely affects the rights of shareholders.

***You may not be able to participate in rights offerings and may experience dilution of your holdings as a result.***

We may from time to time distribute rights to our shareholders, including rights to acquire our securities. Under the deposit agreement for the ADSs, the depositary will not offer those rights to ADS holders unless both the rights and the underlying securities to be distributed to ADS holders are either registered under the Securities Act, or exempt from registration under the Securities Act with respect to all holders of ADSs.

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We are under no obligation to file a registration statement with respect to any such rights or underlying securities or to endeavor to cause such a registration statement to be declared effective. In addition, we may not be able to take advantage of any exemptions from registration under the Securities Act. Accordingly, holders of our ADSs may be unable to participate in our rights offerings and may experience dilution in their holdings as a result.

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### ***You may be subject to limitations on transfer of your ADSs.***

Your ADSs are transferable on the books of the depository. However, the depository may close its transfer books at any time or from time to time when it deems expedient in connection with the performance of its duties. In addition, the depository may refuse to deliver, transfer or register transfers of ADSs generally when our books or the books of the depository are closed, or at any time if we or the depository deems it advisable to do so because of any requirement of law or of any government or governmental body, or under any provision of the deposit agreement, or for any other reason.

### ***You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing original actions in the Cayman Islands or China based on United States or other foreign laws against us or our management.***

We are incorporated in the Cayman Islands and conduct substantially all of our operations in China. Substantially all of our assets are located in China. All of our executive officers reside in China and some or all of the assets of those persons are located outside of the United States. As a result, it may be difficult for you to effect service of process within the United States or elsewhere outside the Cayman Islands and China upon us or our executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws. It may also be difficult or impossible for you to bring an action against us or against our executive officers in the Cayman Islands or in China in the event that you believe that your rights as an ADS holder have been infringed under the securities laws of the United States or otherwise. Even if you are successful in bringing an action of this kind in the United States, the respective laws of the Cayman Islands and China may render you unable to enforce a judgment against our assets or the assets of our directors and officers. There is no statutory recognition in the Cayman Islands of judgments obtained in the United States, although the courts of the Cayman Islands will generally recognize and enforce a non-penal judgment of a foreign court of competent jurisdiction without retrial on the merits. Moreover, our PRC counsel has advised us that the PRC does not have treaties with the United States or many other countries providing for the reciprocal recognition and enforcement of judgment of courts.

### ***We are a Cayman Islands company and, because judicial precedent regarding the rights of shareholders is more limited under Cayman Islands law than under U.S. law, you may have less protection of your shareholder rights than you would under U.S. law.***

Our corporate affairs are governed by our memorandum and articles of association and by the Companies Law (2011 Revision) and common law of the Cayman Islands. The rights of shareholders to take legal action against our directors and us, actions by minority shareholders and the fiduciary responsibilities of our directors to us under Cayman Islands law are to a large extent governed by the common law of the Cayman Islands. The common law of the Cayman Islands is derived in part from comparatively limited judicial precedents in the Cayman Islands as well as from English common law, which has persuasive, but not binding, authority on a court in the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under Cayman Islands law are not as clearly established as they would be under statutes or judicial precedents in the United States. In particular, the Cayman Islands has a less developed body of securities laws as compared to the United States, and provides significantly less protection to investors. In addition, Cayman Islands companies may not have standing to initiate a shareholder derivative action before the federal courts of the United States.

As a result of all of the above, holders and beneficial owners of our ADSs may have more difficulties in protecting their interests through actions against our management, directors or major shareholders than would shareholders of a corporation incorporated in a jurisdiction in the United States.

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***Our articles of association contain anti-takeover provisions that could have a material adverse effect on the rights of holders of our common shares and ADSs.***

Our articles of association contain provisions that limit the ability of others to acquire control of our company or cause us to engage in change-of-control transactions. These provisions could have the effect of depriving our shareholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging third parties from seeking to obtain control of our company in a tender offer or similar transaction. For example, our board of directors has the authority, without further action by our shareholders, to issue preferred shares in one or more series and to fix their designations, powers, preferences, privileges, and relative participating, optional or special rights and the qualifications, limitations or restrictions, including dividend rights, conversion rights, voting rights, terms of redemption and liquidation preferences, any or all of which may be greater than the rights associated with our common shares, in the form of ADS or otherwise. Preferred shares could be issued quickly with terms calculated to delay or prevent a change in control of our company or make removal of management more difficult. If our board of directors decides to issue preferred shares, the price of our ADSs may fall and the voting and other rights of the holders of our common shares and ADSs may be materially and adversely affected.

***We may be classified as a passive foreign investment company, which could result in adverse U.S. federal income tax consequences to U.S. holders of our ADSs or common shares.***

A non-U.S. corporation, such as our company, will be a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for any taxable year if either, (1) 75% or more of its gross income for such year consists of certain types of passive income or (2) 50% or more of its average quarterly assets as determined on the basis of fair market value during such year produce or are held for the production of passive income.

Although the law in this regard is unclear, we treat New Oriental China as being owned by us for U.S. federal income tax purposes, not only because we control its management decisions but also because we are entitled to substantially all of the economic benefits associated with this entity, and, as a result, we consolidate this entity's operating results in our combined financial statements. If it were determined, however, that we are not the owner of New Oriental China for U.S. federal income tax purposes, we may be or become a PFIC. Assuming that we are the owner of New Oriental China for U.S. federal income tax purposes, and based upon an analysis of our company's income and assets in respect of the 2012 taxable year, we do not believe that we were a PFIC, for U.S. federal income tax purposes, for the taxable year ended May 31, 2012. In light of the amount of our cash balances and because the value of our assets for purposes of the PFIC test will generally be determined by reference to the market value of our ADSs and common shares, the determination of whether we will be or become a PFIC will depend in large part upon the market value of our ADSs and common shares, of which we cannot control. Accordingly, fluctuations in the market price of our ADSs and common shares may cause us to become a PFIC for the current taxable year or future taxable years. The determination of whether we will be or become a PFIC will also depend, in part, upon the nature of our income and assets over time, which are subject to change from year to year. There can be no assurance that our business plans will not change in a manner that will affect the composition of our income and assets and our PFIC status. Because there are uncertainties in the application of the relevant rules and PFIC status is a fact-intensive determination made on an annual basis, no assurance can be given that we are not or will not become classified as a PFIC.

If we were to be classified as a PFIC in any taxable year, a U.S. Holder (as defined in Item 10. Additional Information E. Taxation U.S. Federal Income Taxation) may incur significantly increased U.S. income tax on gain recognized on the sale or other disposition of the ADSs or common shares and on the receipt of distributions on the ADSs or common shares to the extent such gain or distribution is treated as an excess distribution under U.S. federal income tax rules. Further, if we are classified as a PFIC for any year during which a U.S. Holder holds our ADSs or common shares, we generally will continue to be treated as a PFIC for all succeeding years during which such U.S. Holder holds our ADSs or common shares. See Item 10. Additional Information E. Taxation U.S. Federal Income Taxation Passive Foreign Investment Company Rules.

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### **ITEM 4. INFORMATION ON THE COMPANY**

#### **A. History and Development of the Company**

Our first school was established by Michael Minhong Yu, our chairman and chief executive officer, in Beijing, China in 1993 to offer TOEFL test preparation courses to college students. We established New Oriental China in 2001 as a domestic holding company to act as the sponsor of our schools and hold some operating subsidiaries. Since our inception, we have grown rapidly and transformed ourselves from primarily a language training and test preparation company to the largest provider of private educational services in China offering a wide range of educational programs, services and products to a varied student population throughout China.

In order to facilitate foreign investment in our company, we established our offshore holding company, New Oriental Education & Technology Group Inc., in the British Virgin Islands in August 2004. On January 25, 2006, our shareholders approved the change of our offshore holding company's corporate domicile to the Cayman Islands, and we are now a Cayman Islands company. Since December 2007, we have established three wholly-owned subsidiaries in Hong Kong, which now directly own our wholly-owned subsidiaries in China.

We and certain selling shareholders of our company completed an initial public offering and listed our ADSs on the NYSE under the symbol EDU in September 2006. In February 2007, we and certain selling shareholders of our company completed an additional public offering of ADSs. On August 18, 2011, we effected a change in the ratio of our ADSs to common shares from one ADS representing four common shares to one ADS representing one common share.

Our principal executive offices are located at No. 6 Hai Dian Zhong Street, Haidian District, Beijing 100080, People's Republic of China. Our telephone number at this address is +(8610) 6260-5566. Our registered office in the Cayman Islands is located at Codan Trust Company (Cayman) Limited, Cricket Square, Hutchins Drive, P.O. Box 2681, Grand Cayman KY1-1111, Cayman Islands. We have branch offices in 49 cities in China.

#### **B. Business Overview**

We are the largest provider of private educational services in China based on the number of program offerings, total student enrollments and geographic presence. We offer a wide range of educational programs, services and products, consisting primarily of English and other foreign language training, test preparation courses for admissions and assessment tests in the United States, the PRC and Commonwealth countries, primary and secondary school education, development and distribution of educational content, software and other technology, and online education. We provide educational services primarily under our New Oriental brand, which we believe is the leading consumer brand in China's private education sector.

Since our inception in 1993, we have had approximately 13.6 million cumulative student enrollments. In the fiscal year ended May 31, 2012, we had approximately 2.4 million student enrollments, including approximately 1.2 million student enrollments in our language training programs and approximately 1.2 million student enrollments in our test preparation courses. We deliver our educational programs, services and products to students through an extensive physical network of schools, learning centers and bookstores, as well as through our virtual online network.

Our total net revenues increased from US\$386.3 million for the fiscal year ended May 31, 2010 to US\$771.7 million for the fiscal year ended May 31, 2012, representing a compound annual growth rate, or CAGR, of 41.3%. Net revenues from our language training and test preparation courses accounted for 87.3%, 87.0% and 86.0%, respectively, of our total net revenues in the fiscal years ended May 31, 2010, 2011 and 2012. Net income attributable to New Oriental Education & Technology Group Inc. increased from US\$77.8 million in the fiscal year ended May 31, 2010 to US\$132.7 million in the fiscal year ended May 31, 2012, representing a CAGR of 30.6%.

**Table of Contents****Our Network**

We deliver our educational programs, services and products to students through an extensive physical network of 55 schools, 609 learning centers and 32 bookstores operated by us, over 5,000 third-party bookstores and approximately 17,600 teachers in 49 cities as of May 31, 2012, as well as through our online network, which has approximately 7.8 million registered users. In addition, we have an extensive network of students and alumni, which has been essential in helping us promote our brand and our programs, services and products by word-of-mouth referrals and through our students' and alumni's academic and career achievements. We plan to continue to open new schools and learning centers in cities that exhibit strong enrollment potential.

All of our schools, learning centers and bookstores operate under our "New Oriental" brand. Our hub schools in major cities consist of classrooms and administrative facilities with full student and administrative services, while our schools in satellite cities and our learning centers consist primarily of classroom facilities and limited course registration and management capabilities. We select new locations based on various factors, including demographics and the number of colleges in, and the economic condition of, the particular region. We have opened bookstores in our established schools to primarily sell educational materials relating to our courses and also sell self-help, know-how, inspirational and other books.

We lease all of our facilities except for our Yangzhou school, part of the premises for our headquarters in Beijing and our schools in Xi'an, Tianjin, Kunming, Wuhan and Guangzhou. The following table sets forth information concerning the locations of our schools, learning centers and bookstores as of May 31, 2012.

City	Number of schools	Number of learning centers	Number of bookstores
Beijing	4	84	1
Shanghai	1	60	1
Guangzhou	1	20	1
Wuhan	1	35	1
Yangzhou	1		
Tianjin	1	35	1
Xi'an	1	14	1
Nanjing	2	13	1
Shenyang	1	19	1
Chongqing	1	9	1
Chengdu	1	15	1
Shenzhen	1	14	
Xiangfan	1	6	
Taiyuan	1	24	1
Haerbin	1	14	1
Changsha	1	17	1
Jinan	1	18	1
Zhengzhou	1	21	1
Hangzhou	1	18	1
Changchun	3	19	1
Shijiazhuang	1	8	1
Suzhou	1	13	1
Zhuzhou	1	2	
Anshan	1	2	
Hefei	1	11	1
Kunming	1	23	1
Wuxi	1	5	
Foshan	1	3	
Fuzhou	1	16	1
Yichang	1		
Nanchang	1	19	1

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City	Number of schools	Number of learning centers	Number of bookstores
Jingzhou	1	2	
Dalian	1	7	1
Lanzhou	1	6	1
Huangshi	1	3	
Ningbo	1	4	1
Xiamen	1	6	1
Qingdao	1	5	1
Nanning	1	5	
Xuzhou	1	5	1
Xiangtan	1		
Zhenjiang	1	1	
Luoyang	1	3	1
Nantong	1		
Jilin	1		
Guiyang	1		
Hohhot	1	1	1
Tangshan	1	3	
Urumqi	1	1	1
Total	55	609	32

**Our Programs, Services and Products**

We provide a wide variety of educational programs, services and products. We deliver education to our students primarily in traditional classroom settings and also through online instruction. With the exception of the full-time primary and secondary school in Yangzhou and a full-time secondary school in Beijing, our classroom-based courses are generally designed to be completed in 2 to 16 weeks. Course fees are determined based on the length of the course, the size and the subject of the class, the area of study and the geographic location of the school. We update and expand our course offerings frequently in response to evolving market needs. We currently have a full-time staff of approximately 360 people involved in our centralized curriculum development process. Our program, service and product offerings are generally divided into six areas: language training; test preparation; primary and secondary schools and kindergartens; educational content, software and other technology development and distribution; online education; and other services and products.

**Language Training Courses**

Our language training courses primarily consist of various types of English language training courses. We also provide training courses for other foreign languages, including German, Japanese, French, Korean and Spanish. In our fiscal year ended May 31, 2012, we had approximately 1.2 million student enrollments in our language training courses, of which over 97% were in our English language training courses.

We recognize that students progress at different rates when learning foreign languages, and our large number of students allows us to offer suitable courses at many different levels of proficiency. While we offer English to students of all age groups and with various motivations for learning English, we generally categorize our English language training courses into the following areas: (1) English for adults; (2) English for children, including our Pop Kids English program; and (3) English for middle school and high schools students.

*English for Adults.* Historically, this has been the primary component of our English language training courses. Many employers in China, including foreign-invested enterprises, multinational corporations branch offices as well as domestic enterprises involved in international business transactions or the tourism industry, require their employees to have a high level of English proficiency.

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Our English for adults program offers courses designed to teach and improve students' English writing, reading, listening and speaking skills. Our schools and learning centers also have language labs at which our students can listen to and recite spoken passages on CDs and audio tapes to improve their listening and speaking skills. A typical course lasts for 6 to 12 weeks with classroom instruction one to four times per week for two to five hours per visit. We also offer more intensive and condensed versions of our courses, in particular during the summer months when many academic institutions are on summer break. The sizes of our English for adults courses typically range from 1 to approximately 150 students per class.

In our fiscal year ended May 31, 2012, we had approximately 214,000 student enrollments in our English for adults courses and approximately 27.6%, 14.5% and 6.2% of the total enrollments were for courses taught in Beijing, Shanghai and Wuhan, respectively. Course fees for our English for adults courses range from approximately RMB300 to approximately RMB3,000 per course.

*English for Children.* We established our English for children program in 2002 for children in kindergarten through grade six and it has achieved rapid growth since that time. We designed our English for children program based upon the following principles: (1) we use localized materials originally published by international education content providers and publishers while taking into account the local public schools' curricula and the skills and abilities of the individual child and adapting to his or her particular needs; (2) we assist students in mastering the basics of the language in various fun ways, including interactive games, activities and cultural studies; and (3) we help children develop a passion for learning the language and guide and inspire them to develop their self-learning abilities. In 2004, we established our Pop Kids English learning centers at which we attempt to immerse young kids in a fun and interactive English-speaking environment dedicated solely to children.

Our English for children classes are typically divided into classes of 1 to approximately 25 students per class. Students attend class one to two times per week for 1.5 to 2 hours per class. We test our students to measure their progress and make sure they are progressing as needed to advance to the next book and class level without jeopardizing the fundamentals that will allow them to excel in the future.

To enhance our Pop Kids English program, we cooperate with the Sino-British Academic Exchange Center for Education Measurement (SBC), Cambridge ESOL's sole representative in China, for the administration of the Cambridge Young Learners English exam (YLE) to our students in the Pop Kids English program. Cambridge ESOL is a not-for-profit department of the University of Cambridge focusing on examinations for the English language. We currently administer the YLE exam for our POP Kids English students in 28 cities.

In our fiscal year ended May 31, 2012, we had approximately 620,000 student enrollments in our English for children program and approximately 13.7%, 8.0% and 7.5% of the enrollments took place in Wuhan, Guangzhou and Shanghai, respectively. Course fees for our English for children courses range from approximately RMB100 to approximately RMB2,000 per course.

*English for Middle School and High School Students.* English proficiency is tested as a major subject of entrance exams for admission into China's high schools, colleges and universities. Given the intense competition to gain admission into top high schools and higher education institutions in China, English exam scores can be a deciding factor in gaining admission. Our English language training courses for middle school and high school students are designed to supplement students' regular school curricula and help students achieve better scores on English exams for admission into high schools or higher education institutions.

Our typical English courses for middle school and high school students last for 8 to 16 weeks with classroom instruction one to four times per week for 1.5 to 5 hours per visit. We also offer more intensive and condensed versions of our courses, in particular during the summer months when many academic institutions are on summer break. The sizes of these courses typically range from 1 to approximately 100 students per class.

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In our fiscal year ended May 31, 2012, we had approximately 305,000 student enrollments in our English language training courses for middle school and high school students, and approximately 18.9%, 11.7%, and 6.2% of the enrollments took place in Beijing, Xi'an and Nanchang, respectively. Course fees for our English training courses for middle school and high school students range from approximately RMB200 to approximately RMB3,500 per course.

### ***Test Preparation Courses***

We offer test preparation courses to students taking language and entrance exams used by educational institutions in the United States, the PRC and Commonwealth countries. In our fiscal year ended May 31, 2012, we had approximately 1.2 million student enrollments in our test preparation courses, of which approximately 340,000 were in overseas test preparation courses, 414,000 were in PRC test preparation courses and 352,000 were in test preparation courses for middle and high school Chinese students.

We offer test preparation courses for the following major overseas exams: TOEFL, TSE, SAT, ACT, IELTS, GRE, GMAT, LSAT, BEC and TOEIC. In addition, we offer test preparation classes for the following major PRC admissions tests: CET 4, CET 6, National Tests for Entrance into Master's Degree Programs, Professional Title English Test and PETS. In November 2006, we established our Beijing New Oriental North Star Training School to expand into the professional certification preparation field, which includes preparation for the PRC bar, the PRC certified public accountant and civil service exams. In November 2007, Educational Testing Service, the creator of TOEFL, and New Oriental reached an agreement making New Oriental's language schools the only language schools in China authorized by the Educational Testing Service to sell the TOEFL Practice Online, or the TPO, in their training classes. As part of the agreement, New Oriental has an exclusive right to provide the TPO as a component of its language training or test preparation courses and may also sell the TPO to the general public through its bookstores. Educational Testing Service will continue to sell the TPO on its own website and through its subsidiaries or other third-party resellers.

In March 2008, we launched our New Oriental U-Can (Non-English) training program, which targets middle and high school Chinese students from ages 13 to 18 who are preparing for the college entrance examination in China, known as the gaokao. The gaokao is required for admission to bachelor degree programs and most associate degree programs at Chinese colleges and universities. To complement New Oriental U-Can (Non-English), we provide tutoring services to students who seek to retake the gaokao through Tongwen Gaokao School, a private school based in Changchun. In February 2009, we launched a customized learning program for students from ages 6 to 18, offering small class size tutoring ranging from one to five students per class, in all subjects required for the college and high school entrance examinations, respectively. In our fiscal year ended May 31, 2012, we had approximately 352,000 student enrollments in New Oriental U-Can (Non-English), including the customized small-class program. With this strategy of offering affordable larger classes and higher priced individualized small classes for school aged children, we aim to capture more market share in the after-school training market in China.

In our fiscal year ended May 31, 2012, approximately 40.8% and 16.1% of the total student enrollments in our overseas test preparation courses took place in Beijing and Shanghai, respectively, and approximately 20.4% of the total student enrollments in our PRC test preparation courses took place in Beijing, while no other city accounted for over 10% of the total student enrollments in our PRC test preparation courses. Our test preparation courses focus on quality instruction and test-taking techniques designed to help students achieve high scores on the admissions and assessment tests. Except for the customized small class program discussed above, our experienced teachers generally teach in large classes ranging from 50 to 500 students. Our students enroll in a 20- to 160-hour program with classes meeting one to four times per week for approximately 2.5 hours per class. We also offer intensive and condensed versions of our courses, which are compacted into shorter time periods. Course fees for our test preparation courses range from RMB150 to RMB25,000 per course.

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### ***Primary and Secondary Schools***

We established the first full-time private primary and secondary school in Yangzhou in 2002. This is a private boarding school for students in grades 1 to 12 seeking a full curriculum taught in both Chinese and English, with a strong emphasis on English language training. We target parents who desire to provide their children with a global vision and an understanding and appreciation of both traditional Chinese culture and the modern world, a competitive advantage in academics and social development and English language proficiency. Our goal is to develop the Yangzhou school, and other new schools to be established in the future, into elite schools whose students consistently gain acceptance into the top universities in China and around the world.

We attempt to immerse our students in the English language at an early age through native English speaking teachers and activities designed to emphasize early and significant exposure to a bilingual environment. The Yangzhou private school has a capacity of up to 4,000 students. In our fiscal year ended May 31, 2012, we had over 3,700 students at the Yangzhou school, approximately 50% of whom came from Yangzhou, with the remainder from various parts of China. Our students must take an admission test and undergo an interview to gain acceptance into our school.

There are over 380 teachers and 280 supporting staff at the Yangzhou school. The school has been regarded as one of the best primary and secondary schools in the local market since shortly after its inception. In our fiscal year ended May 31, 2012, the school accepted 1,095 students out of over approximately 3,500 applicants from the local market as well as elsewhere in China.

The Yangzhou school has received various accreditations from local authorities. We work closely with the local educational authorities to make sure that our curriculum is compatible with public school curriculums and covers the full spectrum of required courses. We have also expanded our curriculum to include subjects, activities and techniques that teach the students to learn and think independently. There is less emphasis on memorization and recitation and greater emphasis on creative thinking and analytical activities. We use computers as a major part of our teaching and learning methods and encourage students to learn in an interactive format. In our fiscal year ended May 31, 2012, tuition at the Yangzhou school ranged from RMB5,000 to RMB22,000 per year.

In July 2006, we established an international high school program within the Yangzhou school. In July 2010, we opened an international high school in Beijing. Our international high school aims to provide students with a full curriculum of high school education in a bilingual environment while preparing them for admission into foreign universities. Each of the students of the class of 2012 of the international high school program at our Yangzhou school was admitted into at least one of the top 100 universities in the United States. In our fiscal year ended May 31, 2012, tuition at our international school ranges from RMB80,000 to RMB90,000 per year.

### ***Educational Content, Software and Other Technology Development and Distribution***

We develop and edit content of educational materials for language training and test preparation, such as books, software, CD-ROMs, magazines and other periodicals. We distribute these materials through various distribution channels, consisting of our classrooms and bookstores as well as third-party distributors, including over 5,000 bookstores in China. In our fiscal year ended May 31, 2012, we developed and edited over 180 titles and distributed over 10 million books authored or licensed by us in China. Most of the materials distributed by us are education-related and include the materials that we use in our courses and a large number of titles that we market for use in English language area.

Our extensive distribution channels have attracted international education content providers to cooperate with us in distributing localized versions of their materials in China. We currently have arrangements with Pearson Education, The McGraw-Hill Companies, Cambridge University Press, Barron's, DynEd International Inc., or their respective authorized local publishers, to develop and distribute localized versions of selected educational materials in China, some of which bear both our logo and the original publisher's logo. We plan to establish additional strategic relationships with leading international education content providers to enrich our content offerings.

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### ***Online Education***

We offer online education programs on our website [www.koolearn.com](http://www.koolearn.com). As of May 31, 2012, approximately 7.8 million users had registered accounts with us, with access to free informational content on our website. In our fiscal year ended May 31, 2012, we had approximately 245,000 users that paid for additional access to our specialized education programs. These users purchase pre-paid cards that give them the right to use our paid content for a specific period of time or for specific courses.

We currently offer approximately 2,000 online courses, including language training courses, test preparation courses, professional certification courses, and business knowledge and skills training courses in the areas of accounting, legal, management and others. We have live interactive online courses as well as courses that allow students to view replays of pre-recorded lectures. Our online courses are particularly attractive to students who need the flexibility to prepare at any time of the day or night and on short notice. As a supplement to our online courses, we also offer many online study services, including online course planning, testing, composition correcting and one-on-one tutoring. Our online tools provide more flexibility by offering our students the ability to choose their best and most convenient way of learning as they experience our programs.

Partially through our [Koolearn.com](http://Koolearn.com) website, we also offer enterprise clients customized training services. By working closely with enterprise clients, we gain a good understanding of the clients' specific training needs and design training solutions to meet those needs. We also have the capability to develop customized e-learning management systems for enterprise clients.

### ***Other Services***

*Overseas Studies Consulting.* Our consultants help students through the application and admission process for overseas educational institutions and provide useful college, graduate and career counseling advice to help students make informed decisions. We also counsel students with the immigration process for overseas studies, such as obtaining visas and student and off-campus housing. We charge each student a fee based on the scope of consulting services requested by the student.

*Pre-school Education.* In September 2007, we established our pre-school business with the opening of our first kindergarten in Beijing, which currently has 150 students. In April 2009, we opened a kindergarten in Nanjing. As of May 31, 2012, our two kindergartens had a total of 540 students. In our fiscal year ended May 31, 2012, we also had approximately 300 student enrollments in two early childhood learning centers in Beijing.

*Brand Name Cooperation.* In January 2010, we established a small pilot program whereby we permit third parties in certain small cities to offer our Pop Kids English program and New Oriental Star kindergarten program under a brand name cooperation model. The cooperation schools operated by such third parties are not included in the counts of our schools and learning centers, and student enrollments from these schools are not included as our student enrollments. As of May 31, 2012, there were a total of 21 brand cooperation schools. For the fiscal years ended May 31, 2010, 2011 and 2012, we recognized revenues in an aggregate amount of US\$35,000, US\$249,000 and US\$811,000, respectively, from license and training fees received from these schools.

### **Marketing and Student Recruitment**

We employ a variety of marketing and recruiting methods to attract students and increase enrollments. We have positioned ourselves as a provider of private educational services that inspires students to achieve their potential and build self-confidence and that boosts students' enthusiasm for learning. We believe prospective students are attracted to our schools due to our excellent brand name, the quality of our programs and our relatively long operating history in the private education sector.

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We employ the following marketing methods to attract new and returning students:

*Speeches and Seminars.* Our management, most of whom are experienced teachers and were among our earliest teachers, and our top teachers frequently give speeches at colleges, universities, high schools and middle schools and to student groups, parent groups and educational organizations. They also participate in educational seminars and workshops. Their speeches include direct program promotion speeches during which they directly explain the merits and advantages of our programs or general English learning methods, as well as inspirational speeches designed to motivate students to reach their full potential and strive for success.

*Referrals.* Historically, our student enrollments have grown primarily through word-of-mouth referrals. Our student enrollments have benefited and will continue to benefit by referrals from our extensive network of students and alumni and the successful academic and professional careers that many of them have achieved.

*Distribution of Marketing Materials.* We use New Oriental booths and information tables to distribute free inspirational books authored by our chairman and chief executive officer Michael Minhong Yu and others, informational brochures, posters and flyers at various on-campus events, educational expos, conferences and college and employment fairs. We also conduct extensive free information sessions to introduce our programs to our target markets.

*Advertisements.* We advertise through our own websites and also on China's leading portals. We also have advertising arrangements with many Chinese national and regional newspapers and other media outlets, including school campus newspapers. In addition, we advertise through local radio stations and other advertisement platforms, including building lobby or elevator LCD displays and outdoor advertisement displays.

*Social Events and Activities.* We participate in and host community events designed to promote awareness of the virtues of education. We believe that these events enhance our public image and increase brand awareness. We also host English speech competitions, English drama performances and cultural events designed to raise enthusiasm for English language learning and to further promote awareness of our brand.

*Cross-Selling.* As we gain footholds in many different markets, we use our programs in one market as an opportunity to advertise our programs in other markets. With a variety of programs aimed at different age groups, our goal is to create a brand name that permeates every stage of our potential students' educational, career and life progression, from English for children to English for adults to test preparation to continuing professional education, and to encourage our students to introduce their children to the same system and courses. Outside of our organization, we have established cross-promotional relationships with a number of companies to promote our programs, services and products and awareness of our brand.

## **Competition**

The private education sector in China is rapidly evolving, highly fragmented and competitive, and we expect competition in this sector to persist and intensify. We face competition in each major program we offer and each geographic market in which we operate. For example, we face nationwide competition for our IELTS preparation courses from Global IELTS School, which offers IELTS preparation courses in many cities in China. We face regional competition for our English for children program from several competitors that focus on children's English language training in specific regions. We face limited competition from many competitors that focus on providing international and/or PRC test preparation courses in specific geographic markets in China. We also face competition from companies that focus on providing after-school tutoring services, including TAL Education Group and Xueda Education Group.

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We believe that the principal competitive factors in our markets include the following:

brand recognition;

overall student experience;

ability to effectively market programs, services and products to a broad base of prospective students;

scope and quality of program, service and product offerings; and

alignment of programs, services and products catering to specific needs of students, parents, educators and employers.

We believe that our primary competitive advantages are our well-known New Oriental brand, our innovative and inspirational instruction methods and the breadth and quality of our programs, services and products. However, some of our existing and potential competitors may have more resources than we do. These competitors may be able to devote greater resources than we can to the development, promotion and sale of their programs, services and products and respond more quickly than we can to changes in student demands, testing materials, admissions standards, market needs or new technologies. In addition, we face competition from many different smaller sized organizations that focus on some of our targeted markets, which may be able to respond more promptly to changes in student preferences in these markets.

The increasing use of the Internet and advances in Internet- and computer-related technologies, such as web video conferencing and online testing simulators, are eliminating geographic and cost-entry barriers to providing private educational services. As a result, many of our international competitors that offer online test preparation and language training courses may be able to more effectively penetrate the China market. Many of these international competitors have strong education brands, and students and parents in China may be attracted to the offerings of our international competitors based in the country that the student wishes to study in or in which the selected language is widely spoken. In addition, many smaller companies are able to use the Internet to quickly and cost-effectively offer their programs, services and products to a large number of students with less capital expenditure than previously required.

## **Regulation**

This section summarizes the principal PRC regulations relating to our businesses.

We operate our business in China under a legal regime consisting of the State Council, which is the highest authority of the executive branch of the PRC central government, and several ministries and agencies under its authority, including the Ministry of Education, or the MOE, the General Administration of Press and Publication, or GAPP, the Ministry of Industry and Information Technology, or the MIIT, the SAIC, the Ministry of Civil Affairs and their respective authorized local counterparts.

### ***Regulations on Private Education***

The principal regulations governing private education in China consist of the Education Law of the PRC, the Law for Promoting Private Education (2003) and the Implementation Rules for the Law for Promoting Private Education (2004), and the Regulations on Chinese-Foreign Cooperation in Operating Schools. Below is a summary of the relevant provisions of these regulations.

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### ***Education Law of the PRC***

On March 18, 1995, the National People's Congress enacted the Education Law of the PRC, or the Education Law. The Education Law sets forth provisions relating to the fundamental education systems of the PRC, including a school system of pre-school education, primary education, secondary education and higher education, a system of nine-year compulsory education and a system of education certificates. The Education Law stipulates that the government should formulate plans for the development of education and establish and operate schools and other institutions of education, and that in principle, enterprises, social organizations and individuals are encouraged to operate schools and other types of educational organizations in accordance with PRC laws and regulations. However, no organization or individual may establish or operate a school or any other institution of education for profit-making purposes, though private schools may be operated for reasonable returns, as described in more detail below.

### ***The Law for Promoting Private Education (2003) and the Implementation Rules for the Law for Promoting Private Education (2004) Overview***

The Law for Promoting Private Education became effective on September 1, 2003, and the Implementation Rules for the Law for Promoting Private Education became effective on April 1, 2004. Under these regulations, private schools are defined as schools established by social organizations or individuals using non-government funds. In addition, private schools providing certifications, pre-school education, education for self-study aid and other academic education shall be subject to approval by the education authorities, while private schools engaging in occupational qualification training and occupational skill training shall be subject to approvals from the authorities in charge of labor and social welfare. A duly approved private school will be granted a Permit for Operating a Private School, and shall be registered with the Ministry of Civil Affairs or its local counterparts as a privately run non-enterprise institution. Each of our schools has obtained the Permit for Operating a Private School and has been registered with the relevant local counterpart of the Ministry of Civil Affairs.

Under the above regulations, private schools have the same status as public schools, though private schools are prohibited from providing military, police, political and other kinds of education which are of a special nature. Government-run schools that provide compulsory education are not permitted to be converted into private schools. In addition, the operation of a private school is highly regulated. For example, the types and amounts of fees charged by a private school providing certifications shall be approved by the governmental pricing authority and be publicly disclosed. A private school that does not provide certifications shall file its pricing information with the governmental pricing authority and publicly disclose such information. Except for our primary and secondary school in Yangzhou and a small high school in Changchun, which provide graduation certifications to students, none of the schools operated by New Oriental China provides a diploma or certification to students.

Private education is treated as a public welfare undertaking under the regulations. Nonetheless, investors of a private school may choose to require reasonable returns from the annual net balance of the school after deduction of costs, donations received, government subsidies, if any, the reserved development fund and other expenses as required by the regulations. Private schools are divided into three categories: private schools established with donated funds; private schools that require reasonable returns and private schools that do not require reasonable returns.

The election to establish a private school requiring reasonable returns shall be provided in the articles of association of the school. The percentage of the school's annual net balance that can be distributed as reasonable return shall be determined by the school's board of directors, taking into consideration the following factors: (1) items and criteria for the school's fees, (2) the ratio of the school's expenses used for educational activities and improving the educational conditions to the total fees collected, and (3) the admission standards and educational quality. The relevant information relating to the above factors shall be publicly disclosed before the school's board determines the percentage of the school's annual net balance that can be distributed as reasonable returns. Such information and the decision to distribute reasonable returns shall also be filed with the approval authorities within 15 days from the decision made by the board. However, none of the current PRC laws and regulations provides a formula or guidelines for determining reasonable returns. In addition, none of the current PRC laws and regulations sets forth different requirements or restrictions on a private school's ability to operate its education business based on such school's status as a school that requires reasonable returns or a school that does not require reasonable returns.

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At the end of each fiscal year, every private school is required to allocate a certain amount to its development fund for the construction or maintenance of the school or procurement or upgrade of educational equipment. In the case of a private school that requires reasonable returns, this amount shall be no less than 25% of the annual net income of the school, while in the case of a private school that does not require reasonable returns, this amount shall be equal to no less than 25% of the annual increase in the net assets of the school, if any. Private schools that do not require reasonable returns shall be entitled to the same preferential tax treatment as public schools, while the preferential tax treatment policies applicable to private schools requiring reasonable returns shall be formulated by the finance authority, taxation authority and other authorities under the State Council. To date, however, no regulations have been promulgated by the relevant authorities in this regard. As of May 31, 2012, 22 of our schools elected as schools not requiring reasonable returns, 24 of our schools elected as schools requiring reasonable returns, and the remaining schools are not classified. Preferential tax treatments granted to our schools by governmental authorities are subject to review and may be adjusted or revoked at any time in the future.

### ***Sponsorship of Private Schools***

Under the Law for Promoting Private Education and the Implementation Rules for Promoting Private Education, entities and individuals that establish private schools are referred to as sponsors. As of May 31, 2012, New Oriental China was the sponsor of 53 schools and Beijing New Oriental Stars was the sponsor of two kindergartens.

The sponsorship interest that a sponsor holds in a private school is, for all practical purposes, substantially equivalent under PRC law and practice to the equity interest a shareholder holds in a company. Pursuant to the Implementation Rules for Promoting Private Education, a sponsor of a private school has the obligation to make capital contributions to the school in a timely manner. The contributed capital can be in the form of tangible or non-tangible assets such as materials in kind, land use rights or intellectual property rights. Pursuant to the Law for Promoting Private Education, the capital contributed by the sponsor becomes assets of the school and the school has independent legal person status. In addition, pursuant to the Law for Promoting Private Education and the Implementation Rules for Promoting Private Education, the sponsor of a private school has the right to exercise ultimate control over the school. Specifically, the sponsor has control over the private school's constitutional documents and has the right to elect and replace the private school's decision making bodies, such as the school's board of directors, and therefore controls the private school's business and affairs.

Before the Law for Promoting Private Education took effect in 2003, the Regulations on Schools Run by Different Sectors of Society had provided that upon liquidation, the residual assets of a private school after the original investment had been returned to the sponsor would be used by the relevant PRC government for the development of private education. However, this is no longer the case, as Article 68 of the Law for Promoting Private Education expressly abolished the Regulations on Schools Run by Different Sectors of Society. As advised by Tian Yuan Law Firm, our PRC counsel, since the Law for Promoting Private Education became effective on September 1, 2003, there has been no case in China where a private school became state property or was otherwise appropriated by a government authority upon liquidation.

Furthermore, we are not aware that PRC law provides that upon liquidation of a private school, the sponsor is legally restricted to receive only its invested capital and is not allowed to have other return. According to our PRC counsel, there is no national law that addresses this subject one way or the other. In the absence of a national law providing for the sponsor's rights upon liquidation of a private school, provincial regulations and interpretations are ambiguous and inconsistent on this subject. There are local regulations or interpretations that specifically provide that sponsors are entitled to private schools' residual assets pro rata based on their respective capital contribution. Nevertheless, there are also local regulations that are less clear in this regard.

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Notwithstanding the legal uncertainties surrounding this issue, we believe that the potential risk that we will not receive all of the residual assets upon the liquidation of a school is immaterial. There were no capital contributions made by any PRC governmental authorities to our schools. Nor did any of our schools ever receive donations from any third parties, including PRC governmental authorities or any third party enterprises. Since the Law for Promoting Private Education became effective on September 1, 2003, we and our PRC counsel are not aware of any case in China where a private school became state property or was otherwise appropriated by a government authority upon liquidation without the prior consent of its sponsor. We historically have never liquidated any school that was profitable and we have no plan to do so in the future. If, for any reason, we would like to divest a profitable school, a commercially sensible way to do so is to sell the school, rather than to liquidate the school. In this situation, the sponsor is entitled to receive consideration for transferring sponsorship, which often exceeds its initial investment in the school.

### ***Regulations on Chinese-Foreign Cooperation in Operating Schools***

Chinese-foreign cooperation in operating schools or training programs is specifically governed by the Regulations on Operating Chinese-Foreign Schools, promulgated by the State Council in 2003 in accordance with the Education Law, the Occupational Education Law and the Law for Promoting Private Education, and the Implementing Rules for the Regulations on Operating Chinese-Foreign Schools. The Regulations on Operating Chinese-foreign Schools and its implementing rules encourage substantive cooperation between overseas educational organizations with relevant qualifications and experience in providing high-quality education and Chinese educational organizations to jointly operate various types of schools in the PRC, with such cooperation in the areas of higher education and occupational education being encouraged. Chinese-foreign cooperative schools are not permitted, however, to engage in compulsory education and military, police, political and other kinds of education that are of a special nature in the PRC.

Permits for Chinese-Foreign Cooperation in Operating Schools shall be obtained from the relevant education authorities or the authorities that regulate labor and social welfare in the PRC. We have not applied for a Permit for Chinese-Foreign Cooperation in Operating Schools at this stage since we currently do not have Chinese-foreign Cooperation Schools.

### ***Outline of China's National Plan for Medium- and Long-Term Education Reform and Development (2010-2020)***

On July 29, 2010, the PRC central government promulgated the Outline of China's National Plan for Medium- and Long-Term Education Reform and Development (2010-2020), which for the first time announced the policy that the government will implement a reform to divide private education entities into two categories: (1) for-profit private education entities and (2) not-for-profit private education entities. On October 24, 2010, the General Office of the State Council issued the Notices on the National Education System Innovation Pilot. Under this notice, the PRC government plans to implement a for-profit and non-profit classified management of the private schools in Shanghai, Zhejiang, Shenzhen and Jilin Huaqiao Foreign Language School. However, the above outline and the innovation pilot is still new and no further national law or regulation has been promulgated to implement them and, except in Shanghai, no other local government of the pilot areas has promulgated relevant regulations on differentiated management of the private schools. If upon the implementation of the above reform, our schools choose to be for-profit private education entities, they may be subject to income tax at the rate of 25% and other taxes as if they were enterprises; if our schools choose to be not-for-profit private education entities, our contractual arrangements with New Oriental China and its schools and subsidiaries may be subject to more stringent scrutiny and the education authorities may not allow our schools to pay us services fees under the contractual arrangements as they currently do. As a result, the implementation of this reform may adversely affect our results of operations.

On June 18, 2012, the MOE issued the Implementation Opinions of the MOE on Encouraging and Guiding the Entry of Private Capital in the Fields of Education and Promoting the Healthy Development of Private Education to encourage private investment and foreign investment in the field of education. According to these opinions, the proportion of foreign capital in a Chinese-foreign education institute shall be less than 50%. These opinions currently do not apply to our schools because we currently do not have Chinese-foreign education institutes.

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### ***Regulations on Online and Distance Education***

Pursuant to the Administrative Regulations on Educational Websites and Online and Distance Education Schools issued by the MOE in 2000, educational websites and online education schools may provide educational services in relation to higher education, elementary education, pre-school education, teaching education, occupational education, adult education, other education and public educational information services.

Educational websites refer to organizations providing education or education-related information services to website visitors by means of a database or online education platform connected via the Internet or an educational television station through an Internet service provider, or ISP.

Online education schools refer to education websites providing academic education services or training services with the issuance of various certificates.

Setting up education websites and online education schools is subject to approval from relevant education authorities, depending on the specific types of education. Any education website and online education school shall, upon the receipt of approval, indicate on its website such approval information as well as the approval date and file number.

According to the Administrative License Law promulgated by the Standing Committee of the National People's Congress on August 27, 2003 and effective as of July 1, 2004, only laws promulgated by the National People's Congress and regulations and decisions promulgated by the State Council may set down administrative license. On June 29, 2004, the State Council promulgated the Decision on Setting Down Administrative Licenses for the Administrative Examination and Approval Items Really Necessary to be Retained, in which the administrative license for online education schools was retained, while the administrative license for educational websites was not retained.

### ***Regulations on Publishing and Distribution of Publications***

On December 25, 2001, the State Council promulgated the Administrative Regulations on Publication, or the Publication Regulations, which became effective on February 1, 2002. The Publication Regulations apply to publication activities, i.e., the publishing, printing, copying, importation or distribution of publications, including books, newspapers, periodicals, audio and video products and electronic publications, each of which requires approval from the relevant publication administrative authorities.

On April 13, 2005, the State Council announced a policy on private investments in China that relate to cultural matters, which affects private investments in businesses that involve publishing. The policy authorizes the Ministry of Culture and several other central government authorities to adopt detailed rules to implement the policy. In July 2005, the Ministry of Culture, together with other central government authorities, issued a regulation that prohibits private and foreign investors from engaging in the publishing business. Our subsidiaries and New Oriental China and its schools and subsidiaries are not permitted to engage in the publishing business under this regulation. Beijing New Oriental Dogwood Cultural Communications Co., Ltd., a subsidiary of New Oriental China, has been cooperating with qualified PRC publishing companies to publish our self-developed teaching materials and other content.

Subsequent to the implementation of the Publication Regulations, GAPP issued the Administrative Regulations on Publications Market, which became effective on September 1, 2003 and which were amended on June 16, 2004. According to the Administrative Regulations on Publications Market, any organization or individual engaged in general distribution, whole sale or retail of publications shall obtain a Permit for Operating Publications. Distribution of publications in the PRC is regulated on different administrative levels. An entity engaged in general distribution of publications shall obtain such permit from GAPP and may conduct general distribution of the publications in the PRC; an entity engaged in wholesaling of publications shall obtain such permit from the provincial counterpart of GAPP and may not engage in general distribution in the PRC; and an entity engaged in retail distribution of publications shall obtain such permit from the local counterpart of GAPP at the county level and may not conduct general distribution or wholesaling of publications in the PRC.

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In addition, pursuant to the Administrative Regulations on Publishing Audio-Video Products promulgated by the State Council on December 25, 2001, which became effective as of February 1, 2002, any entity engaged in the wholesale or retail distribution of audio-video products shall secure a Permit for Operating Audio-Video Products from the relevant culture authorities.

The subsidiaries of New Oriental China engaged in the wholesale and retail distribution of books, periodicals, audio-visual products and electronic publications have obtained the relevant Permits for Operating Publications and the relevant Permits for Operating Audio-Video Products. During the term of the above-mentioned permits or licenses, GAPP or its local counterparts or other competent authorities may conduct annual or random examination or inspection from time to time to ascertain their compliance with applicable regulations and may require for change or renewal of such permits or licenses. If the subsidiaries of New Oriental China engaged in the wholesale and retail distribution of books, periodicals, audio-visual products and electronic publications are not able to pass the subsequent inspection or examination, they may not be able to maintain such permits or licenses necessary for their business.

### ***Regulations on Online Publications***

GAPP and the MIIT jointly promulgated the Tentative Internet Publishing Administrative Measures, or the Internet Publishing Measures, which took effect on August 1, 2002. The Internet Publishing Measures require Internet publishers to obtain approval from GAPP. The term "Internet publishing" is defined as an act of online dissemination whereby Internet information service providers select, edit and process works created by themselves or others (including content from books, newspapers, periodicals, audio and video products, electronic publications, and other sources that have already been formally published or works that have been made public in other media) and subsequently post the same on the Internet or transmit the same to users via the Internet for browsing, use or downloading by the public.

Xuncheng Network, a subsidiary of New Oriental China engaging in Internet content services, received verbal confirmation from GAPP that the online content services that Xuncheng Network provides does not fall within the scope of "Internet publishing" that requires approval or a license from GAPP. Obtaining an online publication license requires certain conditions, including having five or more qualified editors, which Xuncheng Network cannot satisfy. However, because there is no further official or publicly available interpretation of "Internet publishing," we cannot assure you that Xuncheng Network will not require an online publication license in the future.

### ***Regulations on Consulting Services for Overseas Studies or Other Overseas Visits for Private Matters***

The Ministry of Public Security and SAIC jointly issued the Administrative Measures on Intermediate Activities relating to Entry and Exit for Private Purpose on June 6, 2001, which requires that any entity engaged in intermediate and consulting services for Chinese citizens going abroad to visit families, relatives or friends, to reside abroad, to inherit properties, or to conduct other non-business matters other than studying, working or touring, shall obtain a license granted by the relevant provincial authority on public security. With respect to intermediate and consulting business activities relating to self-funded overseas studying, the MOE, the Ministry of Public Security and SAIC jointly issued the Administrative Regulations on Intermediate Services for Overseas Studies with Private Funds and their Implementing Rules in 1999, which require that any intermediate service organization engaged in such services procure from the MOE the Recognition on the Intermediate Service Organization for Self-funded Overseas Studies.

Beijing New Oriental Vision Overseas Consulting Co., Ltd., a subsidiary of New Oriental China engaging in overseas studies consulting and other consulting services, has obtained the relevant licenses from the MOE and the Beijing Municipal Public Security Bureau.

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### ***Regulations on Internet Information Services***

Subsequent to the State Council's promulgation of the Telecom Regulations and the Internet Information Services Administrative Measures on September 25, 2000, or the Internet Information Measures, the MIIT and other regulatory authorities formulated and implemented a number of Internet-related regulations, including but not limited to the Internet Electronic Bulletin Board Service Administrative Measures, or the BBS Measures.

The Internet Information Measures require that commercial Internet content providers, or ICP providers, obtain a license for Internet information services, or ICP license, from the appropriate telecommunications authorities in order to carry on any commercial Internet information services in the PRC. ICP providers shall display their ICP license number in a conspicuous location on their home page. In addition, the Internet Information Measures also provide that ICP providers that operate in sensitive and strategic sectors, including news, publishing, education, health care, medicine and medical devices, must obtain additional approvals from the relevant authorities in charge of those sectors as well. The BBS Measures provide that any ICP provider engaged in providing online bulletin board services, or BBS, is subject to a filing process with the relevant telecommunications industry authorities. Xuncheng Network has obtained the ICP license and is in the process of completing such filing.

In July 2006, the MIIT posted a notice on its website entitled Notice on Strengthening Management of Foreign Investment in Operating Value-Added Telecom Services. The notice prohibits PRC Internet content providers from leasing, transferring or selling their ICP licenses or providing facilities or other resources to any illegal foreign investors. The notice states that PRC Internet content providers should directly own the trademarks and domain names for websites operated by them, as well as servers and other infrastructure used to support these websites. The notice also states that PRC Internet content providers had until November 1, 2006 to evaluate their compliance with the notice and correct any non-compliance. A PRC Internet content provider's failure to do so by November 1, 2006 may result in revocation of its ICP license.

### ***Regulations on Internet Culture Activities***

The Ministry of Culture of the PRC promulgated the Internet Culture Administration Tentative Measures, or the Internet Culture Measures, on May 10, 2003, which became effective on July 1, 2003, and which were amended on July 1, 2004. The Internet Culture Measures require ICP operators engaging in Internet culture activities to obtain an Internet culture business operations license from the Ministry of Culture in accordance with the Internet Culture Measures. The term Internet culture activities includes, among other things, acts of online dissemination of Internet cultural products, such as audio-visual products, games, performances of plays or programs, works of art and cartoons, and the production, reproduction, importation, sale (wholesale or retail), leasing and broadcasting of Internet cultural products.

Xuncheng Network, a subsidiary of New Oriental China engaging in the distribution of certain audio-visual products through the Internet, received verbal confirmation from the Ministry of Culture that the products of Xuncheng Network do not fall within the definition of Internet culture products and its operations do not fall within the definition of Internet culture activities as defined under the Internet Culture Measures. Accordingly, Xuncheng Network is not required to obtain an Internet culture business operations license. However, because there is no further official or publicly-available interpretation of these definitions, we cannot assure you that Xuncheng Network will not need an Internet culture business operations license in the future.

### ***Regulation on Broadcasting Audio-Video Programs through the Internet or Other Information Network***

The State Administration of Radio, Film and Television, or SARFT, promulgated the Rules for Administration of Broadcasting of Audio-Video Programs through the Internet and Other Information Networks, or the Broadcasting Rules, in 2004, which became effective on October 11, 2004. The Broadcasting Rules apply to the activities of broadcasting, integration, transmission, downloading of audio-video programs with computers, televisions or mobile phones as the main terminals and through various types of information networks. Pursuant to the Broadcasting Rules, a Permit for Broadcasting Audio-video Programs via Information Network is required to engage in these Internet broadcasting activities. On April 13, 2005, the State Council announced a policy on private investments in businesses in China that relate to cultural matters, which prohibits private investments in businesses relating to the dissemination of audio-video programs through information networks.

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On December 20, 2007, SARFT and MIIT issued the Internet Audio-Video Program Measures, which became effective on January 31, 2008. Among other things, the Internet Audio-Video Program Measures stipulate that no entities or individuals may provide Internet audio-video program services without a License for Disseminating Audio-Video Programs through Information Network issued by SARFT or its local counterparts or completing the relevant registration with SARFT or its local counterparts and only entities wholly owned or controlled by the PRC government may engage in the production, editing, integration or consolidation, and transfer to the public through the Internet, of audio-video programs, and the provision of audio-video program uploading and transmission services. On February 3, 2008, SARFT and MIIT jointly held a press conference in response to inquiries related to the Internet Audio-Video Program Measures, during which SARFT and MIIT officials indicated that providers of audio-video program services established prior to the promulgation date of the Internet Audio-Video Program Measures that do not have any regulatory non-compliance records can re-register with the relevant government authorities to continue their current business operations. After the conference, the two authorities published a press release that confirms the above guidelines. On September 15, 2009, SARFT promulgated the Notice on Several Issues regarding the License for Disseminating Audio-Video Programs through Information Network. The Notice restates the necessity of applying for such license and sets forth the legal liabilities for those providing Internet audio-video program services without the license. Xuncheng Network, a subsidiary of New Oriental China engaging in online education services, obtained the License for Disseminating Audio-Video Programs through Information Network from SARFT on January 15, 2010.

### ***Regulations on Protection of the Right of Dissemination through Information Networks***

On May 18, 2006, the State Council promulgated the Regulations on Protection of the Right of Dissemination through Information Networks, which became effective on July 1, 2006. This regulation requires that every organization or individual who disseminates a third party's work, performance, audio or visual recording products to the public through information networks shall obtain permission from, and pay compensation to, the legitimate copyright owner of such products, unless otherwise provided under relevant laws and regulations. The legitimate copyright owner may take technical measures to protect his or her right of dissemination through information networks and any organization or individual shall not intentionally avoid, destroy or otherwise assist others in avoiding such protective measures unless permissible under law. This regulation also provides that permission from and compensation for the copyright owner are not required in the event of limited dissemination to teaching or research staff for the purpose of school teaching or scientific research only.

### ***Regulations on Copyright and Trademark Protection***

China has adopted legislation governing intellectual property rights, including copyrights and trademarks. China is a signatory to the main international conventions on intellectual property rights and became a member of the Agreement on Trade Related Aspects of Intellectual Property Rights upon its accession to the World Trade Organization in December 2001.

*Copyright.* The National People's Congress amended the Copyright Law in 2001 to widen the scope of works and rights that are eligible for copyright protection. The amended Copyright Law extends copyright protection to Internet activities, products disseminated over the Internet and software products. In addition, there is a voluntary registration system administered by the China Copyright Protection Center.

To address the problem of copyright infringement related to the content posted or transmitted over the Internet, the National Copyright Administration and the MIIT jointly promulgated the Administrative Measures for Copyright Protection Related to the Internet on April 30, 2005. These measures became effective on May 30, 2005.

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*Trademark.* The PRC Trademark Law, adopted in 1982 and revised in 2001, protects the proprietary rights to registered trademarks. The Trademark Office under SAIC handles trademark registrations and grants a term of ten years to registered trademarks and another ten years to trademarks as requested upon expiry of the prior term. Trademark license agreements must be filed with the Trademark Office for record. We have registered certain trademarks and logos, including New Oriental and Pop Kids, with the Trademark Office and are in the process of registering additional marks. In addition, if a registered trademark is recognized as a well-known trademark in a specific case, the proprietary right of the trademark holder may be extended beyond the registered sphere of products and services of the trademark in such case. Our trademarks and New Oriental were recognized as well-known trademarks in a civil action adjudicated by the Intermediate People's Court of Jilin City, Jilin Province.

On November 5, 2004, the MIIT amended the Measures for Administration of Domain Names for the Chinese Internet, or the Domain Name Measures. The Domain Name Measures regulate the registration of domain names, such as the first tier domain name .cn. In February 2006, China Internet Network Information Center, or CNNIC, issued the Implementing Rules for Domain Name Registration and the Measures on Domain Name Disputes Resolution, pursuant to which CNNIC can authorize a domain name dispute resolution institution to decide disputes. We have registered many domain names with CNNIC.

## **Regulations on Foreign Exchange**

### ***Foreign Currency Exchange***

Pursuant to the Foreign Currency Administration Rules promulgated in 1996 and amended in 2008 and various regulations issued by SAFE and other relevant PRC government authorities, RMB is freely convertible to current account items, such as trade-related receipts and payments, interest and dividend. Capital account items, such as direct equity investments, loans and repatriation of investment, require the prior approval from SAFE or its local counterpart for conversion of RMB into a foreign currency, such as U.S. dollars, and remittance of the foreign currency outside the PRC.

Payments for transactions that take place within the PRC must be made in RMB. Unless otherwise approved, PRC companies must repatriate foreign currency payments received from abroad. Domestic enterprises (including foreign-invested enterprises) may retain foreign exchange derived from current account items, but unless otherwise approved, they must convert all of their foreign currency receipts derived from capital account items into RMB.

SAFE promulgated the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Currency Capital of Foreign Invested Enterprises, or SAFE Circular 142, on August 29, 2008, to regulate the conversion by a foreign-invested company of its capital contribution in foreign currency into RMB. The circular requires that the paid-in capital of a foreign-invested company settled in RMB converted from foreign currencies shall be used only for purposes within the business scope as approved by the authorities in charge of foreign investment or by other competent authorities and as registered with the Administration for Industries and Commerce and, unless set forth in the business scope or in PRC regulations, may not be used for equity investments within the PRC. In addition, SAFE has strengthened its oversight of the flow and use of the paid-in capital of a foreign-invested company settled in RMB converted from foreign currencies. The use of such RMB paid-in capital may not be changed without SAFE's approval. Violations of Circular 142 will result in severe monetary or other penalties. In strengthening Circular 142, SAFE promulgated the Circular on Further Clarifying and Regulating Relevant Issues Concerning the Administration of Foreign Exchange under Capital Account, or SAFE Circular 45, on November 9, 2011, which expressly prohibits a foreign invested company from converting registered capital in foreign exchange into RMB for the purpose of equity investment, granting certain loans, repayment of inter-company loans, or repayment of bank loans which have been transferred to a third party.

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### ***Foreign Exchange Registration of Offshore Investment by PRC Residents***

Pursuant to the SAFE's Notice on Relevant Issues Concerning Foreign Exchange Administration for PRC Residents to Engage in Financing and Inbound Investment via Overseas Special Purpose Vehicles, or SAFE Circular No. 75, issued on October 21, 2005, and the Operating Instructions on SAFE Circular No. 75, or SAFE Circular No. 19, issued on May 27, 2011 and effective July 1, 2011, (1) a PRC citizen residing in the PRC, or PRC Resident, shall register with the local branch of SAFE before it establishes or controls an overseas special purpose vehicle, or SPV, for the purpose of overseas equity financing (including convertible debts financing); (2) when a PRC Resident contributes the assets of or its equity interests in a domestic enterprise into an SPV, or engages in overseas financing after contributing assets or equity interests into an SPV, such PRC Resident shall register his or her interest in the SPV and the change thereof with the local branch of SAFE; and (3) when the SPV undergoes a material event outside of China, such as change in share capital or merger and acquisition, the PRC resident shall, within 30 days from the occurrence of such event, register such change with the local branch of SAFE. PRC residents who are shareholders of SPVs established before November 1, 2005 were required to register with the local SAFE branch before March 31, 2006.

Under SAFE Circular No. 75 and Circular No. 19, failure to comply with the registration procedures set forth above may result in the penalties, including imposition of restrictions on a PRC subsidiary's foreign exchange activities and its ability to distribute dividends to the SPV.

Our beneficial owners immediately before our initial public offering who are PRC residents had registered with the local branch of SAFE prior to our initial public offering as required under SAFE Circular No. 75.

### ***Dividend Distribution***

The principal regulations governing dividend distributions by wholly foreign-owned enterprises and Sino-foreign equity joint ventures include:

Wholly Foreign-Owned Enterprise Law (1986), as amended;

Wholly Foreign-Owned Enterprise Law Implementing Rules (1990), as amended;

Sino-foreign Equity Joint Venture Enterprise Law (1979), as amended; and

Sino-foreign Equity Joint Venture Enterprise Law Implementing Rules (1983), as amended.

Under these regulations, wholly foreign-owned enterprises and Sino-foreign equity joint ventures in the PRC may pay dividends only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. Additionally, these foreign-invested enterprises are required to set aside certain amounts of their accumulated profits each year, if any, to fund certain reserve funds. These reserves are not distributable as cash dividends.

### ***Provisions Regarding Mergers and Acquisitions of Domestic Enterprises by Foreign Investors***

On August 8, 2006, six PRC regulatory agencies, including the CSRC, promulgated the M&A Rule to more effectively regulate foreign investment in PRC domestic enterprises. The M&A Rule, as amended on June 22, 2009, provides that the Ministry of Commerce must be notified in advance of any change-of-control transaction in which a foreign investor takes control of a PRC domestic enterprise and any of the following situations exists: (1) the transaction involves an important industry in China, (2) the transaction may affect national economic security, or (3) the PRC domestic enterprise has a well-known trademark or historical Chinese trade name in China. The M&A Rule also contains a provision requiring offshore special purpose vehicles, or SPVs, formed for listing purposes through acquisitions of PRC domestic companies and controlled by PRC individuals to obtain the approval of the CSRC prior to publicly listing their securities on an overseas stock exchange.

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The M&A Rule became effective on September 8, 2006 without retroactive effect. Based on the advice of Tian Yuan Law Firm, our PRC counsel, we do not believe that the CSRC approval was required for our listing on the NYSE because trading of our ADSs commenced prior to the effective date of the M&A Rule.

### ***Regulations on Taxation***

On March 16, 2007, the National People's Congress, the Chinese legislature, passed the EIT Law, which took effect on January 1, 2008. The EIT Law applies a uniform 25% enterprise income tax rate to both foreign-invested enterprises and domestic enterprises. There is a transition period for the enterprises, whether foreign-invested or domestic, which had received preferential tax treatments granted by relevant tax authorities prior to March 16, 2007. Enterprises that had been subject to an enterprise income tax rate lower than 25% prior to March 16, 2007 may continue to enjoy the lower rate and gradually transfer to the new tax rate within five years after the effective date of the EIT Law. Enterprises that had been entitled to exemptions or reductions from the standard income tax rate for a fixed term prior to March 16, 2007 may continue to enjoy such treatment until the fixed term expires. Preferential tax treatments will continue to be granted to industries and projects that are strongly supported and encouraged by the state, and enterprises otherwise classified as high and new technology enterprises strongly supported by the state upon re-examination will be entitled to a 15% enterprise income tax rate. The EIT Law empowers the State Council to enact appropriate implementing rules and regulations. The State Council promulgated the implementation rules of the EIT Law in December 2007 and the Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation promulgated other supplemental rules in April 2008 and July 2008, respectively, regarding new criteria for the granting of high and new technology enterprises status. According to these rules, all enterprises which have been granted such status before the effectiveness of the EIT Law are required to be re-examined according to such rules before they can continue to be entitled to the preferential tax treatments. Any enterprises to be granted with high and new technology enterprises status shall meet certain requirements, including but not limited to the following: (1) in the latest three years, the enterprise itself owns the intellectual property right for the core technology of its product or service; (2) the enterprise's product or service falls into the ambit of high-tech fields heavily supported by the government; (3) technicians with a bachelor's degree account for more than 30% of all the staff, and the research and development personnel account for more than 10% of all the staff; (4) in the latest three financial years, the research and development expenses account for 3%-6% or more of the latest sales revenue and the research and development expenses incurred within China shall not be less than 60% of the total research and development expenses; and (5) the revenue derived from the high-tech product or service accounts for more than 60% of the total revenue. To apply for the high and new technology enterprises status, an enterprise shall file its corporate certificates and supporting documents evidencing the requirements to the relevant government authority. The government authority will examine the filed certificates and documents to determine whether the enterprise meets the high and new technology enterprises requirements. If the decision is positive, the authority will make a public announcement and grant the enterprise with a high and new technology enterprises certificate with a valid term of three years. Upon the expiration of the initial term, the enterprise shall file a new application to obtain such status. Loss of any preferential tax treatments previously granted to us could have a material and adverse effect on our financial condition and results of operations.

According to the Circular On Several Policies for Further Encouraging the Development of Software Industry and Integrated Circuit Industry promulgated by the State Council on January 28, 2011 and the Circular On Policies of Enterprises Income Tax for Further Encouraging the Development of Software Industry and Integrated Circuit Industry, jointly promulgated by the Ministry of Finance and the State Administration of Taxation on April 20, 2012 and effective from January 1, 2011, or Circular 27, an enterprise that qualifies as a software enterprise established after January 1, 2011, or a Software Enterprise, is exempted from enterprise income tax for two years beginning in the enterprise's first profitable year followed by a tax rate of 12.5% for the succeeding three years before December 31, 2017. The qualifications for a Software Enterprise provided in Circular 27 include the following:

the core business shall be software development;

the enterprise shall be a legal person established after January 1, 2011 and shall be granted the status of a Software Enterprise;

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the enterprise's employees who have at least a junior college degree shall be more than 40% of the average monthly headcount of its total employees of that year, among whom the research and development staff shall be more than 20% of the average monthly headcount of its total employees of that year;

the enterprise shall own core technology and shall base its operation on such core technology, the annual total research and development expenses shall be more than 6% of its total revenue of that fiscal year, among which the research and development expenses incurred in China shall be more than 60% of the total research and development expenses;

the revenue generated from the sale of its software products shall normally be more than 50% of its total revenue (the revenue generated from the sale of embedded software products and integrated information system products shall be more than 40% of its total revenue), among which the revenue generated from the sale of software products developed by such enterprise shall normally be more than 40% of its total revenue (the revenue generated from the sale of embedded software products and integrated information system products shall be more than 30% of its total revenue);

the enterprise shall own intellectual property rights in the technologies used in its core business, among which its software products shall be certified with testing documents issued by a software testing institution recognized by provincial authority in charge of software industry and with Software Product Registration Certificates granted by the authority in charge of software industry;

the enterprise shall possess the means and ability to ensure the quality of the products it designs, and shall have established a quality control system which is fit for software engineering and shall provide the records for the valid operation of such system; and

the enterprise shall possess operation premises and maintain a working environment suitable for software development, and have technical support for the services it provides.

In order to be qualified as a Software Enterprise and be entitled to such preferential treatment, Software Enterprises are required to submit supporting materials to their respective competent tax authorities within four months from the end of each fiscal year.

The Administrative Provisions for Recognition of Software Enterprises shall be separately established by the Ministry of Industry and Information, the State Development and Reform Commission, the Ministry of Finance, the State Administration of Taxation and other relevant authorities.

Enterprises which have been entitled to similar tax preferential treatments according to previous tax regulations are allowed to continue enjoying the above preferential treatments until the tax holiday granted to them expires, even though they were established before January 1, 2011.

Beijing Pioneer and Shanghai Smart Words, two of our wholly owned subsidiaries in China, qualified as Software Enterprises and were exempt from income taxes from January 2010 through December 31, 2011, and from January 2011 through December 31, 2012, respectively, and have a tax rate of 12.5% through December 31, 2014, and through December 31, 2015, respectively. Beijing Smart Wood satisfies the criteria to be considered a Software Enterprise, but this status is subject to the approval by the respective tax authorities scheduled for the end of the calendar year ending December 31, 2012. Upon approval, Beijing Smart Wood would be exempt from income taxes from January 1, 2012 through December 31, 2013 followed by a 12.5% tax rate through December 31, 2016. If our above subsidiaries are not able to continue to satisfy the required qualifications and maintain their status as a Software Enterprise, they will not be able to continue to enjoy the preferential tax treatments for Software Enterprises.

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The EIT Law also provides that enterprises established outside of China whose de facto management bodies are located in China are considered resident enterprises and will generally be subject to the uniform 25% enterprise income tax rate on their global income. Although the term de facto management bodies is defined as management bodies which has substantial and overall management and control power on the operation, human resources, accounting and assets of the enterprise, the circumstances under which an enterprise's de facto management body would be considered to be located in China are currently unclear. A circular issued by the State Administration of Taxation on April 22, 2009 provides that a foreign enterprise controlled by a PRC company or a PRC company group will be classified as a resident enterprise with its de facto management bodies located within China if the following requirements are satisfied: (1) the senior management and core management departments in charge of its daily operations function mainly in the PRC; (2) its financial and human resources decisions are subject to determination or approval by persons or bodies in the PRC; (3) its major assets, accounting books, company seals, and minutes and files of its board and shareholders meetings are located or kept in the PRC; and (4) at least half of the enterprise's directors or senior management with voting rights reside in the PRC.

In addition, the State Administration of Taxation issued a bulletin on August 3, 2011, effective as of September 1, 2011, to provide more guidance on the implementation of the above circular. The bulletin clarified certain matters relating to resident status determination, post determination administration and competent tax authorities. It also specifies that when provided with a copy of a PRC tax resident determination certificate from a resident PRC-controlled offshore incorporated enterprise, the payer should not withhold 10% income tax when paying the PRC-sourced dividends, interest and royalties to the PRC-controlled offshore incorporated enterprise. Although both the circular and the bulletin only apply to offshore enterprises controlled by PRC enterprises and not those by PRC individuals, the determination criteria set forth in the circular and administration clarification made in the bulletin may reflect the SAT's general position on how the de facto management body test should be applied in determining the tax residency status of offshore enterprises and how the administration measures should be implemented, regardless of whether they are controlled by PRC enterprises or PRC individuals.

The EIT Law provides that a maximum income tax rate of 20% may apply to dividends payable to non-PRC investors that are non-resident enterprises, to the extent such dividends are derived from sources within the PRC. The State Council has reduced such rate to 10%, in the absence of any applicable tax treaties that may reduce such rate. We are a Cayman Islands holding company and substantially all of our income may be derived from dividends we receive from our operating subsidiaries located in the PRC. If we are required under the EIT Law to pay income tax for any dividends we receive from our PRC subsidiaries, the amount of dividends, if any, we may pay to our shareholders and ADS holders may be materially and adversely affected.

According to the Double Taxation Arrangement (Hong Kong), which became effective on January 1, 2007, The Notice of the State Administration of Taxation on Negotiated Reduction of Dividends and Interest Rates, which was issued on January 29, 2008, and The Notice of the State Administration of Taxation Regarding Interpretation and Recognition of Beneficial Owners under Tax Treaties, which became effective on October 27, 2009, dividends paid to enterprises incorporated in Hong Kong are subject to a withholding tax of 5% provided that a Hong Kong resident enterprise owns over 25% of the PRC enterprise distributing the dividend and can be considered as a beneficial owner and entitled to treaty benefits under the Double Taxation Arrangement (Hong Kong). Our wholly owned Hong Kong subsidiaries, Elite Concept Holdings Limited, Winner Park Limited and Smart Shine International Limited, own 100% of our PRC subsidiaries. Thus, dividends paid to us by our PRC subsidiaries through our Hong Kong wholly owned subsidiaries may be subject to the 5% withholding tax if we and our Hong Kong subsidiaries are considered as non-resident enterprises under the EIT Law and our Hong Kong subsidiaries are considered as beneficial owners and entitled to treaty benefits under the Double Taxation Arrangement (Hong Kong). If our Hong Kong subsidiaries are not regarded as the beneficial owners of any such dividends, it will not be entitled to the treaty benefits under the Double Taxation Arrangement (Hong Kong). As a result, such dividends would be subject to regular withholding tax of 10% as provided by the PRC domestic law rather than the favorable rate of 5% applicable under the Double Taxation Arrangement (Hong Kong).

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On November 11, 2011, as approved by the State Council, the Ministry of Finance and the State Administration of Taxation, promulgated the Circular Regarding the Launch of Pilot Practice of Replacing Business Tax with Value-Added Tax in Transportation Industry and Some Modern Service Industries in Shanghai, or Circular No. 111, attached with three relevant annexes, namely (1) Annex 1-Measures for the Implementation of the Pilot Practice of Replacing Value Added Tax with Business Tax in the Transportation Industry and Some Modern Service Industries, (2) Annex 2- Provisions on Relevant Matters Concerning the Pilot Practice of Replacing Business Tax with Value-Added Tax in Transportation Industry and Some Modern Service Industries, and (3) Annex 3- Provisions on the Transitional Policies for the Pilot Practice of Replacing Business Tax with Value-Added Tax in Transportation Industry and Some Modern Service Industries. Circular No. 111 and its annexes stipulated that the launch of a pilot practice of replacing business tax with value-added tax ( Pilot Practice ) would commence in the transportation industry and some modern service industries, including software service and information system service, in Shanghai beginning in January 1, 2012. On July 31, 2012, upon approval by the State Council, the Ministry of Finance and the State Administration of Taxation promulgated the Circular Regarding the Launch of Pilot Practice of Replacing Business Tax with Value-Added Tax in Transportation Industry and Some Modern Service Industries in Beijing and other Seven Provinces and Municipalities, or Circular No. 71, which expanded the region for the Pilot Practice from Shanghai to Beijing and other regions. The Pilot Practice commenced in Beijing on August 1, 2012.

### C. Organizational Structure

Substantially all of our operations are conducted in China through contractual arrangements between five of our wholly owned subsidiaries in China, New Oriental China (our variable interest entity) and New Oriental China's schools and subsidiaries and shareholder. The five wholly owned subsidiaries that are parties to these contractual arrangements are Beijing Hewstone Technology Co., Ltd., or Beijing Hewstone, Beijing Decision Education & Consulting Co., Ltd., or Beijing Decision, Beijing Pioneer Technology Co., Ltd., or Beijing Pioneer, Shanghai Smart Words Software Technology Co., Ltd., or Shanghai Smart Words, and Beijing Smart Wood Software Technology Co., Ltd. (which is also translated as Beijing Wisdom Career Software Technology Co., Ltd. ), or Beijing Smart Wood. Beijing Hewstone primarily engages in the educational software development business and also sub-licenses our trademarks to New Oriental China and its schools and subsidiaries. Beijing Decision primarily engages in the business of providing educational technology services and educational management services. Beijing Pioneer primarily engages in the educational software development business. Shanghai Smart Words primarily engages in the educational software development business. Beijing Smart Wood primarily engages in the educational software development business.

In addition, we have a wholly-owned subsidiary in China, Beijing Judgment Education & Consulting Co., Ltd., or Beijing Judgment, which holds the real estate properties on which certain of our schools are located. Beijing Judgment in turn has two subsidiaries in China, Beijing Boost Caring Education & Consulting Co., Ltd., which primarily engages in the business of providing educational technology services and consulting services, and Beijing New Oriental Stars Education & Consulting Co., Ltd., or Beijing New Oriental Stars, which is a holding company for our two kindergartens.

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The following diagram sets out details of our significant subsidiaries and New Oriental China and its schools and subsidiaries as of the date of this annual report:

Equity interest for companies.

Sponsorship interest for schools and kindergartens.

Contractual arrangements including service agreements. See C. Organizational Structure Contractual Arrangements with New Oriental China, its Schools and Subsidiaries and its Shareholder.

Contractual arrangements including equity pledge agreements, option agreement and proxy agreement and power of attorney. See C. Organizational Structure Contractual Arrangements with New Oriental China, its Schools and Subsidiaries and its Shareholder.

- (1) Beijing Century Friendship Education Investment Co., Ltd is 80% owned by Mr. Michael Minhong Yu, our company's founder, chairman and chief executive officer, and 20% owned by Ms. Bamei Li, Mr. Yu's mother.
- (2) Consisting of various PRC companies operating our educational content and other technology development and distributions business, online education business and overseas studies consulting business in China.

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### **Contractual Arrangements with New Oriental China, Its Schools and Subsidiaries and Its Shareholder**

PRC laws and regulations currently require any foreign entity that invests in the education business in China to be an educational institution with relevant experience in providing educational services outside China. Our offshore holding companies are not educational institutions and do not provide educational services outside China. In addition, in the PRC, foreign ownership of high schools for students in grades ten to twelve is restricted and foreign ownership of primary and middle schools for students in grades one to nine is prohibited. As a result, our offshore holding companies are not allowed to directly own and operate schools in China. We conduct substantially all of our education business in China through contractual arrangements between five of our wholly owned subsidiaries in China, namely, Beijing Hewstone, Beijing Decision, Beijing Pioneer, Shanghai Smart Words and Beijing Smart Wood, and New Oriental China, its schools and subsidiaries and its shareholder. In the fiscal years ended May 31, 2010, 2011 and 2012, New Oriental China and its schools and subsidiaries contributed in aggregate 98.9%, 97.2% and 97.2%, respectively, of our total net revenues. New Oriental China is our variable interest entity which is directly wholly owned by Century Friendship, a PRC domestic company controlled by Mr. Michael Minghong Yu, our founder, chairman and chief executive officer.

New Oriental China's schools and subsidiaries hold the requisite licenses and permits necessary to conduct our education business and have been directly conducting our education business. We have been and are expected to continue to be dependent on New Oriental China and its schools and subsidiaries to operate our education business until we qualify for direct ownership of our education business in China under PRC laws and regulations and acquire New Oriental China as our direct, wholly owned subsidiary. We have entered into contractual arrangements with New Oriental China, its schools and subsidiaries and its shareholder, which enable us to:

have power to direct the activities that most significantly affect the economic performance of New Oriental China and its schools and subsidiaries;

receive substantially all of the economic benefits from New Oriental China and its schools and subsidiaries in consideration for the services provided by our wholly owned subsidiaries in China; and

have an exclusive option to purchase all or part of the equity interests in New Oriental China, when and to the extent permitted by PRC law, or request any existing shareholder of New Oriental China to transfer all or part of the equity interest in New Oriental China to another PRC person or entity designated by us at any time in our discretion.

These contractual arrangements are summarized in the following paragraphs.

**Equity Pledge Agreements.** Pursuant to the equity pledge agreements dated as of May 25, 2006 among New Oriental China, all of the eleven shareholders of New Oriental China, Beijing Hewstone and Beijing Decision, each shareholder of New Oriental China agreed to pledge his or its equity interests in New Oriental China to Beijing Hewstone and Beijing Decision to secure the performance of obligations of New Oriental China and its schools and subsidiaries under the existing service agreements and any such agreements to be entered into in the future. The shareholders of New Oriental China agreed not to transfer, sell, pledge, dispose of or otherwise create any encumbrance on their equity interests in New Oriental China without the prior written consent of Beijing Decision and Beijing Hewstone. All parties to the equity pledge agreement have agreed that the equity pledge agreement is binding upon New Oriental China's shareholders and their successors.

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In January 2012, the ten former shareholders of New Oriental China completed the transfer of all of their equity interests in New Oriental China to Century Friendship, a PRC domestic enterprise controlled by Mr. Michael Minhong Yu, our founder, chairman and chief executive officer, without consideration. Prior to the transfer, Century Friendship had held 53% of the equity interests in the New Oriental China while the ten former shareholders of New Oriental China held the remaining equity interests. The purpose of the transfers was to further strengthen our corporate structure by simplifying the shareholding structure of New Oriental China.

Pursuant to the five new equity pledge agreements dated April 23, 2012 among New Oriental China, Century Friendship and five of our wholly owned subsidiaries in China, namely Beijing Hewstone, Beijing Decision, Shanghai Smart Words, Beijing Pioneer and Beijing Smart Wood, Century Friendship agreed to pledge its equity interests in New Oriental China to these five subsidiaries to secure New Oriental China's and its schools and subsidiaries' performance of their obligations under the relevant principal agreements, including certain new enrollment system development service agreements, other operating service agreements, sale of educational software agreements and trademark license agreements, and Century Friendship has agreed not to transfer, sell, pledge, dispose of or otherwise create any encumbrance on its equity interests in New Oriental China without the prior written consents of our wholly owned subsidiaries in China. The equity pledge agreements are agreements which collateralize the security interest. The equity pledges of Century Friendship under these equity pledge agreements have been registered with the Haidian District, Beijing branch of the SAIC. The terms of the April 2012 equity pledge agreements are substantially the same as the 2006 agreements.

**Exclusive Option Agreement.** Exclusive option agreements were entered into by us and New Oriental China and the shareholders of New Oriental China on various dates, and amended on May 25, 2006. After the ten former shareholders of New Oriental China completed the transfer of all of their equity interests in New Oriental China to Century Friendship in early 2012, Century Friendship, as the sole shareholder of New Oriental China, executed a new option agreement with Shanghai Smart Words, which is one of our wholly owned subsidiaries in China, and New Oriental China on April 23, 2012, replacing previous exclusive option agreements. Pursuant to the current option agreement, Century Friendship is obligated to sell to Shanghai Smart Words, and Shanghai Smart Words has an exclusive, irrevocable and unconditional right to purchase from Century Friendship, in its sole discretion, part or of all of Century Friendship's equity interests in New Oriental China when and to the extent that applicable PRC law permits it to own part or all of the equity interest in New Oriental China. In addition, Shanghai Smart Words has an exclusive option to require Century Friendship to transfer all or part of Century Friendship's equity interest in New Oriental China to another PRC person or entity designated by Shanghai Smart Words at any time in its discretion. The purchase price to be paid by Shanghai Smart Words will be the minimum amount of consideration permitted by applicable PRC law at the time when such share transfer occurs.

**Power of Attorney.** On December 3, 2012, Century Friendship, in the capacity of the sole shareholder of New Oriental China, executed a proxy agreement and power of attorney with Beijing Pioneer, which is one of our wholly owned subsidiaries in China, and New Oriental China, whereby Century Friendship irrevocably appoints and constitutes Beijing Pioneer as its attorney-in-fact to exercise on Century Friendship's behalf any and all rights that Century Friendship has in respect of its equity interests in New Oriental China. This proxy agreement and power of attorney became effective on December 3, 2012 and replaces the powers of attorney executed by Century Friendship on April 23, 2012. The proxy agreement and power of attorney will remain effective as long as New Oriental China exists. Century Friendship does not have the right to terminate the proxy agreement and power of attorney or revoke the appointment of the attorney-in-fact without the prior written consent of Beijing Pioneer.

**Service Agreements.** Five of our wholly owned subsidiaries in China have entered into a series of service agreements with New Oriental China and its schools and subsidiaries to enable them to receive substantially all of the economic benefits of New Oriental China and its schools and subsidiaries. In the fiscal years ended May 31, 2010, 2011 and 2012, the total amount of service fees that these five PRC subsidiaries received from New Oriental China and its schools and subsidiaries under all the service agreements was US\$59.4 million, US\$65.7 million and US\$118.6 million, respectively.

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There are four categories of service agreements, namely, new enrollment system development service agreements, other operating service agreements, sale of educational software agreements and trademark license agreements, each of which is summarized below.

*New Enrollment System Development Service Agreements.* Since 2005, Beijing Decision has entered into new enrollment system service agreements with certain schools of New Oriental China, under which Beijing Decision agreed to provide new enrollment system development and regular maintenance services to the schools of New Oriental China for a fee calculated based upon the number of enrollments. For the fiscal year ended May 31, 2012, there were 23 new enrollment system service agreements. These agreements may be renewed by both parties to the agreements. The service fees are equal to the applicable fee rate multiplied by the number of student enrollments. The fees under the agreements are subject to the periodic review by our group financial department and are typically reviewed and adjusted each year. If no adjustment is made, the most recent fee rate will apply. For the fiscal year ended May 31, 2012, the fee rate was up to RMB60 per new student enrollment.

*Other Operating Service Agreements.* Pursuant to the operating service agreements between certain of our wholly owned subsidiaries in China and certain schools or subsidiaries of New Oriental China, our wholly owned subsidiaries in China have agreed to provide certain operating services to the schools or subsidiaries of New Oriental China for fees which are calculated based on a percentage of the respective revenues of New Oriental China's schools and subsidiaries. For the fiscal year ended May 31, 2012, there were 95 such service agreements between our wholly owned subsidiaries in China and New Oriental China's schools and subsidiaries. Of these agreements, 79 agreements provide unlimited two-year or five-year automatic renewal terms and New Oriental China's schools and subsidiaries cannot terminate the agreements without the consent of our wholly owned subsidiaries in China. The remaining agreements may be renewed with mutual consent. The fees under these agreements were 2.0 to 6.0% of the monthly revenues of the applicable New Oriental China school or subsidiary for the fiscal year ended May 31, 2012. The fees under the agreements are subject to periodic review by our group financial department and typically are reviewed and adjusted each year. If no adjustment is made, the most recent fee rate will apply.

*Sale of Educational Software.* Beijing Hewstone, Beijing Pioneer, Beijing Smart Wood and Shanghai Smart Words sell various self-developed educational software to New Oriental China's schools and subsidiaries, which are in turn included as part of the course materials for students enrolled in relevant courses. For the fiscal year ended May 31, 2012, there were 142 such agreements between our wholly owned subsidiaries in China and New Oriental China's schools or subsidiaries. Except for four agreements that are silent on renewal, these agreements provide unlimited two-year automatic renewal terms and schools and subsidiaries of New Oriental China cannot terminate the agreements without the consent of our wholly owned subsidiaries in China. The price of the software is determined by our PRC subsidiaries Beijing Hewstone, Beijing Pioneer, Beijing Smart Wood and Shanghai Smart Words.

*Trademark License Agreements.* Pursuant to the trademark license agreement dated May 13, 2006 between us as the licensor and New Oriental China as the licensee, we have licensed our trademarks to New Oriental China for their use in China. We have also allowed New Oriental China to enter into a sub-license agreement with each school and subsidiary of New Oriental China pursuant to which each of these schools and subsidiaries may use our trademarks in China by paying certain licensing fees. New Oriental China is authorized to collect the licensing fees from each sub-licensee and handle other related matters. The license is valid from May 14, 2006 to December 31, 2050, subject to the renewal on the expiry of the trademark registration every ten years. Pursuant to the second trademark license agreement entered into between Shanghai Smart Words as the licensor and a subsidiary of New Oriental China as the licensee, dated as of December 20, 2010, Shanghai Smart Words has granted a license to a subsidiary of New Oriental China to use certain trademarks for a license fee that equals 5% of the licensee's monthly revenues. The initial term of this license is two years, and can be automatically renewed and the subsidiary of New Oriental China cannot terminate the agreement without the consent of our wholly owned subsidiary in China.

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In the opinion of Tian Yuan Law Firm, our PRC legal counsel:

the corporate structure of New Oriental China and its schools and subsidiaries and our wholly owned subsidiaries in China are in compliance with existing PRC laws and regulations; and

the contractual arrangements among our wholly owned subsidiaries in China, New Oriental China and its schools and subsidiaries and the shareholder of New Oriental China are valid, binding and enforceable under, and do not violate, PRC laws or regulations currently in effect.

We have been advised by our PRC legal counsel, however, that there are substantial uncertainties regarding the interpretation and application of current and future PRC laws and regulations. Accordingly, there can be no assurance that the PRC regulatory authorities will not in the future take a view that is contrary to the above opinion of our PRC legal counsel. We have been further advised by our PRC counsel that if the PRC government finds that the agreements that establish the structure for operating our education business in China do not comply with PRC regulatory restrictions on foreign investment in the education business, we could be subject to severe penalties. The imposition of any of these penalties could result in a material adverse effect on our ability to conduct our business. See Item 3. Key Information D. Risk Factors Risks Related to Our Corporate Structure If the PRC government finds that the agreements that establish the structure for operating our China business do not comply with applicable PRC laws and regulations, we could be subject to severe penalties and Item 3. Key Information D. Risk Factors Risks Related to Doing Business in China Uncertainties with respect to the PRC legal system could adversely affect us.

We are evaluating whether to make additional changes to the agreements with New Oriental China and its schools and subsidiaries to further strengthen our corporate structure. Century Friendship has informed us that it is willing to sign additional documents or amendments if and when we request it to do so in the best interests of our company.

### **D. Property, Plants and Equipment**

Our headquarters are located in Beijing, China, where we own approximately 14,000 square meters of office and classroom space. In addition, we lease or own an aggregate of approximately 1,050,000 square meters of space for our schools, learning centers and bookstores in various cities in China. We lease all of our facilities except for our Yangzhou school and part of the premises for our headquarters in Beijing and our schools in Xi'an, Tianjin, Kunming, Wuhan and Guangzhou.

## **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our consolidated financial statements and the related notes included elsewhere in this annual report on Form 20-F. This discussion may contain forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under Item 3. Key Information D. Risk Factors or in other parts of this annual report on Form 20-F.

### **A. Operating Results**

#### ***General Factors Affecting Our Results of Operations***

We have benefited significantly from favorable demographic trends, the overall economic growth and the demand for high-quality private education and English language training in China. The overall economic growth and the increase in the GDP per capita in China have led to a significant increase in spending on education in China. At the same time, China's integration into the global economy has continued, resulting in more career opportunities for Chinese citizens who are able to communicate effectively in English. We anticipate that the demand for private education and English language training in China will continue to increase as China's economy continues to grow and as disposable income of urban households continues to rise. However, any adverse changes in the economic conditions or regulatory environment in China may have a material adverse effect on the private education industry in China, which in turn may harm our business and results of operations.



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### ***Specific Factors Affecting Our Results of Operations***

While our business is influenced by factors affecting the private education industry in China generally and by conditions in each of the geographic markets we serve, we believe our business is more directly affected by company-specific factors such as the number of student enrollments, the amount of course fees and our operating costs and expenses. The number of student enrollments is in turn largely driven by the demand for our courses, the effectiveness of our marketing and brand promotion efforts, the locations of our schools and learning centers, our ability to maintain the consistency and quality of our teaching, and our ability to respond to competitive pressure, as well as seasonal factors. We determine course fees primarily based on demand for our courses, the targeted market for our courses, the subject of the course, the geographic location of the school, cost of services, and the course fees charged by our competitors for the same or similar courses.

Our future results of operations will depend significantly upon our ability to increase student enrollments at existing schools and learning centers and further expand our school network throughout China, as well as offer a greater variety of courses, including smaller-size classes. Our planned expansion may result in substantial demands on our management, operational, technological, financial and other resources. To manage and support our growth, we must improve our existing operational, administrative and technological systems and our financial and management controls, and recruit, train and retain additional qualified teachers and school management personnel as well as other administrative and sales and marketing personnel, particularly as we grow outside of our existing markets. We will continue to implement additional systems and measures and recruit qualified personnel in order to effectively manage and support our growth. If we cannot achieve these improvements, our financial condition and results of operations may be materially adversely affected.

Due to certain restrictions and qualification requirements under PRC law that apply to foreign investment in China's education industry, we conduct substantially all of our education business in China through contractual arrangements between five of our wholly owned subsidiaries in China, New Oriental China, and the schools and subsidiaries and shareholder of New Oriental China. New Oriental China's schools and subsidiaries hold the requisite licenses and permits necessary to conduct our educational services business in China and operate our schools and learning centers and have been directly conducting our education business and operating our schools and learning centers.

*Net Revenues.* In the fiscal years ended May 31, 2010, 2011 and 2012, we generated total net revenues of US\$386.3 million, US\$557.9 million and US\$771.7 million, respectively. Our revenues are net of PRC business taxes and related surcharges, as well as scholarships and refunds.

We currently derive revenues from the following sources:

educational programs and services, which accounted for 91.3%, 91.1% and 89.9% of our total net revenues in the fiscal years ended May 31, 2010, 2011 and 2012, respectively; and

books and others, which accounted for 8.7%, 8.9% and 10.1% of our total net revenues in the fiscal years ended May 31, 2010, 2011 and 2012, respectively.

*Educational Programs and Services.* Our educational programs and services consist of language training and test preparation courses, primary and secondary school education and online education. Revenues from language training courses and test preparation courses accounted for 87.3%, 87.0% and 86.0%, respectively, of our total net revenues in the fiscal years ended May 31, 2010, 2011 and 2012.

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We recognize revenues from course fees collected for enrollment in our language training and test preparation courses proportionally as we deliver the instruction over the period of the course. Course fees are generally paid in advance by students and are initially recorded as deferred revenues. Students are entitled to a short-term trial period which commences on the date the course begins. Tuition refunds are provided to students if they decide within the trial period that they no longer want to take the course. After the trial period, if a student withdraws from a class, usually no refunds will be provided and any collected but unearned portion of the fee is recognized at that time. We recognize revenues from school fees collected for enrollment in our primary and secondary schools ratably over the corresponding academic year. We sell pre-paid online education cards primarily to distributors, who in turn sell them to students. We recognize revenues from sales of pre-paid cards in proportion to the actual time that students spend on our online courses. Course fees and school fees collected and amounts received from sales of pre-paid cards are recorded as deferred revenues until they can be recognized as revenues upon their use or expiration. Upon expiration of a prepaid card, which is six months to one year from the date of the sale of the card, we recognize the remaining amount of deferred revenues as revenues.

The most significant factors that directly affect our revenues from educational programs and services are the number of student enrollments and the amount of course fees. We believe our students are attracted to us primarily because of our established brand and reputation in the private education sector, especially in the areas of English language training and overseas admissions and assessment test preparation, the quality of our instruction and the variety of our programs, services and products. For the past several years, our revenue growth has been driven primarily by increased enrollments in our English language training courses and test preparation courses and other programs and services. The number of student enrollments for our courses is affected by the demand for our courses, the effectiveness of our marketing and brand promotion, the demographic composition of the cities where we have schools and learning centers, our ability to respond to competitive pressure, as well as seasonal factors. To further penetrate the English language training markets for children and high-income individuals, we have offered and plan to continue offering an increasing number and a greater variety of smaller classes for children and adults, such as Pop Kids English classes for students in kindergarten through grade six with 1 to 25 students per class. In addition, we have expanded the scope of our test preparation course offerings to cover non-English subjects, including through our New Oriental U-Can (Non-English) all subjects training program for middle and high school students, and plan to further expand our course offerings in the future to capture a larger share of the huge after-school training market in China.

Our courses generally have the largest student enrollments in our first fiscal quarter, which runs from June 1 to August 31 of each year, primarily because many students enroll in our courses during the summer vacation to enhance their foreign language skills and/or prepare for admissions and assessment tests in subsequent school terms. In addition, we have generally experienced larger student enrollments in our third fiscal quarter, which runs from December 1 to February 28 of each year, primarily because many students enroll in our language training and other courses during the winter school holidays. We expect this seasonality in enrollment pattern to continue, especially for most of our language training courses for college and middle school students and test preparation courses.

We determine course fees primarily based on demand for our courses, the targeted market for our courses, the subject of the course, the geographic location of the school, cost of services, and the course fees charged by our competitors for the same or similar programs. Our test preparation courses are generally delivered in class settings ranging from 1 student to 500 students per class and our English language training courses are delivered in class settings generally ranging from 1 student to 300 students per class. We typically adjust course fees or school fees based on the market conditions of the city where the particular school is located, subject to the relevant local governmental authority's advance approval, if required. We expect to continue to derive a substantial majority of our revenues from educational programs and services.

A significant portion of our revenues has been derived from test preparation courses. The success of our test preparation courses depends on the continued use of admissions and assessment tests by educational institutions and governmental authorities both in China and abroad. If the use of admissions and assessment tests declines or falls out of favor with educational institutions, government authorities and other entities, the markets for our test preparation courses will shrink and our business may be materially and adversely affected.

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*Books and Others.* We distribute and sell books and other educational materials developed or licensed by us through our own distribution channels, which consist of our bookstores and websites, and also through third-party distributors. We normally provide books and other educational materials that are required for our courses and do not separately charge students for these items. We recognize revenues from sales of books and other educational materials when the products are sold to end customers. As we believe successful content development is important to the success of our business in China, we intend to continuously enhance the quality and breadth of our education content offerings and distribute more books and other educational materials through our own bookstores, as well as third-party distributors, including over 5,000 bookstores. Accordingly, we expect revenues from sales of books and other educational materials to continue to increase in the future.

We also provide consulting services to students regarding overseas studies and related processes, such as visa applications. We charge each student a fee based on the scope of consulting services requested by the student and recognize revenues when our consulting services are delivered. We expect that revenues from these consulting services will continue to constitute a small portion of our total revenues in the future.

*Operating Costs and Expenses.* Our operating costs and expenses consist of cost of revenues, selling and marketing expenses and general and administrative expenses. The following table sets forth the components of our operating costs and expenses, both in absolute amount and as a percentage of total net revenues for the periods indicated.

<i>(in thousands, except percentages)</i>	For the Year Ended					
	2010		2011		2012	
	US\$	%	US\$	%	US\$	%
Net revenues	386,307	100	557,872	100	771,718	100
Operating costs and expenses:						
Cost of revenues	(147,261)	(38.1)	(222,625)	(39.9)	(304,027)	(39.4)
Selling and marketing	(58,396)	(15.1)	(82,797)	(14.8)	(115,151)	(14.9)
General and administrative	(103,336)	(26.8)	(155,412)	(27.9)	(235,743)	(30.5)
Loss on disposal of subsidiaries			(1,537)	(0.3)		
Total operating costs and expenses	(308,993)	(80.0)	(462,371)	(82.9)	(654,921)	(84.8)

We rely on our teachers to deliver educational services. Our teachers consist of both full-time teachers and contract teachers. Full-time teachers deliver instruction and may also be involved in management, administration and other functions at our schools. Full-time teachers' compensation and benefits primarily consist of teaching fees based on hourly rates, performance-linked bonuses based on student evaluations, as well as base salary, annual bonus and standard employee benefits in connection with their services other than teaching. Compensation of our contract teachers is comprised primarily of teaching fees based on hourly rates and performance-linked bonuses based on student evaluations and other factors. To attract and retain high-quality teachers, we have granted equity incentives, including restricted shares and share options, to some of our teachers. We account for teaching fees and performance-linked bonuses paid to our teachers as cost of revenues as they are directly associated with the provision of educational services, and account for the other compensation and benefits to our teachers as general and administrative expenses.

*Cost of Revenues.* Cost of revenues for educational programs and services primarily consists of teaching fees and performance-linked bonuses paid to our teachers and rental payments for our schools and learning centers and, to a lesser degree, depreciation and amortization of property and equipment used in the provision of educational services, as well as costs of course materials. Cost of books and others primarily consist of printing costs of books and other materials, and licenses fees, royalties and other fees paid to content licensors, publishing companies and third-party distributors. We anticipate that our total cost of revenues will continue to increase as we continue to open new schools and learning centers and hire additional teachers.

*Selling and Marketing Expenses.* Our selling and marketing expenses primarily consist of expenses relating to advertising, seminars, marketing and promotional trips and other community activities for brand promotion purpose. We expect that our selling and marketing expenses will continue to increase as we further expand into new geographic locations and enhance our brand recognition.

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*General and Administrative Expenses.* Our general and administrative expenses primarily consist of compensation and benefits of administrative staff, compensation and benefits of full-time teachers excluding teaching fees and performance-linked bonuses and, to a lesser extent, costs to develop curriculum, costs of third-party professional services, rental and utilities payments relating to office and administrative functions, and depreciation and amortization of property and equipment used in our general and administrative activities. We expect that our general and administrative expenses will increase in the near term as we hire additional personnel and incur additional costs in connection with the expansion of our business.

*Share-based Compensation Expenses.* In January 2006, we adopted the 2006 Share Incentive Plan, under which we are authorized to, starting from 2006, issue up to 8,000,000 common shares pursuant to awards (including options) granted under the plan to our employees, directors and consultants in 2006, as well as additional shares in future periods. In the fiscal years ended May 31, 2006 and 2007, we granted options to purchase a total of 12,766,000 common shares, and in the fiscal year ended May 31, 2012, we granted options to purchase 3,060,000 common shares. Of those options, options to purchase 1,236,608 common shares had been forfeited as of May 31, 2012. During the past five fiscal years, we have granted a total of 5,043,316 non-vested equity shares, of which 862,792 shares had been forfeited as of May 31, 2012. We account for share-based compensation expenses in accordance with an authoritative accounting pronouncement, which requires share-based compensation expense to be determined based on the fair value of our common shares as of their grant date.

The following table sets forth the allocation of our share-based compensation expenses, both in absolute amount and as a percentage of total share-based compensation expenses, among our employees based on the nature of work which they were assigned to perform.

<i>(in thousands, except percentages)</i>	For the Year Ended					
	2010		2011		2012	
	US\$	%	US\$	%	US\$	%
<b>Allocation of Share-based Compensation Expenses:</b>						
Cost of revenues	657	4.1	900	6.0	216	0.9
Selling and marketing	117	0.7				
General and administrative	15,409	95.2	14,145	94.0	23,909	99.1

For options granted to our employees and directors, we record share-based compensation expenses based on the fair value of our common shares underlying options as of the date of option grant and amortize the expenses over the vesting periods of the options. For non-vested equity shares granted to employees and directors, we record share-based compensation expenses based on the quoted market price of our ADSs on the grant date and amortize the expenses over the vesting periods of the non-vested equity shares.

*Loss on disposal of subsidiaries.* In April 2011, we sold a 60% equity interest in Mingshitang and a 100% equity interest in Tomorrow Oriental, resulting in disposal losses of US\$1.5 million.

**Taxation***Cayman Islands*

We are incorporated in the Cayman Islands. Under the current law of the Cayman Islands, we are not subject to income or capital gains tax. In addition, dividend payments are not subject to withholding tax in the Cayman Islands.

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Other than our primary and secondary schools, our operating entities in China are subject to a 3% to 5% business tax on gross revenues generated from providing services and related surcharges, and a value-added tax at varying rates ranging from 4% to 17% on gross revenues from sales of books, educational software and other products. According to Circular No. 111 and Circular No. 71 issued by the Ministry of Finance and the State Administration of Taxation on November 11, 2011 and July 31, 2012, respectively, the new enrollment system development services and other operating services provided by Beijing Hewstone, Beijing Decision, Shanghai Smart Words, Beijing Smart Wood and Beijing Pioneer which were previously subject to business tax before the implementation of Circular No. 111 and Circular No. 71, have since become subject to value-added tax following the implementation of these two circulars. Following this change, the applicable tax rate for such services shall increase by 1%, from 5% up to 6%, while the tax payable amount of value-added tax relating to such services shall be the output tax amount in a tax period minus input tax amount in the same period. Circular No. 111 and Circular No. 71 and the relevant implementation measures and rules are relatively new and the interpretation and enforcement these circulars involve uncertainties; however, to date, the Pilot Practices in Shanghai and Beijing instituted under the two circulars have had no material adverse effect on the tax positions of our operating entities in China.

With regard to income tax, according to the Implementation Rules for the Law for Promoting Private Education (2004), private schools that do not require reasonable returns enjoy the same preferential tax treatment as public schools, while the preferential tax treatment policies applicable to private schools requiring reasonable returns shall be separately formulated by the relevant authorities under the State Council. As of May 31, 2012, 22 of our schools elected as schools not requiring reasonable returns, 24 of our schools elected as requiring reasonable returns and the remaining schools were not classified. The implementing rules of the EIT Law provide certain conditions under which not-for-profit entities may be exempted from enterprise income tax. According to such conditions, our schools may not be entitled to income tax exemption. To date, however, no separate specific regulations or policies have been promulgated by the relevant authorities in this regard and whether our schools can be entitled to any preferential income tax treatment remains unclear. In practice, tax treatments for private schools vary across different cities in China. For example, private schools in certain cities are subject to a 25% standard enterprise income tax starting from January 1, 2008, while in other cities, private schools are subject to a fixed amount of enterprise income tax each year as determined by the local tax authority in lieu of the 25% standard enterprise income tax or are not required to pay enterprise income tax. Among our schools in the four major cities from which we derived a significant portion of our revenues in the fiscal year ended May 31, 2012, three schools are subject to the standard 25% enterprise income tax rate and one school is exempted from the enterprise income tax. For more information on the income tax rates or tax exemptions applicable to our schools, please see Note 16 to our consolidated financial statements included in this annual report.

Under PRC laws and regulations in effect before January 1, 2008, three wholly owned subsidiaries of our company in China, Beijing Judgment, Beijing Hewstone and Beijing Decision, were certified high and new technology enterprises located in a high-tech zone in Beijing as their primary sources of revenues were educational software development and educational technology development and implementation. However, the implementation rules of the EIT Law promulgated by the State Council in December 2007 and other supplemental rules promulgated by the Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation in April 2008 and July 2008, respectively, have provided new criteria for such high and new technology enterprises and all enterprises which had been granted such status before the effectiveness of the EIT Law are required to be re-examined according to such new rules before they can continue to be entitled to such preferential tax treatments. In December 2008, two of our wholly owned subsidiaries in China, Beijing Hewstone and Beijing Decision, were recertified as high and new technology enterprise in Beijing. Both of them are entitled to a 15% tax rate as long as they continue to qualify as a high and new technology enterprise. The deferred tax balance of Beijing Decision and Beijing Hewstone is calculated at a rate of 15%, as we expect Beijing Decision and Beijing Hewstone to continue to be qualified as high and new technology enterprise. As Beijing Judgment did not seek recertification, it became subject to the standard enterprise income tax rate of 25% from 2008. Enterprises that qualify as a newly established software enterprise are exempt from enterprise income tax for two years beginning in the enterprise's first profitable year followed by a tax rate of 12.5% for the succeeding three years. Beijing Pioneer Technology Co., Ltd. and Shanghai Smart Words Software Technology Co., Ltd. qualified as newly established software enterprises and were exempt from income taxes from January 2010 through December 31, 2011, and from January 2011 through December 31, 2012, respectively, and a tax rate of 12.5% through December 31, 2014, and through December 31, 2015, respectively. New Oriental China's subsidiaries other than schools are either subject to the standard enterprise income tax rate, which has been 25% since the beginning of 2008, or enjoy various preferential income tax rates approved by local tax authorities.

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Preferential tax treatments granted to our schools by local governmental authorities are subject to review and may be adjusted or revoked at any time. In addition, if the government regulations or authorities were to phase out preferential tax benefits currently granted to high and new technology enterprises, New Oriental China and our wholly owned subsidiaries in China would be subject to the 25% uniform statutory tax rate. The discontinuation of any preferential tax treatments currently available to our schools, especially those schools in major cities, and to New Oriental China and our wholly owned subsidiaries, will cause our effective tax rate to increase, which could have a material adverse effect on our results of operations.

For additional information on PRC regulations on taxation, see Item 4. Information on the Company B. Business Overview Education Regulations on Taxation.

**Recent Acquisition**

In April 2012, our company signed an agreement with a third party to acquire a 100% equity interest in China Management Software Institute for US\$18.0 million. A deposit of US\$3.28 million has been paid. The acquisition closed in September 2012.

**Results of Operations**

The following table sets forth a summary of our consolidated results of operations for the periods indicated. This information should be read together with our consolidated financial statements and related notes included elsewhere in this annual report. The operating results in any period are not necessarily indicative of the results that may be expected for any future period.

<i>(in thousands of US\$)</i>	<b>For the Year Ended May 31,</b>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
Net revenues:			
Educational programs and services	352,857	508,439	693,712
Books and others	33,450	49,433	78,006
Total net revenues	386,307	557,872	771,718
Operating costs and expenses <sup>(1)</sup> :			
Cost of revenues	(147,261)	(222,625)	(304,027)
Selling and marketing	(58,396)	(82,797)	(115,151)
General and administrative	(103,336)	(155,412)	(235,743)
Loss on disposal of subsidiaries		(1,537)	
Total operating costs and expenses	(308,993)	(462,371)	(654,921)
Operating income	77,314	95,501	116,797
Other income (expense), net	6,222	14,274	26,663
Provision for income tax	(5,974)	(8,236)	(10,772)
Less: Net income attributable to the noncontrolling interests	227	235	
Net income attributable to New Oriental Education & Technology Group	77,789	101,774	132,688

(1) Share-based compensation expenses are included in our operating costs and expenses as follows:

<i>(in thousands of US\$)</i>	<b>For the Year Ended May 31,</b>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
Cost of revenues	657	900	216
Selling and marketing	117		
General and administrative	15,409	14,145	23,909



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***Fiscal Year Ended May 31, 2012 Compared to Fiscal Year Ended May 31, 2011***

*Net Revenues.* Our total net revenues increased by 38.3% from US\$557.9 million for the fiscal year ended May 31, 2011 to US\$771.7 million for the fiscal year ended May 31, 2012. This increase was due to the increased revenues from both educational programs and services as well as from books and others.

*Educational Programs and Services.* Net revenues from our educational programs and services increased by 36.4% from US\$508.4 million for the fiscal year ended May 31, 2011 to US\$693.7 million for the fiscal year ended May 31, 2012. This increase was primarily due to the growth in revenues from language training and test preparation courses from US\$485.6 million in the fiscal year ended May 31, 2011 to US\$663.5 million in the fiscal year ended May 31, 2012 and, to a lesser extent, an increase in average selling prices resulting from price increases and an increase in the number of students selecting more expensive, smaller class options. The increase in revenues from language training and test preparation courses was mainly attributable to the increase in the number of student enrollments from approximately 2.1 million in the fiscal year ended May 31, 2011 to approximately 2.4 million in the fiscal year ended May 31, 2012, and in particular, the increased number of student enrollments in test preparation courses for middle and high school students, language training courses for children and PRC test preparation courses. Our total number of schools and learning centers increased from 54 and 433, respectively, as of May 31, 2011, to 55 and 609, respectively, as of May 31, 2012.

*Books and Others.* Net revenues from sales of books and other educational materials and services increased by 57.8% from US\$49.4 million in the fiscal year ended May 31, 2011 to US\$78.0 million in the fiscal year ended May 31, 2012, primarily due to the increased volume of books that we sold in the fiscal year ended May 31, 2012, as we offered new titles and further expanded our content distribution channel.

*Operating Costs and Expenses.* Our total operating costs and expenses increased by 41.6% from US\$462.4 million in the fiscal year ended May 31, 2011 to US\$654.9 million in the fiscal year ended May 31, 2012. This increase resulted from increases in our cost of revenues, selling and marketing expenses and general and administrative expenses line items.

*Cost of Revenues.* Our cost of revenues increased by 36.6% from US\$222.6 million in the fiscal year ended May 31, 2011 to US\$304.0 million in the fiscal year ended May 31, 2012. This increase was primarily due to an increase in teaching fees and performance-linked bonuses paid to our teachers as we hired over 5,800 new teachers during the fiscal year ended May 31, 2012, as compared to the over 3,500 new teachers hired during the fiscal year ended May 31, 2011, and an increase in our rental payments as we had leased facilities for 55 schools and 609 learning centers as of May 31, 2012, as compared to 54 schools and 433 learning centers as of May 31, 2011.

*Selling and Marketing Expenses.* Our selling and marketing expenses increased by 39.1% from US\$82.8 million in the fiscal year ended May 31, 2011 to US\$115.2 million in the fiscal year ended May 31, 2012. This increase was primarily due to increased marketing and promotional expenses in connection with opening new learning centers and the addition of over 300 new sales and marketing personnel during the fiscal year ended May 31, 2012.

*General and Administrative Expenses.* Our general and administrative expenses increased by 51.7% from US\$155.4 million in the fiscal year ended May 31, 2011 to US\$235.7 million in the fiscal year ended May 31, 2012. This increase was primarily due to an increase of US\$56.0 million in personnel related expenses, primarily as a result of the addition of approximately 2,900 new general and administrative personnel during the fiscal year ended May 31, 2012. General and administrative expenses for the fiscal year ended May 31, 2012 included US\$23.9 million in share-based compensation expenses, an increase from US\$14.1 million in the fiscal year ended May 31, 2011.

*Other Income, Net.* Our other income, net which primarily includes interest income, increased by 86.8% from US\$14.3 million in the fiscal year ended May 31, 2011 to US\$26.7 million in the fiscal year ended May 31, 2012.

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*Provision for Income Tax.* Our income tax expense increased by 30.8% from US\$8.2 million in the fiscal year ended May 31, 2011 to US\$10.8 million in the fiscal year ended May 31, 2012. The increase was primarily due to increased taxable income for New Oriental China.

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*Net Income Attributable to New Oriental Education & Technology Group Inc.* As a result of the foregoing, net income attributable to New Oriental Education & Technology Group Inc. increased by 30.4% from US\$101.8 million for the fiscal year ended May 31, 2011 to US\$132.7 million for the fiscal year ended May 31, 2012.

### ***Fiscal Year Ended May 31, 2011 Compared to Fiscal Year Ended May 31, 2010***

*Net Revenues.* Our total net revenues increased by 44.4% from US\$386.3 million for the fiscal year ended May 31, 2010 to US\$557.9 million for the fiscal year ended May 31, 2011. This increase was due to the increased revenues from both educational programs and services as well as from books and others.

*Educational Programs and Services.* Net revenues from our educational programs and services increased by 44.1% from US\$352.9 million for the fiscal year ended May 31, 2010 to US\$508.4 million for the fiscal year ended May 31, 2011. This increase was primarily due to the growth in revenues from language training and test preparation courses from US\$337.2 million in the fiscal year ended May 31, 2010 to US\$485.6 million in the fiscal year ended May 31, 2011 and, to a lesser extent, the increase in average revenues per student in the fiscal year ended May 31, 2011 as more students took smaller-size classes with higher course fees. The increase in revenues from language training and test preparation courses was mainly attributable to the increase in the number of student enrollments from approximately 1,807,000 in the fiscal year ended May 31, 2010 to approximately 2,089,600 in the fiscal year ended May 31, 2011, and in particular, the increased number of student enrollments in our language training courses for children, test preparation courses for middle and high school students and overseas test preparation courses. Our total number of schools and learning centers increased from 48 and 319, respectively, as of May 31, 2010, to 54 and 433, respectively, as of May 31, 2011.

*Books and Others.* Net revenues from sales of books and other educational materials and services increased by 47.8% from US\$33.5 million in the fiscal year ended May 31, 2010 to US\$49.4 million in the fiscal year ended May 31, 2011, primarily due to the increased volume of books that we sold in the fiscal year ended May 31, 2011, as we offered new titles and further expanded our content distribution channel.

*Operating Costs and Expenses.* Our total operating costs and expenses increased by 49.6% from US\$309.0 million in the fiscal year ended May 31, 2010 to US\$462.4 million in the fiscal year ended May 31, 2011. This increase resulted from increases in all of our operating cost and expense line items.

*Cost of Revenues.* Our cost of revenues increased by 51.2% from US\$147.3 million in the fiscal year ended May 31, 2010 to US\$222.6 million in the fiscal year ended May 31, 2011. This increase was primarily due to an increase in teaching fees and performance-linked bonuses paid to our teachers as we hired over 3,500 new teachers during the fiscal year ended May 31, 2011, as compared to the over 2,900 new teachers hired during the fiscal year ended May 31, 2010, and an increase in our rental payments as we had leased facilities for 54 schools and 433 learning centers as of May 31, 2011, as compared to 48 schools and 319 learning centers as of May 31, 2010.

*Selling and Marketing Expenses.* Our selling and marketing expenses increased by 41.8% from US\$58.4 million in the fiscal year ended May 31, 2010 to US\$82.8 million in the fiscal year ended May 31, 2011. This increase was primarily due to increased marketing and promotional expenses in connection with opening new learning centers and the addition of over 600 new sales and marketing personnel during the fiscal year ended May 31, 2011.

*General and Administrative Expenses.* Our general and administrative expenses increased by 50.4% from US\$103.3 million in the fiscal year ended May 31, 2010 to US\$155.4 million in the fiscal year ended May 31, 2011. This increase was primarily due to an increase of \$30.5 million in human resources related expenses, primarily as a result of the addition of approximately 2,340 new employees in our management departments during the fiscal year ended May 31, 2011.

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*Loss on Disposal of Subsidiaries.* Loss on disposal of subsidiaries increased from nil in the fiscal year ended May 31, 2010 to US\$1.5 million in the fiscal year ended May 31, 2011 due to the disposal of Mingshitang and Tomorrow Oriental.

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*Other Income, Net.* Our other income, net which primarily includes interest income, increased by 129.4% from US\$6.2 million in the fiscal year ended May 31, 2010 to US\$14.3 million in the fiscal year ended May 31, 2011.

*Provision for Income Tax.* Our income tax expense increased by 37.9% from US\$6.0 million in the fiscal year ended May 31, 2010 to US\$8.2 million in the fiscal year ended May 31, 2011. The increase was primarily due to increased taxable income for New Oriental China.

*Net Income Attributable to New Oriental Education & Technology Group Inc.* As a result of the foregoing, net income attributable to New Oriental Education & Technology Group Inc. increased by 30.8% from US\$77.8 million for the fiscal year ended May 31, 2010 to US\$101.8 million for the fiscal year ended May 31, 2011.

## **Discussion of Segment Operations**

In our management's view, we operate through six operating segments: language training and test preparation, primary and secondary school education, online education, content development and distribution, post-secondary education and overseas study consulting services. Language training and test preparation and primary and secondary education have been identified as reportable segments. Online education, content development and distribution, post-secondary education and overseas study consulting services operating segments were aggregated as others because individually they do not exceed the 10% quantitative threshold.

Net revenues from our language training and test preparation courses accounted for 87.3%, 87.0% and 86.0%, respectively, of our total net revenues in the fiscal years ended May 31, 2010, 2011 and 2012. Net revenues from our primary and secondary school education accounted for 2.6%, 2.5% and 2.3%, respectively, of our total net revenues in the fiscal years ended May 31, 2010, 2011 and 2012. We recognize revenues from course fees collected for enrollment in our language training and test preparation courses proportionally as we deliver the instruction over the period of the course. We recognize revenues from school fees collected for enrollment in New Oriental China's primary and secondary schools ratably over the corresponding academic year.

Cost of revenues for our language training and test preparation courses primarily consists of teaching fees and performance-linked bonuses paid to our teachers, rental payments for our schools and learning centers and, to a lesser degree, depreciation and amortization of property and equipment used in the provision of educational services. Cost of revenues for our primary and secondary schools primarily consists of compensation and benefits to school teachers and depreciation and amortization of property and equipment used in the provision of educational services.

Selling and marketing expenses for each of our reportable segments primarily consist of marketing and promotion expenses and other costs related to our selling and marketing activities for the corresponding reportable segment.

General and administrative expenses for our language training and test preparation courses primarily consist of compensation and benefits of administrative staff of our language training and test preparation courses segment, compensation and benefits, rental and utilities payments relating to office and administrative functions of our language training and test preparation courses segment, depreciation and amortization of property and equipment used in the general and administrative activities of our language training and test preparation courses segment and, to a lesser extent, costs to develop our curriculum. General and administrative expenses for our primary and secondary school education segment primarily consist of compensation and benefits of administrative staff of our primary and secondary schools, depreciation and amortization of property and equipment used in the general and administrative activities of our primary and secondary schools and, to a lesser extent, costs to develop our curriculum.

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The following table lists our net revenues and operating costs and expenses by reportable segment for the periods indicated.

<i>(in thousands of US\$)</i>	For the Year Ended May 31,		
	2010	2011	2012
<b>Net revenues of reportable segments:</b>			
Language training and test preparation courses	337,209	485,563	663,504
Primary and secondary education	9,860	13,766	17,757
<b>Total net revenues of reportable segments</b>	<b>347,069</b>	<b>499,329</b>	<b>681,261</b>
<b>Total net revenues of our company</b>	<b>386,307</b>	<b>557,872</b>	<b>771,718</b>
<b>Operating costs and expenses of reportable segments:</b>			
<b>Cost of revenues:</b>			
Language training and test preparation courses	(127,069)	(191,375)	(256,132)
Primary and secondary education	(5,532)	(6,398)	(8,160)
<b>Selling and marketing:</b>			
Language training and test preparation courses	(42,985)	(62,320)	(78,646)
Primary and secondary education	(211)	(637)	(1,335)
<b>General and administrative:</b>			
Language training and test preparation courses	(61,992)	(104,391)	(158,655)
Primary and secondary education	(2,720)	(4,145)	(5,532)
<b>Total operating costs and expenses of reportable segments</b>	<b>(240,509)</b>	<b>(369,266)</b>	<b>(508,460)</b>
<b>Total operating costs and expenses of our company</b>	<b>(308,993)</b>	<b>(462,371)</b>	<b>(654,921)</b>

**Fiscal Year Ended May 31, 2012 Compared to Fiscal Year Ended May 31, 2011***Net Revenues of Reportable Segments*

*Language Training and Test Preparation Courses.* Net revenues from our language training and test preparation courses increased by 36.6% from US\$485.6 million for the fiscal year ended May 31, 2011 to US\$663.5 million for the fiscal year ended May 31, 2012, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2012 Compared to Fiscal Year Ended May 31, 2011 Net Revenues Educational Programs and Services.

*Primary and Secondary School Education.* Net revenues from our primary and secondary school education increased by 29.0% from US\$13.8 million for the fiscal year ended May 31, 2011 to US\$17.8 million for the fiscal year ended May 31, 2012, primarily due to an increase in the number of students as we offered additional classes.

*Operating Costs and Expenses of Reportable Segments**Cost of Revenues*

*Language Training and Test Preparation Courses.* Cost of revenues for our language training and test preparation courses increased by 33.8% from US\$191.4 million for the fiscal year ended May 31, 2011 to US\$256.1 million for the fiscal year ended May 31, 2012, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2012 Compared to Fiscal Year Ended May 31, 2011 Operating Costs and Expenses Cost of Revenues.

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*Primary and Secondary School Education.* Cost of revenues for our primary and secondary school education increased from US\$6.4 million for the fiscal year ended May 31, 2011 to US\$8.2 million for the fiscal year ended May 31, 2012, primarily due to an increase in teaching fees paid to our teachers.

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### *Selling and Marketing Expenses*

*Language Training and Test Preparation Courses.* Selling and marketing expenses for our language training and test preparation courses increased by 26.2% from US\$62.3 million for the fiscal year ended May 31, 2011 to US\$78.6 million for the fiscal year ended May 31, 2012, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2012 Compared to Fiscal Year Ended May 31, 2011 Operating Costs and Expenses Selling and Marketing Expenses.

*Primary and Secondary School Education.* Selling and marketing expenses for our primary and secondary school education increased by 109.6% from US\$0.6 million for the fiscal year ended May 31, 2011 to US\$1.3 million for the fiscal year ended May 31, 2012, primarily due to an increase in advertisement expenses.

### *General and Administrative Expenses*

*Language Training and Test Preparation Courses.* General and administrative expenses for our language training and test preparation courses increased by 52.0% from US\$104.4 million for the fiscal year ended May 31, 2011 to US\$158.7 million for the fiscal year ended May 31, 2012, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2012 Compared to Fiscal Year Ended May 31, 2011 Operating Costs and Expenses General and Administrative Expenses.

*Primary and Secondary School Education.* General and administrative expenses for our primary and secondary school education increased by 33.5% from US\$4.1 million for the fiscal year ended May 31, 2011 to US\$5.5 million for the fiscal year ended May 31, 2012, primarily due to an increase in salaries and welfare benefits for administrative staff.

### ***Fiscal Year Ended May 31, 2011 Compared to Fiscal Year Ended May 31, 2010***

### *Net Revenues of Reportable Segments*

*Language Training and Test Preparation Courses.* Net revenues from our language training and test preparation courses increased by 44.0% from US\$337.2 million for the fiscal year ended May 31, 2010 to US\$485.6 million for the fiscal year ended May 31, 2011, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2011 Compared to Fiscal Year Ended May 31, 2010 Net Revenues Educational Programs and Services.

*Primary and Secondary School Education.* Net revenues from our primary and secondary school education increased by 39.6% from US\$9.9 million for the fiscal year ended May 31, 2010 to US\$13.8 million for the fiscal year ended May 31, 2011, primarily due to an increase in the number of students as we offered additional classes.

### *Operating Costs and Expenses of Reportable Segments*

### *Cost of Revenues*

*Language Training and Test Preparation Courses.* Cost of revenues for our language training and test preparation courses increased by 50.6% from US\$127.1 million for the fiscal year ended May 31, 2010 to US\$191.4 million for the fiscal year ended May 31, 2011, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2011 Compared to Fiscal Year Ended May 31, 2010 Operating Costs and Expenses Cost of Revenues.

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*Primary and Secondary School Education.* Cost of revenues for our primary and secondary school education increased from US\$5.5 million for the fiscal year ended May 31, 2010 to US\$6.4 million for the fiscal year ended May 31, 2011, primarily due to an increase in teaching fees paid to our teachers.

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### *Selling and Marketing Expenses*

*Language Training and Test Preparation Courses.* Selling and marketing expenses for our language training and test preparation courses increased by 45.0% from US\$43.0 million for the fiscal year ended May 31, 2010 to US\$62.3 million for the fiscal year ended May 31, 2011, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2011 Compared to Fiscal Year Ended May 31, 2010 Operating Costs and Expenses Selling and Marketing Expenses.

*Primary and Secondary School Education.* Selling and marketing expenses for our primary and secondary school education increased by 201.5% from US\$0.2 million for the fiscal year ended May 31, 2010 to US\$0.6 million for the fiscal year ended May 31, 2011, primarily due to an increase in advertisement expenses.

### *General and Administrative Expenses*

*Language Training and Test Preparation Courses.* General and administrative expenses for our language training and test preparation courses increased by 68.4% from US\$62.0 million for the fiscal year ended May 31, 2010 to US\$104.4 million for the fiscal year ended May 31, 2011, primarily due to the factors discussed in Results of Operations Fiscal Year Ended May 31, 2011 Compared to Fiscal Year Ended May 31, 2010 Operating Costs and Expenses General and Administrative Expenses.

*Primary and Secondary School Education.* General and administrative expenses for our primary and secondary school education increased by 52.4% from US\$2.7 million for the fiscal year ended May 31, 2010 to US\$4.1 million for the fiscal year ended May 31, 2011, primarily due to an increase in salaries and welfare benefits for administrative staff.

### **Inflation**

According to the National Bureau of Statistics of China, the year-over-year percent changes in the consumer price index in China for May 2010, 2011 and 2012 were increases of 3.1%, 5.5% and 3.0%, respectively. Inflation has had some impact on our operations in recent years, in the form of higher salaries for our teachers and other staff and higher rental payments for certain of the properties we lease. Additionally, because a substantial portion of our assets consists of cash and cash equivalents and short-term investments in RMB, high inflation could significantly reduce the value and purchasing power of these assets. We are not able to hedge our exposure to higher inflation in China. We can provide no assurance that we will not continue to be affected in the future by higher rates of inflation in China.

### **Critical Accounting Policies**

We prepare our financial statements in accordance with U.S. GAAP, which requires us to make judgments, estimates and assumptions that affect the reported amounts of our assets and liabilities and the disclosure of our contingent assets and liabilities at the end of each fiscal period and the reported amounts of revenues and expenses during each fiscal period. We continually evaluate these judgments and estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and assumptions that we believe to be reasonable, which together form our basis for making judgments about matters that are not readily apparent from other sources. Since the use of estimates is an integral component of the financial reporting process, our actual results could differ from those estimates. Some of our accounting policies require a higher degree of judgment than others in their application.

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The selection of critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors that should be considered when reviewing our financial statements. We believe the following accounting policy involves the most significant judgments and estimates used in the preparation of our financial statements.

### ***Revenue recognition***

We recognize revenue when persuasive evidence that an arrangement exists, delivery of the product or service has occurred, the selling price is both fixed and determinable and collection is reasonably assured. The primary sources of our company's revenues are as follows:

#### ***Educational programs and services***

Educational programs and services consist of language training and test preparation courses, primary and secondary school education and college admission examination retaking training services. Tuition is generally paid in advance and is initially recorded as deferred revenue. Tuition revenue for educational programs and services is recognized proportionately as the educational services are delivered, and is reported net of scholarships, business taxes and related surcharges, and tuition refunds. Students are entitled to a short term course trial period which commences on the date the course begins. Tuition refunds are provided to students if they decide within the trial period that they no longer want to take the course. Tuition refunds have been insignificant in each of the past three fiscal years ended May 31, 2012. Generally speaking, if a student withdraws from a class after the trial period is over, no refunds will be provided and any collected but unearned portion of the fee is recognized at that time.

We also sell online-learning cards primarily to distributors at fixed prices after deducting a pre-determined fixed discount to the face value of the cards. Online-learning card sales represent prepaid service fees received from students for e-learning services. The prepaid service fee is recorded as deferred revenue upon receiving the upfront payment. Revenue is recognized upon actual usage of the cards by the students based on the number of minutes the students use the e-learning services, of which the actual usage is tracked by us on an individual basis. Upon the expiration of the online-learning card, which ranges from six months to one year from the date of sale of the card to the distributor, we will recognize the remaining unused minutes as revenue.

#### ***Books and others***

Our company sells educational books or other educational materials either through our own book stores or websites or through third party distributors. Revenue from sales made through our book stores is recognized upon sales to customers. Revenue through distributors is recognized once the products are sold to the end customers.

### ***Consolidation of Variable Interest Entity***

PRC laws and regulations currently require any foreign entity that invests in the education business in China to be an educational institution with relevant experience in providing educational services outside China. Our offshore holding companies are not educational institutions and do not provide educational services outside China. To comply with the PRC laws and regulations, we conduct substantially all of our business through New Oriental China, our variable interest entity, and its schools and subsidiaries. We have, through five of our wholly owned subsidiaries in the PRC, entered into contractual arrangements with New Oriental China, its schools and subsidiaries and its shareholder such that New Oriental China and its schools and subsidiaries are considered variable interest entities for which we are considered their primary beneficiary. We believe we have substantive kick-out rights per the terms of the option agreement, which gives us the power to control the shareholder of New Oriental China. More specifically, we believe that the terms of the exclusive option agreement are currently exercisable and legally enforceable under PRC laws and regulations. We also believe that the minimum amount of consideration permitted by the applicable PRC law to exercise the option does not represent a financial barrier or disincentive for us to exercise our rights under the exclusive option agreement. A simple majority vote of our board of directors is required to pass a resolution to exercise our rights under the exclusive option agreement, for which consent of the shareholder of New Oriental China is not required. Therefore, we believe this gives us the power to direct the activities that most significantly impact New Oriental China's economic performance. We believe that our ability to exercise effective control, together with the service agreements and the equity pledge agreements, give us the rights to receive substantially all of the economic benefits from New Oriental China and its schools and subsidiaries in consideration for the services provided by our wholly owned subsidiaries in China. Accordingly, as the primary beneficiary of New Oriental China and its schools and subsidiaries and in accordance with U.S. GAAP, we consolidate their financial results and assets and liabilities in our consolidated financial statements.



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As advised by Tian Yuan Law Firm, our PRC counsel, our corporate structure in China complies with all existing PRC laws and regulations. However, our PRC legal counsel has also advised us that as there are substantial uncertainties regarding the interpretation and application of PRC laws and regulations, and we cannot assure you that the PRC government would agree that our corporate structure or any of the above contractual arrangements comply with current or future PRC laws or regulations. PRC laws and regulations governing the validity of these contractual arrangements are uncertain and the relevant government authorities may have broad discretion in interpreting these laws and regulations. See Item 3. Risk factors D. Risks Related to Our Corporate Structure If the PRC government finds that the agreements that establish the structure for operating our China business do not comply with applicable PRC laws and regulations, we could be subject to severe penalties and Risks Related to Our Corporate Structure We rely on contractual arrangements for our operations in China, which may not be as effective in providing operational control as direct ownership , Risks Related to Our Corporate Structure Our ability to enforce the equity pledge agreements between us and New Oriental China s shareholder may be subject to limitations based on PRC laws and regulations and Risks Related to Our Corporate Structure The controlling shareholder of Century Friendship, which is the sole shareholder of New Oriental China, may have potential conflicts of interest with us, and if any such conflicts of interest are not resolved in our favor, our business may be materially and adversely affected.

We are a holding company with no material operations of our own. We conduct substantially all of our education business in China through contractual arrangements with New Oriental China, our variable interest entity, and its schools and subsidiaries and shareholder. See Item 4. Information on the Company C. Organizational Structure Contractual Arrangements with New Oriental China, its Schools and Subsidiaries and its Shareholder for a summary of these contractual arrangements. In the fiscal years ended May 31, 2010, 2011 and 2012, New Oriental China and its schools and subsidiaries contributed in aggregate 98.9%, 97.2% and 97.2%, respectively, of our total net revenues. Our operations not conducted through contractual arrangements with New Oriental China primarily consist of our kindergarten programs and the leasing of our commercial property. As of the fiscal years ended May 31, 2011 and 2012, New Oriental China and its schools and subsidiaries accounted for an aggregate of 62.2% and 60.4%, respectively, of our total assets, and 96.2% and 85.2%, respectively, of our total liabilities. The assets not associated with New Oriental China primarily consist of cash, investments and commercial property.

### ***Business Combinations***

Business combinations are recorded using the acquisition method of accounting. The purchase price of the acquisition is allocated to the tangible assets, liabilities, identifiable intangible assets acquired and non-controlling interest, if any, based on their estimated fair values as of the acquisition date. The excess of the purchase price over those fair values is recorded as goodwill. Acquisition-related expenses and restructuring costs are expensed as incurred.

Where the consideration in an acquisition includes contingent consideration and the payment of which depends on the achievement of certain specified conditions post-acquisition, the contingent consideration is recognized and measured at its fair value at the acquisition date and if recorded as a liability, it is subsequently carried at fair value with changes in fair value reflected in earnings. For contingent consideration related to acquisitions made prior to June 1, 2009, contingent consideration was not recorded until the contingency was resolved.

**Table of Contents*****Share-based Compensation***

Share-based payments to employees and directors are measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense net of a forfeiture rate on a straight-line basis over the requisite service period, with a corresponding addition to paid-in capital. We use the binomial option pricing model to measure the fair value of options granted and the quoted market price of our company's equity shares to measure the fair value of non-vested equity shares granted to employees at each measurement date. The amount of compensation expense recognized at any date is at least equal to the portion of the fair value of the awards that are vested as of that date. The estimate of forfeitures is based on historical turnover rate and will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will impact the amount of share-based compensation expense to be recognized in future periods.

Summarized below are the key terms and estimates for the valuation of options granted on January 17, 2012:

Risk-free interest rate of return	1.83%
Volatility	56%
Dividend yield	0.0%
Fair value of the underlying common shares	US\$22.36
Exercise Price	US\$22.00
Exercisable Date	1/6 of options vests every six months through December 31, 2014
Expiry Date	January 17, 2017
Life of Option (years)	5
Exercise Multiple	2.8
Turnover Rate	5.57%
Number of Nodes	200

*Risk-Free Interest Rate.* Risk-free interest rate was estimated based on the yield to maturity of US\$ denominated China international government bonds with a maturity period commensurate with the contractual life of the share options.

*Volatility.* The volatility of the underlying common shares during the life of the share options was estimated based on the Company's historical stock price volatility over a period commensurate to the expected term of the share options.

*Dividend Yield.* The dividend yield was estimated based on our company's expected dividend distributions during a period commensurate with the contractual life of the share options.

*Exercise price.* The exercise price of the share options was determined by our board of directors, which is generally the quoted market price of our company's common shares on the date of grant.

*Fair value of underlying common shares:* The fair value of the common shares underlying the share options is the quoted market price of our company's common shares on the date of grant.

*Life of option:* The life of the share option is based on the stated contractual life of the share options.

*Number of nodes:* This number divides the life to expiration into a number of equal time slots. It determines the number of level in the binomial tree.

*Exercise multiple:* A ratio of the stock price to the contractual strike price at which point it is assumed that the share option will be exercised prior to expiration.

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*Forfeiture rate:* Our company's estimate based on historical employee turnover.

### ***Income Taxes***

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. Significant judgment is required in determining our provision for income taxes and income tax assets and liabilities, including evaluating uncertainties in the application of accounting principles and complex tax laws.

We account for income taxes using the asset and liability approach. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect for the period in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in the consolidated statements of operations in the period of change. Deferred tax assets are reduced by a valuation allowance when it is considered more likely than not that some portion or all of the deferred tax assets will not be realized.

We account for uncertain tax positions by reporting a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. Tax benefits are recognized from uncertain tax positions when we believe that it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. We recognize interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

Uncertainties exist with respect to how the PRC's Enterprise Income Tax Law applies to our overall operations, and more specifically, with regard to our tax residency status. The Enterprise Income Tax Law includes a provision specifying that legal entities organized outside of the PRC will be considered residents for PRC income tax purposes if their place of effective management or control is within the PRC. The implementation rules to the Enterprise Income Tax Law provide that non-resident legal entities will be considered PRC residents if substantial and overall management and control over the manufacturing and business operations, personnel, accounting, properties, among others, occur within the PRC. Despite the present uncertainties resulting from the limited PRC tax guidance on the issue, we do not believe that our legal entities organized outside of the PRC should be treated as residents for the Enterprise Income Tax Law's purposes. If one or more of our legal entities organized outside of the PRC were characterized as PRC tax residents, the impact would adversely affect our results of operation. See

Item 3. Key Information D. Risk Factors Risks Related to Doing Business in China We may be treated as a resident enterprise for PRC tax purposes under the EIT Law, which may subject us to PRC income tax for our global income and withholding for any dividends we pay to our non-PRC shareholders and ADS holders.

### ***Impairment of goodwill and indefinite-lived intangible assets***

We review the carrying value of intangible assets not subject to amortization, including goodwill, to determine whether impairment may exist, whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable at least annually.

Specifically, goodwill impairment is determined using a two-step process. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. Estimating fair value is performed by utilizing various valuation techniques, with the primary technique being a discounted cash flow.

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The impairment test for other intangible assets not subject to amortization consists of a comparison of the estimated fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its estimated fair value, an impairment loss is recognized in an amount equal to that excess.

### **Recently Issued Accounting Pronouncements**

#### *Recently adopted accounting pronouncements*

In December 2010, the FASB issued an authoritative pronouncement on disclosure of supplementary pro forma information for business combinations. The objective of this guidance is to address diversity in practice regarding the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The amendments in this update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments affect any public entity as defined by Topic 805 Business Combinations that enters into business combinations that are material on an individual or aggregate basis. We applied the disclosure requirements of this pronouncement for business combinations consummated in periods beginning June 1, 2011, which did not have a significant impact on our consolidated financial condition or results from operations.

#### *Recently issued accounting pronouncements not yet adopted*

In May 2011, the FASB issued an authoritative pronouncement on fair value measurement. The guidance is the result of joint efforts by the FASB and IASB to develop a single, converged fair value framework. The guidance is largely consistent with existing fair value measurement principles in U.S. GAAP. The guidance expands the existing disclosure requirements for fair value measurements and makes other amendments, mainly including

Highest-and-best-use and valuation-premise concepts for nonfinancial assets the guidance indicates that the highest-and-best-use and valuation-premise concepts only apply to measuring the fair value of nonfinancial assets.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk the guidance permits an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk when several criteria are met. When the criteria are met, an entity can measure the fair value of the net risk position.

Premiums or discounts in fair value measure the guidance states that premiums or discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement.

Fair value of an instrument classified in a reporting entity's shareholders' equity the guidance prescribes a model for measuring the fair value of an instrument classified in shareholders' equity; this model is consistent with the guidance on measuring the fair value of liabilities.

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Disclosures about fair value measurements the guidance expands disclosure requirements, particularly for Level 3 inputs. Required disclosures include:

For fair value measurements categorized in Level 3 of the fair value hierarchy: (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation process in place (e.g., how the entity decides its valuation policies and procedures, as well as changes in its analyses of fair value measurements, from period to period), and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.

The level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed.

The guidance is to be applied prospectively and effective for interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. We do not expect the adoption of this pronouncement to have a significant impact on our consolidated financial condition or results of operations.

In June 2011, the FASB issued an authoritative pronouncement to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. These amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The guidance should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. In December 2011, the FASB issued an authoritative pronouncement related to deferral of the effective date for amendments to the presentation of reclassifications of items out of accumulated other comprehensive income. This guidance allows the FASB to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. We do not expect the adoption of these pronouncements to have a significant impact on our consolidated financial condition or results from operations.

In September 2011, the FASB issued an authoritative pronouncement related to testing goodwill for impairment. The guidance is intended to simplify how entities, both public and nonpublic, test goodwill for impairment. The pronouncement permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We do not expect the adoption of this pronouncement to have a significant impact on our consolidated financial condition or results from operations.

In December 2011, the FASB issued an authoritative pronouncement related to Disclosures about Offsetting Assets and Liabilities. The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. We do not expect the adoption of this pronouncement to have a significant impact on our consolidated financial condition or results from operations.

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In July 2012, the FASB issued an authoritative pronouncement related to testing indefinite-lived intangible assets, other than goodwill, for impairment. Under the pronouncement, entities testing indefinite-lived intangible assets for impairment would have the option of performing a qualitative assessment before calculating the fair value of the asset. If an entity determines, on the basis of qualitative factors, that the indefinite-lived intangible asset is not more likely than not impaired, a quantitative fair value calculation would not be needed. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. We do not expect the adoption of this pronouncement to have a significant impact on our consolidated financial condition or results from operations.

**B. Liquidity and Capital Resources**

Our principal source of liquidity has been cash generated from operating activities. As of May 31, 2012, we had US\$428.3 million in cash and cash equivalents. Our cash and cash equivalents consist of cash on hand and liquid investments that are unrestricted as to withdrawal or use, have maturities of three months or less and are placed with banks and other financial institutions. Although we consolidate the results of New Oriental China and its schools and subsidiaries, we do not have direct access to the cash and cash equivalents or future earnings of New Oriental China. However, a portion of the cash balances of New Oriental China and its schools and subsidiaries are paid to our wholly owned subsidiaries in China pursuant to contractual arrangements for the services our subsidiaries provide to New Oriental China and its schools and subsidiaries.

We expect to require cash to fund our ongoing business needs, particularly the rent and other costs and expenses relating to opening new schools and learning centers. We opened 177 new learning centers in fiscal year 2012, and plan to open additional schools and learning centers in the future depending on local market conditions of the new markets we plan to enter. We expect to incur capital expenditures ranging from approximately RMB1.0 million (US\$0.1 million) to RMB4.0 million (US\$0.6 million) per new school depending primarily on the size and geographic location of the school. Other cash needs include acquisitions of businesses and properties that complement our operations when suitable opportunities arise. We have not encountered any difficulties in meeting our cash obligations to date. We believe that our current cash and cash equivalents and anticipated cash flow from operations will be sufficient to meet our anticipated cash needs for the foreseeable future.

The following table sets forth a summary of our cash flows for the periods indicated:

<i>(in thousands of US\$)</i>	<b>For the Year Ended May 31,</b>		
	<b>2010</b>	<b>2011</b>	<b>2012</b>
Net cash provided by operating activities	141,890	215,819	249,304
Net cash used in investing activities	(97,925)	(198,152)	(143,701)
Net cash used in / (provided by) financing activities	(17,550)	6,432	945
Effect of foreign exchange rate changes	(83)	12,057	4,453
Net change in cash and cash equivalents	26,332	36,156	111,001
Cash and cash equivalents at beginning of period	254,772	281,104	317,260
Cash and cash equivalents at end of the period	281,104	317,260	428,261

***Operating Activities***

Net cash provided by operating activities amounted to US\$249.3 million in the fiscal year ended May 31, 2012. Our net cash provided by operating activities in the fiscal year ended May 31, 2012 reflected net income of US\$132.7 million, as adjusted by the reconciliation of certain non-cash items, including US\$26.2 million in depreciation and amortization and US\$24.1 million in share-based compensation expense. Additional factors affecting operating cash flow included an increase in deferred revenues in the amount of US\$71.8 million due to the increased amount of course fees received during the period, an increase in the accrued expenses and other current liabilities account of US\$28.4 million, primarily due to an increase in accrued employee salary expenses and welfare benefits, and a decrease in prepaid expenses and other current assets of US\$23.7 million.

Net cash provided by operating activities amounted to US\$215.8 million in the fiscal year ended May 31, 2011. Our net cash provided by operating activities in the fiscal year ended May 31, 2011 reflected net income of US\$101.5 million, as adjusted by the reconciliation of certain non-cash items, including US\$16.4 million in depreciation and amortization and US\$15.0 million in share-based compensation expense. Additional factors affecting operating cash flow included an increase in deferred revenues in the amount of US\$76.6 million due to the increased

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amount of course fees received during the period and an increase in the accrued expenses and other current liabilities account of US\$19.7 million.

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Net cash provided by operating activities amounted to US\$141.9 million in the fiscal year ended May 31, 2010. Our net cash provided by operating activities in the fiscal year ended May 31, 2010 reflected net income of US\$77.6 million, as adjusted by the reconciliation of certain non-cash items, including US\$12.2 million in depreciation and amortization and US\$16.2 million in share-based compensation expense. Additional factors affecting operating cash flow included an increase in deferred revenues in the amount of US\$32.3 million due to the increased amount of course fees received during the period and an increase in the accrued expenses and other current liabilities account of US\$13.9 million.

### ***Investing Activities***

We lease all of our facilities except for part of the premises for the Beijing, Xi'an, Tianjin, Kunming, Wuhan, Guangzhou and Yangzhou schools, which premises we own. Our cash used in investing activities is primarily related to our purchase of land use rights and the premises for the Beijing, Xi'an, Tianjin, Kunming, Wuhan, Guangzhou and Yangzhou schools and equipment used in our operations and our investment in term deposits and short term investments. Net cash used in investing activities amounted to US\$143.7 million in the fiscal year ended May 31, 2012, compared to US\$198.2 million in the fiscal year ended May 31, 2011 and US\$97.9 million in the fiscal year ended May 31, 2010.

Net cash used in investing activities in the fiscal year ended May 31, 2012 was primarily attributable to net purchase of short term investments in the amount of US\$175.1 million and the purchase of property and equipment in the amount of US\$71.7 million in connection with the expansion of our school network, offset in part by bank deposits maturing over three months in the amount of US\$104.8 million.

Net cash used in investing activities in the fiscal year ended May 31, 2011 was primarily attributable to short term investments in the amount of US\$139.9 million and the purchase of property and equipment in the amount of US\$49.1 million in connection with the expansion of our school network.

Net cash used in investing activities in the fiscal year ended May 31, 2010 was primarily attributable to the following factors: the term deposit in the amount of US\$78.1 million and the purchase of property and equipment in the amount of US\$19.6 million in connection with the expansion of our school network.

### ***Financing Activities***

Net cash provided by financing activities amounted to US\$0.9 million in the fiscal year ended May 31, 2012, compared to net cash provided by financing activities of US\$6.4 million in the fiscal year ended May 31, 2011 and net cash used in financing activities of US\$17.6 million in the fiscal year ended May 31, 2010.

Net cash provided by financing activities in the fiscal year ended May 31, 2012 was primarily attributable to proceeds from the issuance of common shares upon exercise of share options in the amount of US\$0.9 million.

Net cash provided by financing activities in the fiscal year ended May 31, 2011 was primarily attributable to proceeds from the issuance of common shares upon exercise of share options in the amount of US\$6.4 million.

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Net cash used in financing activities in the fiscal year ended May 31, 2010 was primarily attributable to the repurchases of ADSs representing 1,625,320 common shares.

### **Holding Company Structure**

#### ***Overview***

We are a holding company with no material operations of our own. We conduct substantially all of our education business in China through contractual arrangements with New Oriental China, our variable interest entity, and its schools and subsidiaries and shareholder. See Item 4. Information on the Company C. Organizational Structure Contractual Arrangements with New Oriental China, its Schools and Subsidiaries and its Shareholder for a summary of these contractual arrangements. In the fiscal years ended May 31, 2010, 2011 and 2012, New Oriental China and its schools and subsidiaries contributed in aggregate 98.9%, 97.2% and 97.2%, respectively, of our total net revenues. Our operations not conducted through contractual arrangements with New Oriental China primarily consist of our kindergarten programs and the leasing of our commercial property. As of May 31, 2011 and 2012, New Oriental China and its schools and subsidiaries accounted for an aggregate of 62.2% and 60.4%, respectively, of our total assets, and 96.2% and 85.2%, respectively, of our total liabilities. The assets not associated with New Oriental China primarily consist of cash and cash equivalents, term deposits and short-term investments. As of May 31, 2011 and 2012, \$89.3 million and \$84.3 million, respectively, of these assets were denominated in U.S. dollars, and \$174.2 million and \$267.3 million, respectively, of these assets were denominated in RMB.

As a holding company, our ability to pay dividends and other cash distributions to our shareholders depends in part upon dividends and other distributions paid to us by our PRC subsidiaries. The amount of dividends paid by our PRC subsidiaries to us primarily depends on the service fees paid to five of our PRC subsidiaries from New Oriental China and its schools and subsidiaries, and, to a lesser degree, our PRC subsidiaries retained earnings. As of May 31, 2011 and 2012, the total amount of service fees payable to these five PRC subsidiaries from New Oriental China and its schools and subsidiaries under the service agreements was US\$59.5 million and US\$64.8 million, respectively. Conducting our operations through contractual arrangements with New Oriental China entails a risk that we may lose the power to direct the activities that most significantly affect the economic performance of New Oriental China and its schools and subsidiaries, which may result in our being unable to consolidate their financial results with our results and may impair our access to their cash flow from operations and thereby reduce our liquidity. See Item 3. Risk Factors D. Risks Related to Our Corporate Structure for more information, including the risk factors titled If the PRC government finds that the agreements that establish the structure for operating our China business do not comply with applicable PRC laws and regulations, we could be subject to severe penalties and We rely on contractual arrangements for our operations in China, which may not be as effective in providing operational control as direct ownership.

#### ***Dividend Distributions***

Under PRC law, each of our PRC subsidiaries, New Oriental China and its subsidiaries which is not a school is required to set aside at least 10% of its after-tax profits each year, if any, to fund a statutory surplus reserve until such reserve reaches 50% of its registered capital and to further set aside a portion of its after-tax profit to fund the reserve fund at the discretion of our board of directors. Although the statutory reserves can be used, among other ways, to increase the registered capital and eliminate future losses in excess of retained earnings of the respective companies, the reserve funds are not distributable as cash dividends except in the event of liquidation. In addition, at the end of each fiscal year, each of our schools in China is required to allocate a certain amount out of its annual net income, if any, to its development fund for the construction or maintenance of the school or procurement or upgrade of educational equipment. For our schools which have elected to require reasonable returns, this amount shall be no less than 25% of the annual net income of the school, and for our schools which have elected not to require reasonable returns, this amount shall be equivalent to no less than 25% of the annual increase in the net assets of the school, if any. Our PRC subsidiaries are permitted to pay dividends to us only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations.

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Pursuant to contractual arrangements that Beijing Hewstone, Beijing Decision, Beijing Pioneer, Shanghai Smart Words and Beijing Smart Wood have with New Oriental China, the earnings and cash of New Oriental China and its schools and subsidiaries are used to pay service fees in RMB to these five of our PRC subsidiaries in the manner and amount set forth in these agreements. After paying the applicable withholding taxes and making appropriations for its statutory reserve requirement, the remaining net profits of our PRC subsidiaries would be available for distribution to three Hong Kong-incorporated intermediate holding companies wholly owned by our company, and from these three Hong Kong-incorporated intermediate holding companies to our company. See Item 4. Information on the Company C. Organizational Structure for a diagram of our corporate structure. As of May 31, 2012, the net assets of our PRC subsidiaries and New Oriental China and its schools and subsidiaries which were restricted due to statutory reserve requirements and other applicable laws and regulations, and thus not available for distribution, was in aggregate US\$177.2 million, and the net assets of our PRC subsidiaries and New Oriental China and its schools and subsidiaries which were unrestricted and thus available for distribution was in aggregate US\$494.1 million. We do not believe that these restrictions on the distribution of our net assets will have a significant impact on our ability to timely meet our financial obligations in the future. See Item 3. Key Information D. Risk Factors Risks Related to Doing Business in China We may rely on dividends and other distributions on equity paid by our wholly owned subsidiaries to fund any cash and financing requirements we may have, and any limitation on the ability of our subsidiaries and New Oriental China and its schools and subsidiaries to make payments to us could have a material adverse effect on our ability to conduct our business for more information.

Furthermore, cash transfers from our PRC subsidiaries to our Hong Kong-incorporated intermediate holding companies are subject to PRC government control of currency conversion. Restrictions on the availability of foreign currency may affect the ability of our PRC subsidiaries and New Oriental China and its schools and subsidiaries to remit sufficient foreign currency to pay dividends or other payments to us, or otherwise satisfy their foreign currency denominated obligations. See Item 3. Key Information D. Risk Factors Risks Related to Doing Business in China Governmental control of currency conversion may affect the value of your investment.

## **Capital Expenditures**

The rapid expansion of our network of schools, learning centers and bookstores has required significant investment. Our capital expenditures were US\$19.6 million, US\$49.1 million and US\$71.7 million in the fiscal years ended May 31, 2010, 2011 and 2012, respectively. Our capital expenditures are incurred primarily in connection with facility acquisitions, leasehold improvements and investments in equipment, technology and operating systems. Our capital expenditures for the fiscal year ended May 31, 2012 were primarily due to our investments in facilities, equipment, technology and operating systems to meet the expected growth of our operations, as well as the purchase of property in Wuhan and Guangzhou in the aggregate amount of US\$11.9 million. We intend to cost-efficiently allocate our capital resources by leasing most of our new facilities in the foreseeable future. We may also make acquisitions of businesses and properties that complement our operations when suitable opportunities arise. We believe that we will be able to fund our capital needs in the foreseeable future through cash generated from our operating activities.

## **C. Research and Development, Patents and Licenses, etc.**

### **Technology**

Our technology platform is designed to provide systems that help distinguish us in the marketplace, operate cost-effectively and accommodate future growth. We currently use a combination of commercially available and custom developed software and hardware systems. Our technology platform is a combination of e-learning platforms, alumni platforms, content management systems, exam platforms, e-business promotion platforms and bookstore platforms, live Internet classrooms, as well as licensed speech recognition platforms. Our investment in system infrastructure has several key benefits: simplification of the storage and processing of large amounts of data, facilitation of the deployment and operation of large-scale programs and services and automation of much of the administration of our business. It also provides us with the ability to scale both capacity and functionality and build large clusters seamlessly.

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One of our ongoing primary objectives is to maintain reliable systems. We have implemented performance monitoring for all key web and business systems to enable us to respond quickly to potential problems. Based on cluster technology, our system can identify errors and isolate failed servers automatically so that our clients can access our services at any time. Our websites are hosted at third party facilities in Beijing. This facility provides redundant utility systems, a backup electric generator and 24-hour a day server support. All servers have redundant power supplies and file systems to maximize system and data availability. We regularly back up our database on a server hosted at an Internet data center to minimize the impact of data loss due to system failures. Our research and development costs were immaterial for the fiscal years ended May 31, 2010, 2011 and 2012. We do not capitalize any related costs.

## **Intellectual Property**

Our trademarks, copyrights, trade secrets and other intellectual property rights distinguish our services and products from those of our competitors and contribute to our competitive advantage in our target markets. To protect our brand and other intellectual property, we rely on a combination of trademark, copyright and trade secret laws as well as confidentiality agreements with our employees, contractors and others. New Oriental are registered trademarks in China and have been recognized as well-known trademarks in a civil action adjudicated in China. We have also registered additional trademarks and logos, including Pop Kids, with the Trademark Office of the State Administration for Industry and Commerce in China. Our main websites are located at [www.neworiental.org](http://www.neworiental.org), [english.neworiental.org](http://english.neworiental.org), [www.tol24.com](http://www.tol24.com) and [www.koolearn.com](http://www.koolearn.com). In addition, we have registered other domain names, including [www.dogwood.com.cn](http://www.dogwood.com.cn), [www.xdf.cn](http://www.xdf.cn), [www.neworiental-kl2.org](http://www.neworiental-kl2.org) and [www.gznos.org](http://www.gznos.org).

In order to develop, improve, market and deliver new programs and services, we are required to obtain licenses from others from time to time. For example, we currently have arrangements with international education content providers and publishers such as Pearson Education, The McGraw-Hill Companies, Cambridge University Press Barron's, DynEd International Inc., or their respective authorized local publishers, to develop and distribute localized versions of specified books in China. There can be no assurance that we will be able to continue to obtain licenses on commercially reasonable terms or at all or that rights granted under any licenses will be valid and enforceable.

We cannot be sure that our efforts to protect our intellectual property rights will be adequate or that third parties will not infringe or misappropriate these rights. In addition, there can be no assurance that competitors will not independently develop similar intellectual property. If others are able to copy and use our programs and services, we may not be able to maintain our competitive position. Furthermore, the application of laws governing intellectual property rights in China and abroad is uncertain and evolving and could involve substantial risks to us. If litigation is necessary to enforce our intellectual property rights or determine the scope of the proprietary rights of others, we may have to incur substantial costs or divert other resources, which could harm our business.

In addition, competitors, content providers, publishers and others may claim that we have infringed their intellectual property rights. Defending any such lawsuit, whether with or without merit, could be time-consuming, result in costly litigation or prevent us from offering our programs and services, which could harm our business. If a lawsuit against us is successful, we may lose the rights to use our products or be required to modify them, or we may have to pay financial damages.

We have adopted guidelines, procedures and safeguards designed to educate our employees and contractors regarding the importance of respecting the intellectual property rights of third parties, and detect and prevent any conduct or activities by our employees or contractors that infringe or have the potential to infringe upon such third-party rights. The guidelines specify certain key principles and policies that we require all of our employees and contractors to uphold as a fundamental condition of their employment. The procedures and safeguards we have implemented to ensure compliance with these principles and policies include the assignment of dedicated staff to monitor and enforce compliance with these intellectual property guidelines, including in particular our content control group, which reviews the content of our course materials to ensure that no infringing materials are used in our classrooms. We have also made efforts to ensure that our marketing materials are reviewed and approved by appropriate management before being distributed to the public. We believe these guidelines, procedures and safeguards will further improve our ability to avoid infringing or potentially infringing activities, minimize our exposure to third party claims and protect our reputation as a company that respects the intellectual property rights of third parties.

**Table of Contents****D. Trend Information**

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events since the beginning of our fiscal year 2012 that are reasonably likely to have a material effect on our net revenues, income from operations, profitability, liquidity or capital resources, or that would cause the disclosed financial information to be not necessarily indicative of future operating results or financial condition.

**E. Off-balance Sheet Arrangements**

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholders' equity, or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

**F. Tabular Disclosure of Contractual Obligations**

The following table sets forth our contractual obligations as of May 31, 2012:

<i>(in thousands of US\$)</i>	<b>Total</b>	<b>2013</b>	<b>Payment due by May 31,</b>			<b>2017</b>	<b>Thereafter</b>
			<b>2014</b>	<b>2015</b>	<b>2016</b>		
Operating Lease Obligations <sup>(1)</sup>	468,371	106,227	96,411	89,945	65,005	44,967	65,816
Purchase and Leasehold Improvements Obligations <sup>(2)</sup>	6,465	6,465					

(1) Represents lease obligations under our facility leases.

(2) Represents leasehold improvement obligations in connection with renovations of the leased facilities.

**ITEM 8. FINANCIAL INFORMATION****A. Consolidated Statements and Other Financial Information**

See Item 18 Financial Statements.

**Legal and Administrative Proceedings**

From time to time, we are subject to legal proceedings, investigations and claims incidental to the conduct of our business.

***Litigation***

On July 23, 2012, a putative shareholder class action lawsuit against our company, Michael Minhong Yu and Louis T. Hsieh, *Wong v. New Oriental Education & Technology Group Inc.*, No. 2:12-cv-06316-MMM-JEM, was filed in the United States District Court for the Central District of California. Shortly thereafter, three more putative shareholder class action suits against the same defendants were filed in the United States District Court for the Southern District of New York: *Sax v. New Oriental Education & Technology Group, Inc.*, No. 1:12-cv-05724-JGK (S.D.N.Y. filed July 25, 2012); *Gabel v. New Oriental Education & Technology Group, Inc.*, No. 1:12-cv-05963-JGK (S.D.N.Y. filed Aug. 3, 2012); and *Tardio v. New Oriental Education & Technology Group, Inc.*, No. 1:12-cv-06619-JGK (S.D.N.Y. filed Aug. 29, 2012).

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The four actions contain similar factual allegations, allege virtually the same class period, are brought against the same defendants, and advance the same theories of liability. These actions seek to represent a class of persons who suffered damages as a result of their trading activities related to our ADSs from July 21, 2009 to July 23, 2012. All four actions allege violations of section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5 (2012), and section 20(a) of the Exchange Act, 15 U.S.C. §§ 78j(b), 78t(a). The complaints allege that various press releases, financial statements and other related disclosures made by our company during the class period contained material misstatements and omissions, in violation of the federal securities laws, and that such press releases, financial statements and other related disclosures artificially inflated the value of our company's ADSs and affected the trading prices of our ADSs. The complaints generally seek monetary damages on behalf of the class of persons who suffered losses during the class period.

The actions remain at their preliminary stages. We believe the cases are without merit and intend to defend the actions vigorously. For risks and uncertainties relating to the pending cases against us, please see Item 3. Key Information D. Risk Factors Risks Related to Our Business. We have been named as a defendant in several putative shareholder class action lawsuits that could have a material adverse impact on our business, financial condition, results of operation, cash flows and reputation.

We have been subject to copyright, trademark and trade name infringement claims and legal proceedings in the past which related to, among other things, infringement of third parties' copyrights in materials distributed by us and the unauthorized use of a third party's name in connection with the marketing and promotion of one of our programs, and we may be subject to similar claims and legal proceedings from time to time in the future. See Item 3. Key Information D. Risk Factors Risks Related to Our Business. Third parties have in the past brought intellectual property infringement claims against us based on the content of the books and other teaching or marketing materials that we or our teachers authored and/or distributed and may bring similar claims against us in the future.

### ***SEC Investigation***

On July 13, 2012, we were informed that the SEC had issued a formal order of investigation captioned *In the Matter of New Oriental Education & Technology Group Inc.* In that investigation the SEC's enforcement staff has requested documents and information concerning the basis for the consolidation of New Oriental China, a variable interest entity of our company, and its schools and subsidiaries, into our consolidated financial statements and other issues related to certain allegations about us contained in a report issued on July 18, 2012 by Muddy Waters LLC. We are cooperating fully with the SEC in its investigation. We cannot predict the timing, outcome or consequences of the SEC investigation.

### ***Independent Investigation by Special Committee***

On July 20, 2012, our board of directors formed a special committee, or the Special Committee, to conduct an independent review of certain allegations raised in a report issued on July 18, 2012 by Muddy Waters LLC. The Special Committee was comprised of the three independent directors of our company, Mr. Denny Lee, Mr. Robin Yanhong Li, and Dr. John Zhuang Yang, and the Special Committee was authorized to retain independent advisors in connection with its investigation. The Special Committee subsequently retained a major U.S. law firm to assist it in conducting its investigation; this U.S. law firm, in turn, has been assisted in its efforts by a big four accounting firm that is not affiliated with our external auditors and a major PRC law firm.

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Together with its U.S. legal counsel, the Special Committee focused its investigation on the three core allegations articulated in the Muddy Waters report, summarized as follows: (1) the allegation that some or all of our schools are actually franchises-in-disguise and thus inaccurately inflate our count of our own schools and the revenue said to be derived therefrom; (2) the allegation that our financial statements do not accurately reflect enterprise income tax paid by the Beijing Haidian school; and (3) the allegation that our consolidation of the financial results of New Oriental China and its schools and subsidiaries into our own consolidated financial statements is improper because we do not have sufficient control over New Oriental China and its schools and subsidiaries necessary for consolidation under U.S. GAAP. The scope of the Special Committee's investigation did not extend to examination of various general and un-particularized allegations for which the Muddy Waters report provided no specific detail.

On September 30, 2012, the Special Committee completed the investigation concerning the first two subjects identified above. The Special Committee's work on the franchise issue uncovered no significant evidence that supports the Muddy Waters allegation mentioned above. The evidence collected indicates that we have ownership interests in our 55 schools and associated learning centers, and the activities related to the 21 third parties with whom we have entered into brand cooperation agreements is entirely separate, is immaterial, and in any event is properly accounted for in our financial statements.

The Special Committee's work on the tax issue uncovered no significant evidence that supports the Muddy Waters allegation mentioned above.

Although substantial work has been completed by the Special Committee in connection with the issue concerning the consolidation of the financial results of New Oriental China and its schools and subsidiaries into our consolidated financial statements, the Special Committee understands that the SEC's Division of Corporation Finance has stated that based on the representations we made to the SEC, it has no objection to the consolidation of our schools into New Oriental China or into our wholly foreign owned subsidiaries in China, and also has no objection to the consolidation of New Oriental China into our consolidated financial statements. As a result, the Special Committee does not believe it is necessary to do further work or conclude on this issue.

## **Dividend Policy**

On April 17, 2012, our board of directors declared a special cash dividend in the amount of US\$0.30 per ADS. The cash dividend was paid on September 28, 2012 to shareholders of record at the close of business on August 31, 2012. The aggregate amount of cash dividends paid was approximately US\$50.0 million, which was funded by surplus cash on our balance sheet.

Other than the declaration of the special cash dividend described in the preceding paragraph, we have not declared any dividend since the completion of our initial public offering and have no present plan to declare any additional dividends on our shares in the near future. We currently intend to retain most, if not all, of our available funds and any future earnings to operate and expand our business. No withholding tax on dividend was provided as of May 31, 2012.

We are a holding company incorporated in the Cayman Islands. We rely on dividends from our subsidiaries in China and consulting, license and other fees paid to us by New Oriental China and its schools and subsidiaries. Current PRC regulations permit our subsidiaries to pay dividends to us only out of their accumulated profits, if any, determined in accordance with PRC accounting standards and regulations. In addition, each of our PRC subsidiaries and New Oriental China and its subsidiaries are required to set aside at least 10% of its after-tax profits each year, if any, to fund a statutory reserve until such reserve reaches 50% of its registered capital, and to further set aside a portion of its after-tax profits to fund the employee welfare fund at the discretion of the board. These reserves may not be distributed as cash dividends. Further, if our PRC subsidiaries or New Oriental China and its schools and subsidiaries incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to pay dividends or make other payments to us. Moreover, at the end of each fiscal year, every private school in China is required to allocate a certain amount out of its annual net income, if any, to its development fund for the construction or maintenance of the school or procurement or upgrade of educational equipment. In the case of a private school that requires reasonable returns, this amount shall be no less than 25% of the annual net income of the school, while in the case of a private school that does not require reasonable returns, this amount shall be equivalent to no less than 25% of the annual increase in the net assets of the school, if any.

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Our board of directors has complete discretion regarding whether to declare and distribute dividends. Even if our board of directors decides to pay dividends, the form, frequency and amount will depend upon our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors that the board of directors may deem relevant. If we pay any dividends, we will pay our ADS holders to the same extent as holders of our common shares, subject to the terms of the deposit agreement, including the fees and expenses payable thereunder.

**B. Significant Changes**

Except as disclosed elsewhere in this annual report, we have not experienced any significant changes since the date of our audited consolidated financial statements included in this annual report.

**PART III**

**ITEM 18. FINANCIAL STATEMENTS**

The consolidated financial statements of New Oriental Education & Technology Group Inc. are included at the end of this annual report.

**ITEM 19. EXHIBITS**

<b>Exhibit Number</b>	<b>Description of Document</b>
1.1	Amended and Restated Memorandum and Articles of Association (incorporated by reference to Exhibit 3.2 of the Registrant's F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
2.1	Form of Registrant American Depositary Receipt (incorporated by reference to Exhibit A to Exhibit (a)(4) of post-effective amendment No. 1 to the registration statement on Form F-6 (File No. 333-176069), filed with the Commission on April 25, 2012)
2.2	Registrant's Specimen Certificate for Common Shares (incorporated by reference to Exhibit 4.2 of the Registrant's F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
2.3	Form of Deposit Agreement among the Registrant, the depositary and holders of the American Depositary Receipts (incorporated by reference to Exhibit 4.3 of the Registrant's F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
2.4	Supplement and Amendment No. 2 to Deposit Agreement, dated as of August 5, 2011, between the Registrant, the depositary and holders and beneficial owners of American Depositary Receipts issued thereunder (incorporated by reference to Exhibit (a)(3) to the registration statement on Form F-6 (File No. 333-176069), filed with the Commission on August 5, 2011)
2.5	Supplement and Amendment No. 3 to Deposit Agreement, dated as of April 25, 2012, between the Registrant, the depositary and holders and beneficial owners of American Depositary Receipts issued thereunder (incorporated by reference to Exhibit (a)(4) of post-effective amendment No. 1 to the registration statement on Form F-6 (File No. 333-176069), filed with the Commission on April 25, 2012)

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<b>Exhibit Number</b>	<b>Description of Document</b>
4.1*	2006 Share Incentive Plan, as amended
4.2	Form of Indemnification Agreement with the Registrant's directors and officers (incorporated by reference to Exhibit 10.2 of the Registrant's F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
4.3	Form of Employment Agreement (incorporated by reference to Exhibit 10.3 of the Registrant's F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
4.4	English Translation of Form of New Enrollment System Development Service Agreement between Beijing Decision and New Oriental schools (incorporated by reference to Exhibit 99.4 of our F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
4.5	English Translation of Trademark License Agreement dated May 13, 2006 between the Registrant and New Oriental China (incorporated by reference to Exhibit 99.6 of our F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
4.6	English Translation of Building Mortgage and Loan Agreement dated March 31, 2005 between New Oriental China and China Minsheng Banking Corporation Ltd. Beijing Hepingli Branch (incorporated by reference to Exhibit 99.12 of our F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
4.7*	English Translation of Equity Pledge Agreement, dated April 23, 2012, among New Oriental China, Beijing Century Friendship Education Investment Co., Ltd. and Beijing Hewstone Technology Co., Ltd.
4.8*	English Translation of Equity Pledge Agreement, dated April 23, 2012, among New Oriental China, Beijing Century Friendship Education Investment Co., Ltd. and Beijing Decision Education & Consulting Co., Ltd.
4.9*	English Translation of Equity Pledge Agreement, dated April 23, 2012, among New Oriental China, Beijing Century Friendship Education Investment Co., Ltd. and Shanghai Smart Words Software Technology Co., Ltd.
4.10*	English Translation of Equity Pledge Agreement, dated April 23, 2012, among New Oriental China, Beijing Century Friendship Education Investment Co., Ltd. and Beijing Pioneer Technology Co., Ltd.
4.11*	English Translation of Equity Pledge Agreement, dated April 23, 2012, among New Oriental China, Beijing Century Friendship Education Investment Co., Ltd. and Beijing Smart Wood Software Technology Co., Ltd.
4.12*	English Translation of Option Agreement, dated April 23, 2012, among New Oriental China, Beijing Century Friendship Education Investment Co., Ltd. and Shanghai Smart Words Software Technology Co., Ltd.
4.13*	English Translation of Powers of Attorney, dated April 23, 2012, by Beijing Century Friendship Education Investment Co., Ltd. in favor of Beijing Hewstone Technology Co., Ltd.

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<b>Exhibit Number</b>	<b>Description of Document</b>
4.14*	English Translation of Powers of Attorney, dated April 23, 2012, by Beijing Century Friendship Education Investment Co., Ltd. in favor of Beijing Decision Education & Consulting Co., Ltd.
4.15*	English Translation of Powers of Attorney, dated April 23, 2012, by Beijing Century Friendship Education Investment Co., Ltd. in favor of Shanghai Smart Words Software Technology Co., Ltd.
4.16*	English Translation of Powers of Attorney, dated April 23, 2012, by Beijing Century Friendship Education Investment Co., Ltd. in favor of Beijing Pioneer Technology Co., Ltd.
4.17*	English Translation of Powers of Attorney, dated April 23, 2012, by Beijing Century Friendship Education Investment Co., Ltd. in favor of Beijing Smart Wood Software Technology Co., Ltd.
4.18*	English Translation of New Enrollment System Development Service Agreement between Beijing Decision Education & Consulting Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.19*	English Translation of HS Intelligent Learning Progress Management System Development Service Agreement between Beijing Hewstone Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.20*	English Translation of Data-Protected Media Distribution System Development Service Agreement between Beijing Hewstone Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.21*	English Translation of Education Call Center Platform Development Service Agreement between Beijing Pioneer Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.22*	English Translation of CRM System Development Service Agreement between Beijing Pioneer Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.23*	English Translation of Overseas Study Management System Development Service Agreement between Beijing Pioneer Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.24*	English Translation of Multi-dimensional Thesaurus Management System Development Service Agreement between Beijing Pioneer Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.25*	English Translation of Students Online Service Platform System Development Service Agreement between Shanghai Smart Words Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.26*	English Translation of Courses Search Platform System Development Service Agreement between Shanghai Smart Words Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.27*	English Translation of Technology Service Agreement IETLS DPS Learning System V1.0 between Shanghai Smart Words Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China

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<b>Exhibit Number</b>	<b>Description of Document</b>
4.28*	English Translation of Trademark License Agreement between Shanghai Smart Words Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.29*	English Translation of Software Sales Agreement between Beijing Hewstone Technology Co., Ltd. / Beijing Pioneer Technology Co., Ltd. / Shanghai Smart Words Software Technology Co., Ltd. / Beijing Smart Wood Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.30*	English Translation of Technology Service Agreement Teaching and Research Materials Compiling System V1.0 between Beijing Smart Wood Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.31*	English Translation of Technology Service Agreement Distance Teacher Development System V1.0 between Beijing Smart Wood Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.32*	English Translation of Technology Service Agreement Book Evaluation and Research System V1.0 between Beijing Smart Wood Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.33*	English Translation of Technology Service Agreement Diagnostic and Evaluation of Students Learning System V1.0 between Beijing Smart Wood Software Technology Co., Ltd. and one or more schools or subsidiaries of New Oriental China
4.34**	Proxy Agreement and Power of Attorney, dated as of December 3, 2012, by and among Beijing Pioneer Technology Co., Ltd., Beijing Century Friendship Education Investment Co., Ltd. and New Oriental China
8.1*	Subsidiaries of the Registrant
11.1	Code of Business Conduct and Ethics of the Registrant (incorporated by reference to Exhibit 99.1 from our F-1 registration statement (File No. 333-136825), as amended, initially filed with the Commission on August 22, 2006)
12.1**	Certification by Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
12.2**	Certification by Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
13.1***	Certification by Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
13.2***	Certification by Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
15.1**	Consent of Tian Yuan Law Firm
15.2**	Consent of Deloitte Touche Tohmatsu Certified Public Accountants LLP
101.INS****	XBRL Instance Document
101.SCH****	XBRL Taxonomy Extension Schema Document

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<b>Exhibit Number</b>	<b>Description of Document</b>
101.CAL****	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF****	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB****	XBRL Taxonomy Extension Label Linkbase Document
101.PRE****	XBRL Taxonomy Extension Presentation Linkbase Document

\* Previously filed with the 2012 Form 20-F on October 12, 2012.

\*\* Filed herewith.

\*\*\* Furnished herewith.

\*\*\*\* Furnished herewith. XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F/A and that it has duly caused and authorized the undersigned to sign this Amendment No. 2 to the Form 20-F on its behalf.

NEW ORIENTAL EDUCATION & TECHNOLOGY  
GROUP INC.

By: /s/ Michael Minhong Yu  
Name: Michael Minhong Yu  
Title: Chairman and Chief Executive Officer

Date: February 22, 2013

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF

NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.

We have audited the accompanying consolidated balance sheets of New Oriental Education & Technology Group Inc., its subsidiaries, variable interest entity and its schools and subsidiaries (collectively, the Group ) as of May 31, 2012 and 2011, and the related consolidated statements of operations, changes in equity and comprehensive income, and cash flows for each of the three years in the period ended May 31, 2012, and the related financial statement schedule included in Schedule I. These consolidated financial statements and financial statement schedule are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of May 31, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended May 31, 2012, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Group's internal control over financial reporting as of May 31, 2012, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated October 12, 2012 expressed an unqualified opinion on the Group's internal control over financial reporting.

/s/ Deloitte Touche Tohmatsu CPA Ltd.

Beijing, the People's Republic of China

October 12, 2012

**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share data)**

	As of May 31,	
	2011	2012
	US\$	US\$
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	317,260	428,261
Restricted cash	3,374	3,591
Term deposits	152,680	50,612
Short term investments	143,704	321,182
Accounts receivable, net of allowance of US\$60 and US\$48 for 2011 and 2012, respectively	1,655	3,794
Inventory	18,011	20,074
Deferred tax assets	5,337	7,316
Prepaid expenses and other current assets, net	33,248	60,546
Total current assets	675,269	895,376
Property and equipment, net	160,421	204,342
Land use rights, net	3,502	3,476
Prepaid rent and deposit to a related party		1,449
Long term deposit	7,826	12,819
Long term prepaid rent	2,789	2,205
Prepayment for an acquisition		3,279
Deferred tax assets, non-current	997	1,238
Intangible assets	4,976	833
Goodwill	7,588	1,798
Long term investment	2	2,002
Total assets	863,370	1,128,817
<b>LIABILITIES AND EQUITY</b>		
Current liabilities		
Accounts payable (including accounts payable of the consolidated variable interest entity without recourse to the Company of US\$9,416 and US\$8,943 as of May 31, 2011 and 2012, respectively)	9,518	8,943
Accrued expenses and other current liabilities (including accrued expenses and other current liabilities of the consolidated variable interest entity without recourse to the Company of US\$67,971 and US\$88,681 as of May 31, 2011 and 2012, respectively)	77,002	99,773
Income taxes payable (including income taxes payable of the consolidated variable interest entity without recourse to the Company of US\$7,050 and US\$8,979 as of May 31, 2011 and 2012, respectively)	7,163	10,012
Amounts due to a related party (including amounts due to related parties of the consolidated variable interest entity without recourse to the Company of nil and US\$164 as of May 31, 2011 and 2012, respectively)		164
Deferred revenue (including deferred revenue of the consolidated variable interest entity without recourse to the Company of US\$192,481 and US\$266,814 as of May 31, 2011 and 2012, respectively)	194,317	269,411
Dividend payable (including dividend payable of the consolidated variable interest entity without recourse to the Company of nil and nil as of May 31, 2011 and 2012, respectively)		50,000
Total current liabilities	288,000	438,303

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Deferred tax liabilities, non-current (including deferred tax liabilities, non-current of the consolidated variable interest entity without recourse to the Company of US\$1,081 and US\$112 as of May 31, 2011 and 2012, respectively)	1,147	112
<b>Total liabilities</b>	<b>289,147</b>	<b>438,415</b>

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**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****CONSOLIDATED BALANCE SHEETS - continued****(In thousands, except share and per share data)**

	As of May 31,	
	2011	2012
	US\$	US\$
Commitments (Note 19)		
Equity		
Common shares (US\$0.01 par value; 300,000,000 shares authorized as of May 31, 2011 and 2012, respectively; 158,379,387 and 158,379,387 shares issued and outstanding as of May 31, 2011 and 2012, respectively)	1,540	1,555
Additional paid-in capital	186,585	161,485
Statutory reserves	16,104	85,253
Retained earnings	323,432	386,971
Accumulated other comprehensive income	46,562	55,138
Total equity	574,223	690,402
Total liabilities and equity	863,370	1,128,817

See accompanying notes to consolidated financial statements.

**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except share and per share data)**

	Years ended May 31,		
	2010	2011	2012
	US\$	US\$	US\$
<b>NET REVENUES</b>			
Educational programs and services	352,857	508,439	693,712
Books and others	33,450	49,433	78,006
Total net revenues	386,307	557,872	771,718
<b>Operating costs and expenses</b>			
Cost of revenues	(147,261)	(222,625)	(304,027)
Selling and marketing	(58,396)	(82,797)	(115,151)
General and administrative	(103,336)	(155,412)	(235,743)
Loss on disposal of subsidiaries		(1,537)	
Total operating costs and expenses	(308,993)	(462,371)	(654,921)
<b>OPERATING INCOME</b>	77,314	95,501	116,797
<b>OTHER INCOME (EXPENSE), NET</b>			
Interest income	6,474	13,017	25,488
Miscellaneous income (expense), net	(252)	1,257	1,175
Income before provisions for income taxes and noncontrolling interest	83,536	109,775	143,460
Provision for income taxes:			
Current	(7,845)	(9,390)	(14,027)
Deferred	1,871	1,154	3,255
Provision for income taxes	(5,974)	(8,236)	(10,772)
Net income	77,562	101,539	132,688
Add: Net loss attributable to noncontrolling interest	227	235	
Net income attributable to New Oriental Education & Technology Group Inc.	77,789	101,774	132,688
Net income per share attributable to shareholders of New Oriental Education & Technology Group Inc. - basic (Note 17)	0.52	0.66	0.86

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Net income per share attributable to shareholders of New Oriental Education & Technology Group Inc. - diluted (Note 17)	0.50	0.65	0.85
Weighted average shares used in calculating basic net income per share	150,952,249	153,253,065	154,627,784
Weighted average shares used in calculating diluted net income per share	154,831,633	156,071,833	156,872,441
Share-based compensation expense included in:			
Cost of revenues	657	900	216
Selling and marketing	117		
General and administrative	15,409	14,145	23,909
Total	16,183	15,045	24,125

See accompanying notes to consolidated financial statements

**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY AND COMPREHENSIVE INCOME****(In thousands, except share data)**

	New Oriental Education & Technology Group Inc. Shareholders					Total New Oriental Education & Technology Group Inc.			Total comprehensive income US\$	
	Common shares Number	US\$	Additional paid-in capital US\$	Accumulated other comprehensive income US\$	Statutory reserve US\$	Retained earnings US\$	shareholder equity US\$	Noncontrolling interest US\$		Total equity US\$
Balance at June 1, 2009	153,004,707	1,500	166,370	23,403	12,871	147,102	351,246	238	351,484	
Common shares converted to ADS shares for future exercises of share options or non-vested equity shares	4,000,000									
Issuance of ADS shares for the exercises of employee share options		28	12,408				12,436		12,436	
The vesting of non-vested equity shares		6	(6)							
Shares repurchase (a)	(1,625,320)	(16)	(29,980)				(29,996)		(29,996)	
Share-based compensation expense			16,183				16,183		16,183	
Transfer to statutory reserves					136	(136)				
Comprehensive income:										
Net income						77,789	77,789	(227)	77,562	77,562
Foreign currency translation adjustment				(91)			(91)		(91)	(91)
<b>Total comprehensive income</b>										<b>77,471</b>
Balance at May 31, 2010	155,379,387	1,518	164,975	23,312	13,007	224,755	427,567	11	427,578	
Common shares converted to ADS shares for future exercises of share options or non-vested equity shares	3,000,000									
Issuance of ADS shares for the exercises of employee share options		13	6,574				6,587		6,587	
The vesting of non-vested equity shares		9	(9)							
Share-based compensation expense			15,045				15,045		15,045	
Transfer to statutory reserves					3,097	(3,097)				
Noncontrolling interest of Mingshitang								224	224	
Comprehensive income:										
Net income						101,774	101,774	(235)	101,539	101,539
Foreign currency translation adjustment				23,250			23,250		23,250	23,250
<b>Total comprehensive income</b>										<b>124,789</b>

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Balance at May 31, 2011	158,379,387	1,540	186,585	46,562	16,104	323,432	574,223	574,223
Issuance of ADS shares for the exercises of employee share options		2	788				790	790
The vesting of non-vested equity shares		13	(13)					
Share-based compensation expense			24,125				24,125	24,125
Transfer to statutory reserves					69,149	(69,149)		
Dividend declared (b)			(50,000)				(50,000)	(50,000)
Comprehensive income:								
Net income						132,688	132,688	132,688
Foreign currency translation adjustment				8,576			8,576	8,576
Total comprehensive income								141,264
Balance at May 31, 2012	158,379,387	1,555	161,485	55,138	85,253	386,971	690,402	690,402

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY AND COMPREHENSIVE INCOME - continued**

**(In thousands, except share data)**

- (a) In July 2009, the Company's board of directors approved the repurchase of up to US\$30,000 of ADSs during the period from August 5, 2009 through December 31, 2009, during which time 1,625,320 ADSs representing 1,625,320 common shares were repurchased for US\$29,996. All repurchases were recorded at cost and all related shares were subsequently retired.
- (b) On April 17, 2012, the Company declared a special cash dividend in the amount of US\$0.30 per ADS, or a total of approximately US\$50,000 which was paid on September 29, 2012 to shareholders of record at the close of business on August 31, 2012.  
See accompanying notes to consolidated financial statements

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**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Years ended May 31,		
	2010 US\$	2011 US\$	2012 US\$
<b>Cash flows from operating activities</b>			
Net income	77,562	101,539	132,688
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation of property and equipment	12,190	16,407	26,219
Amortization of intangible assets	79	529	52
Amortization of land use rights	81	83	87
Loss on disposal of property and equipment	214	431	543
Impairment of goodwill	76		
(Gain) Loss on deconsolidation/ disposal of subsidiaries		1,537	(408)
Share-based compensation expense	16,183	15,045	24,125
Allowance for doubtful accounts	27	55	52
Write off of the amount due from related parties		406	
Deferred income taxes	(1,871)	(1,154)	(3,255)
Changes in operating assets and liabilities			
Accounts receivables	(410)	314	(2,164)
Prepaid expenses and other current assets	(7,953)	(10,012)	(23,672)
Inventory	(1,982)	91	(1,753)
Long term deposit	(1,645)	(3,859)	(4,861)
Long term prepaid rent	(521)	(816)	633
Accounts payable	1,746	(2,068)	(740)
Accrued expenses and other current liabilities	13,857	19,749	28,395
Income taxes payable	2,023	929	2,854
Deferred revenue	32,322	76,627	71,794
Amounts due to a related party	(88)	(14)	164
Prepaid rent and deposit to a related party			(1,449)
<b>Net cash provided by operating activities</b>	<b>141,890</b>	<b>215,819</b>	<b>249,304</b>
<b>Cash flows from investing activities</b>			
Restricted cash paid for establishing new school subsidiaries	(43)	(2,687)	(158)
Bank deposits maturing over three months	(78,108)	(7,092)	104,802
Investments in held-to-maturity investments		(139,903)	(656,622)
Settlement of held-to-maturity investments			481,477
Purchase of Tongwen	(549)	(188)	(193)
Purchase of Newave, net of cash acquired of US\$72		(1,720)	
Refund of purchase consideration for Newave net of cash disposed of US\$448 (Note 3)			1,752
Purchase of property and equipment	(19,558)	(49,138)	(71,690)
Proceeds from disposal of property and equipment	333	1,714	3,210
Purchase of intangible assets		(415)	
Long term investment in Dajie.com Ltd. (Note 13)			(2,000)
Prepayment for acquisition of China Management Software Institute (Note 12)			(3,279)
Payment for other assets			(1,000)
Proceeds received from disposal of Mingshitang (Note 4)		150	
Proceeds received from disposal of Beijing Tomorrow Oriental Technology Co., Ltd. (Note 4)		1,127	

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Net cash used in investing activities	(97,925)	(198,152)	(143,701)
Cash flows from financing activities			
Proceeds from issuance of common share upon exercise of share option	12,446	6,432	945
Cash paid for shares repurchased	(29,996)		
Net cash provided by (used in) financing activities	(17,550)	6,432	945

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**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS - continued****(In thousands)**

	Years ended May 31,		
	2010	2011	2012
	US\$	US\$	US\$
Effects of exchange rate changes	(83)	12,057	4,453
Net change in cash and cash equivalents	26,332	36,156	111,001
Cash and cash equivalents at beginning of year	254,772	281,104	317,260
Cash and cash equivalents at end of year	281,104	317,260	428,261
<b>Supplement disclosure of cash flow information</b>			
Income taxes paid	5,823	7,977	11,178
<b>Non-cash investing and financing activities:</b>			
Payable for purchase of property and equipment	3,374	7,475	7,069
Payable for acquisition of Tongwen	183	193	
Payable for acquisition of Newave		4,243	
Dividend payable			50,000

See accompanying notes to consolidated financial statements.

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012**

**(In thousands, except share and per share data)**

**1. ORGANIZATION AND PRINCIPAL ACTIVITIES**

New Oriental Education & Technology Group Inc. (the Company) was established in the British Virgin Islands on August 18, 2004. On January 25, 2006, the Company changed its corporate domicile to the Cayman Islands. The Company, its wholly owned subsidiaries and its variable interest entity, Beijing New Oriental Education & Technology (Group) Co., Ltd. (New Oriental China) and its schools and subsidiaries (collectively, the VIE), are collectively referred to as the Group.

The Group provides educational services in the People's Republic of China (the PRC) primarily under the New Oriental brand. The Group offers a wide range of educational programs, services and products, consisting primarily of English and other foreign language training, test preparation courses for admissions and assessment tests in the United States, the PRC and Commonwealth countries, primary and secondary school education, development and distribution of educational content, software and other technology, and online education.

In September 2006, the Company and certain selling shareholders of the Company completed an initial public offering of 34,500,000 American depositary shares (ADSs) representing 34,500,000 of the Company's common shares, on the New York Stock Exchange. In February 2007, the Company and certain selling shareholders of the Company completed an additional public offering of 2,393,596 ADSs representing 2,393,596 common shares. As of May 31, 2012, 158,379,387 ADSs representing 158,379,387 common shares were issued and outstanding. On August 18, 2011, the Company effected a change in the conversion ratio of ADSs to common shares from one ADS representing four common shares to one ADS representing one common share. The effect of such change has been retroactively reflected in consolidated financial statements.

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

**FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012**

**(In thousands, except share and per share data)**

**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

As of May 31, 2012, details of the Company's subsidiaries, variable interest entity and its schools and subsidiaries were as follows:

Name	Date of incorporation or establishment	Place of incorporation (or establishment) /operation	Legal ownership	Principal activity
<b>Subsidiaries of the Company:</b>				
Beijing Decision Education & Consulting Company Limited ( Beijing Decision )	April 20, 2005	PRC	100%	Educational information system and other consulting services
Beijing Judgment Education & Consulting Company Limited ( Beijing Judgment )	April 20, 2005	PRC	100%	Educational consulting and investing activities
Beijing Hewstone Technology Company Limited ( Beijing Hewstone )	April 20, 2005	PRC	100%	Educational software development and distribution and other consulting services
Beijing Pioneer Technology Company Limited ( Beijing Pioneer )	January 8, 2009	PRC	100%	Educational software development and distribution and other consulting services
Beijing Boost Caring Education & Consulting Company Limited ( Beijing Boost Caring )	March 25, 2010	PRC	100%	Educational consulting and software development
Shanghai Smart Words Software Technology Company Limited ( Shanghai Smart Words )	December 8, 2010	PRC	100%	Educational consulting and software development
Beijing Smart Wood Software Technology Company Limited ( Beijing Smart Wood )	December 21, 2011	PRC	100%	Educational consulting and software development
Beijing New Oriental Stars Education & Consulting Co., Ltd ( Stars )	July 11, 2007	PRC	100%	Kindergarten
Beijing Chao Yang District Kindergarten of Stars ( ChaoYang Kindergarten )	November 9, 2007	PRC	100%	Kindergarten
Nanjing Yuhuatai District Kindergarten of Stars ( Nanjing Kindergarten )	February 20, 2009	PRC	100%	Kindergarten
Elite Concept Holdings Limited ( Elite Concept )	December 3, 2007	Hong Kong	100%	Educational Consulting
Winner Park Limited ( Winner Park )	December 9, 2008	Hong Kong	100%	Educational Consulting
	December 9, 2008	Hong Kong	100%	Educational Consulting

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Smart Shine International Limited ( Smart Shine )

**Variable interest entity of the Company:**

Beijing New Oriental Education & Technology (Group) Co., Ltd ( New Oriental China )	August 2, 2001	PRC	N/A	Education consulting, software development and distributions and other services
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**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued****FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012****(In thousands, except share and per share data)****1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

Name	Date of incorporation or establishment	Place of incorporation (or establishment) /operation	Legal ownership	Principal activity
<b>Schools and subsidiaries of New Oriental China:</b>				
Beijing Haidian District Privately-Funded New Oriental School ( Beijing Haidian School )	October 5, 1993	PRC	N/A	Language and post-secondary education
Shanghai Yangpu District New Oriental Advanced Study School	June 1, 2000	PRC	N/A	Language education
Guangzhou Haizhu District Privately-Funded New Oriental Training School	September 8, 2000	PRC	N/A	Language education
Wuhan New Oriental Training School	April 28, 2002	PRC	N/A	Language education
Tianjin New Oriental Training School	August 21, 2002	PRC	N/A	Language education
Xi'an Yanta District New Oriental Training School	November 26, 2002	PRC	N/A	Language education
Nanjing Gulou New Oriental Advanced Study School	November 28, 2002	PRC	N/A	Language education
Shenzhen New Oriental Training School ( Shenzhen School )	October 15, 2003	PRC	N/A	Language education
Shenyang New Oriental Foreign Language Training School	June 18, 2003	PRC	N/A	Language education
Chongqing New Oriental Training School	August 15, 2003	PRC	N/A	Language education
Chengdu New Oriental School	August 18, 2003	PRC	N/A	Language education
Xiangyang New Oriental Training School	October 26, 2004	PRC	N/A	Language education
Changsha Furong District New Oriental Training School	May 25, 2005	PRC	N/A	Language education
Jinan New Oriental School	May 31, 2005	PRC	N/A	Language education
Taiyuan New Oriental Training School	April 20, 2005	PRC	N/A	Language education
Ha'er Bin Nangang District New Oriental Training School	May 20, 2005	PRC	N/A	Language education
Changchun New Oriental Training School	July 26, 2005	PRC	N/A	Language education
Hangzhou New Oriental Advanced Study School	July 21, 2005	PRC	N/A	Language education
Zhengzhou New Oriental Training School	July 19, 2005	PRC	N/A	Language education
Zhuzhou New Oriental Training School	April 30, 2006	PRC	N/A	Language education
Shijiazhuang New Oriental School	April 3, 2006	PRC	N/A	Language education
Suzhou New Oriental School	April 26, 2006	PRC	N/A	Language education
Anshan New Oriental Training School	June 13, 2006	PRC	N/A	Language education

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Hefei New Oriental Foreign Language Training School	June 13, 2006	PRC	N/A	Language education
Kunming Xishan New Oriental School	June 13, 2006	PRC	N/A	Language education
Wuxi New Oriental Advanced Study School	August 14, 2006	PRC	N/A	Language education
Fuzhou Gulou District New Oriental Training School	September 1, 2006	PRC	N/A	Language education

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

**FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012**

**(In thousands, except share and per share data)**

**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

Name	Date of incorporation or establishment	Place of incorporation (or establishment) /operation	Legal ownership	Principal activity
<b>Schools and subsidiaries of New Oriental China:</b>				
Beijing New Oriental North Star Training School	September 26, 2006	PRC	N/A	Language education
Nanchang Donghu District New Oriental Language School	March 16, 2007	PRC	N/A	Language education
Yichang Wujiagang District Yichang New Oriental School	January 1, 2006	PRC	N/A	Language education
Jingzhou New Oriental School	April 10, 2007	PRC	N/A	Language education
Dalian New Oriental Training School	June 12, 2007	PRC	N/A	Language education
Huangshi New Oriental Training School	March 17, 2008	PRC	N/A	Language education
Ningbo New Oriental School	April 16, 2008	PRC	N/A	Language education
Lanzhou Chenguan District New Oriental School	March 19, 2008	PRC	N/A	Language education
Xiamen Siming District New Oriental Education Training School	July 8, 2008	PRC	N/A	Language education
Qingdao New Oriental Language Training School	August 5, 2008	PRC	N/A	Language education
Nanning New Oriental Education Training School	September 18, 2008	PRC	N/A	Language education
Xuzhou New Oriental Advanced Study School	March 31, 2009	PRC	N/A	Language education
Xiangtan Yuhu District New Oriental School	July 15, 2010	PRC	N/A	Language education
Zhenjiang New Oriental School	July 19, 2010	PRC	N/A	Language education
Luoyang New Oriental School	November 25, 2010	PRC	N/A	Language education
Nantong Chongchuan District New Oriental School	December 28, 2010	PRC	N/A	Language education
Jilin Chuanying District New Oriental School	March 17, 2011	PRC	N/A	Language education
Guiyang Yunyan District New Oriental School	March 21, 2011	PRC	N/A	Language education
Inner Mongolia Hohhot New Oriental School	April 2, 2011	PRC	N/A	Language education
Foshan New Oriental School	September 1, 2011	PRC	N/A	Language education
Tangshan Lubei District New Oriental School	May 25, 2011	PRC	N/A	Language education
Urumqi New Oriental School	May 22, 2011	PRC	N/A	Language education

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Changchun Tongwen Gaokao Training School ( Tongwen Gaokao )	October 27, 2008	PRC	N/A	College admission examination training
Changchun Tongwen Senior High School ( Tongwen High School )	October 27, 2008	PRC	N/A	Primary secondary school education
Beijing New Oriental Yangzhou Foreign Language School	June 6, 2002	PRC	N/A	Primary secondary school education
Beijing Changping New Oriental Foreign Language School ( Changping school )	July 19, 2010	PRC	N/A	Primary secondary school education
Beijing New Oriental Dogwood Cultural Communications Co., Ltd.	May 16, 2003	PRC	N/A	Sales of educational materials and products
Beijing New Oriental Dogwood, Bookstore, Audio & Video Co., Ltd.	March 2, 2004	PRC	N/A	Sales of educational materials and products

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

**FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012**

**(In thousands, except share and per share data)**

**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

Name	Date of incorporation or establishment	Place of incorporation (or establishment) /operation	Legal ownership	Principal activity
<b>Schools and subsidiaries of New Oriental China:</b>				
Chengdu New Oriental Dogwood Bookstore Products Co., Ltd.	January 18, 2004	PRC	N/A	Sales of educational materials and products
Chongqing New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	February 25, 2004	PRC	N/A	Sales of educational materials and products
Shenyang new Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	September 18, 2003	PRC	N/A	Sales of educational materials and products
Guangzhou Dogwood Bookstore & Audio-Visual Products Co., Ltd.	November 11, 2003	PRC	N/A	Sales of educational materials and products
Wuhan New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	December 16, 2003	PRC	N/A	Sales of educational materials and products
Xi'an New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	June 3, 2003	PRC	N/A	Sales of educational materials and products
Shanghai Dogwood Bookstore & Audio-Visual Products Co., Ltd.	September 28, 2003	PRC	N/A	Sales of educational materials and products
Nanjing New Oriental Dogwood Bookstore Products Co., Ltd.	April 21, 2003	PRC	N/A	Sales of educational materials and products
Tianjin Dogwood Bookstore & Audio-Visual Products Co., Ltd.	December 15, 2003	PRC	N/A	Sales of educational materials and products
Changchun New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	October 8, 2005	PRC	N/A	Sales of educational materials and products
Changsha New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	April 3, 2006	PRC	N/A	Sales of educational materials and products
Ha'er Bin New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	March 13, 2006	PRC	N/A	Sales of educational materials and products
Taiyuan New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	July 12, 2006	PRC	N/A	Sales of educational materials and products
Zhengzhou New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd.	August 9, 2006	PRC	N/A	Sales of educational materials and products
Hefei Dogwood Bookstore & Audio-Visual Products Co., Ltd.	November 22, 2006	PRC	N/A	Sales of educational materials and products

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Fuzhou Gulou District Dogwood Bookstore & Audio-Visual Products Co., Ltd	August 26, 2009	PRC	N/A	Sales of educational materials and products
Hangzhou Dogwood Bookstore Products Co., Ltd	July 25, 2007	PRC	N/A	Sales of educational materials and products
Nanchang Dogwood Bookstore & Audio-Visual Products Co., Ltd	September 14, 2007	PRC	N/A	Sales of educational materials and products
Kunming Dogwood Bookstore & Audio-Visual Products Co., Ltd	November 21, 2007	PRC	N/A	Sales of educational materials and products

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**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued****FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012****(In thousands, except share and per share data)****1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

Name	Date of incorporation or establishment	Place of incorporation (or establishment) /operation	Legal ownership	Principal activity
<b>Schools and subsidiaries of New Oriental China:</b>				
Dalian New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	March 25, 2008	PRC	N/A	Sales of educational materials and products
Jinan Dogwood Bookstore & Audio-Visual Products Co., Ltd	April 21, 2008	PRC	N/A	Sales of educational materials and products
Lanzhou New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	October 28, 2008	PRC	N/A	Sales of educational materials and products
Shijiazhuang New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	July 28, 2009	PRC	N/A	Sales of educational materials and products
Ningbo Haishu New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	May 31, 2010	PRC	N/A	Sales of educational materials and products
Suzhou New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	June 1, 2010	PRC	N/A	Sales of educational materials and products
Qingdao New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	July 28, 2010	PRC	N/A	Sales of educational materials and products
Xuzhou New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	September 29, 2010	PRC	N/A	Sales of educational materials and products
Urumqi Dogwood Bookstore & Audio-Visual Products Co., Ltd	September 13, 2011	PRC	N/A	Sales of educational materials and products
Luoyang Dogwood Bookstore & Audio-Visual Products Co., Ltd	November 16, 2011	PRC	N/A	Sales of educational materials and products
Xiamen New Oriental Dogwood Bookstore & Audio-Visual Products Co., Ltd	December 8, 2011	PRC	N/A	Sales of educational materials and products
Hohhot Dogwood Bookstore & Audio-Visual Products Co., Ltd	February 7, 2012	PRC	N/A	Sales of educational materials and products
Beijing New Oriental Vision Overseas Consultancy Co., Ltd.	February 19, 2004	PRC	N/A	Consulting

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Shanghai Vision Overseas Service Co., Ltd.	March 24, 2011	PRC	N/A	Consulting
Shandong New Oriental Vision Overseas Consultancy Co., Ltd	September 8, 2011	PRC	N/A	Consulting
Beijing New Oriental Dogwood Advertisement Co., Ltd. ( Dogwood Advertisement )	January 20, 2004	PRC	N/A	Advertising
Beijing New Oriental Xuncheng Network Technology Co., Ltd. ( Xuncheng )	March 11, 2005	PRC	N/A	On-line education

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**(In thousands, except share and per share data)**

**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

**The VIE arrangements**

PRC laws and regulations currently require any foreign entity that invests in the education business in China to be an educational institution with relevant experience in providing educational services outside China. The Company's offshore holding companies are not educational institutions and do not provide educational services outside China. In addition, in the PRC, foreign ownership of high schools for students in grades ten to twelve is restricted and foreign ownership of primary and middle schools for students in grades one to nine is prohibited. Accordingly, the Company's offshore holding companies are not allowed to directly own and operate schools in China. The Company conducts substantially all of its education business in China through contractual arrangements with its VIE, New Oriental China and its schools and subsidiaries. Since the operations of New Oriental China and the schools are closely interrelated and almost indistinguishable from one another, the risks and rewards associated with their operations are substantially the same. In addition, the Company consolidates New Oriental China, its schools and subsidiaries as disclosed. Therefore, the Company aggregates the disclosures related to New Oriental China and New Oriental China's schools and subsidiaries as variable interest entities and referred to them as the VIE in the Company's consolidated financial statements. The VIE holds the requisite licenses and permits necessary to conduct the Company's education business. In addition, the VIE holds leases and other assets necessary to operate the Company's schools and learning centers, employs teachers and generates substantially all of the Company's revenues. The Company and its wholly owned subsidiaries in China (the WFOEs) have entered into the following contractual arrangements with New Oriental China, New Oriental China's schools and subsidiaries and New Oriental China's shareholders that enable the Company to (1) have power to direct the activities that most significantly affects the economic performance of the VIE, and (2) receive the economic benefits of the VIE that could be significant to the VIE. Accordingly, the Company is considered the primary beneficiary of the VIE and has consolidated the VIE's financial results of operations, assets and liabilities in the Company's consolidated financial statements. In making the conclusion that the Company is the primary beneficiary of the VIE, the Company believes the Company's rights under the terms of the exclusive option agreement provide it with a substantive kick out right. More specifically, the Company believes the terms of the exclusive option agreement are valid, binding and enforceable under PRC laws and regulations currently in effect. The Company also believes that the minimum amount of consideration permitted by the applicable PRC law to exercise the option does not represent a financial barrier or disincentive for the Company to currently exercise its rights under the exclusive option agreement. A simple majority vote of the Company's board of directors is required to pass a resolution to exercise the Company's rights under the exclusive option agreement, for which Mr. Yu's consent is not required. The Company's rights under the exclusive option agreement give the Company the power to control the shareholder of New Oriental China and thus the power to direct the activities that most significantly impact the schools' economic performance given that New Oriental China has the power to direct the activities of the schools via its sponsorship interest. In addition, the Company's rights under the powers of attorney also reinforce the Company's abilities to direct the activities that most significantly impact the VIE's economic performance. The Company also believes that this ability to exercise control ensures that the VIE will continue to execute and renew service agreements and pay service fees to the Company. By charging service fees in whatever amounts the Company deems fit, and by ensuring that service agreements are executed and renewed indefinitely, the Company has the rights to receive substantially all of the economic benefits from the VIE.

**Service agreements.** There are four types of service agreements: (i) trademark license agreements, (ii) new enrollment system development service agreements, (iii) other operating service agreements, and (iv) sale of educational software agreements.

(i) Trademark license agreements. Pursuant to the trademark license agreement dated May 13, 2006 between the Company as the licensor and New Oriental China as the licensee, the Company has licensed the trademarks to New Oriental China for its use in China. The Company has also allowed New Oriental China to enter into sub-license agreements with its schools and subsidiaries pursuant to which each of the schools and subsidiaries may use the trademarks in China by paying license fees. This license is valid from May 14, 2006 to December 31, 2050, subject to the renewal every ten years upon the expiration of the trademark registration. Pursuant to the second trademark license agreement dated December 20, 2010 entered into between Shanghai Smart Words as the licensor and a subsidiary of New Oriental China as the licensee, Shanghai Smart Words has granted a license to a subsidiary of New Oriental China to use certain trademarks for a license fee equal to 5% of the licensee's monthly revenues. The term of this license is two years and is automatically renewed unless otherwise terminated by Shanghai Smart

Words.

(ii) New enrollment system development service agreements. Beijing Decision has entered into new enrollment system service agreements with the schools of New Oriental China, under which Beijing Decision agreed to provide new enrollment system development and regular maintenance services to those schools of New Oriental China for a fee equal to the applicable fee rate multiplied by the number of new student enrollments. These agreements can be renewed by both parties to the agreements.

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**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

**The VIE arrangements - continued**

(iii) Other operating service agreements. Pursuant to operating service agreements between certain WFOEs and the schools or the subsidiaries of New Oriental China, the WFOEs have agreed to provide certain operating services to the schools or the subsidiaries of New Oriental China for fees that are calculated based on a percentage, ranging from 2.0% to 6.0%, of respective revenues of each of the schools and subsidiaries. A majority of these agreements provide unlimited two-year or five-year automatic renewal without consent of the WFOEs. The remaining agreements can be renewed by both parties to the agreements.

(iv) Sale of educational software agreements. Four WFOEs, namely Beijing Hewstone, Beijing Pioneer, Beijing Smart Wood and Shanghai Smart Words, entered into agreements whereby the WFOEs sell various self-developed educational software to the schools or subsidiaries of New Oriental China. Except for four agreements that are silent on renewal, these agreements provide unlimited two-year automatic renewal terms, schools and subsidiaries of New Oriental China cannot terminate the agreements without the consent of the WFOEs in China.

**Equity pledge agreement.** Pursuant to the equity pledge agreements dated May 25, 2006 among New Oriental China, all of the shareholders of New Oriental China, Beijing Hewstone and Beijing Decision, each shareholder of New Oriental China agreed to pledge his or its equity interest in New Oriental China to Beijing Hewstone and Beijing Decision to secure the performance of the VIE's obligations under the existing service agreements and any such agreements to be entered into in the future. The shareholders of New Oriental China agreed not to transfer, sell, pledge, dispose of or otherwise create any encumbrance on their equity interests in New Oriental China without the prior written consent of Beijing Decision and Beijing Hewstone.

In January 2012, ten former shareholders of New Oriental China completed the transfer, for no consideration, of all of their equity interests in New Oriental China to Century Friendship, a PRC domestic enterprise controlled by the Company's founder, chairman and chief executive officer, Mr. Michael Minhong Yu ( Mr. Yu ). Prior to the transfer, Century Friendship had held 53% of the equity interests in the New Oriental China while the ten former shareholders of New Oriental China held the remaining equity interests. In connection to the transfer, five new equity pledge agreements dated April 23, 2012 were entered into among New Oriental China, Century Friendship and five WFOEs, whereby Century Friendship has agreed to pledge all of its equity interests in New Oriental China to the WFOEs to secure the VIE's performance of their obligations under the trademark license agreements, new enrollment system development service agreements, other operating service agreements and sale of educational software agreements. Century Friendship has agreed not to transfer, sell, pledge, dispose of or otherwise create any encumbrance on its equity interests in New Oriental China without the prior written consents of the WFOEs. The terms of the April 2012 equity pledge agreements are substantially the same as the 2006 agreements.

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**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

**The VIE arrangements - continued**

*Exclusive option agreements.* Pursuant to the exclusive option agreements entered into on various dates, as amended on May 25, 2006, among the Company, New Oriental China and its shareholders, the shareholders of New Oriental China are obligated to sell to the Company, and the Company have an exclusive, irrevocable and unconditional right to purchase, or cause the shareholders of New Oriental China to sell to the Company's designated party, in the Company's sole discretion, part or all of the shareholders' equity interests in New Oriental China when and to the extent that applicable PRC law permits the Company to own part or all of such equity interests in New Oriental China. In addition, pursuant to the exclusive option agreements, the Company has an exclusive, irrevocable and unconditional right to request any existing shareholder of New Oriental China to transfer all or part of the equity interest in New Oriental China held by such shareholder to another PRC person or entity designated by the Company at any time in the discretion. The price to be paid by the Company or a PRC person or entity designated by the WFOEs will be the minimum amount of consideration permitted by applicable PRC law at the time when such share transfer occurs. As a result of the ten former shareholders of New Oriental China transferring all of their equity interests in New Oriental China to Century Friendship in January 2012, Century Friendship executed a new option agreement with Shanghai Smart Words and New Oriental China on April 23, 2012. The terms of this new option agreement are substantially the same as the 2006 agreements.

*Risks in relation to the VIE structure*

The Company believes that the contractual arrangements with New Oriental China and its schools and subsidiaries and its current sole shareholder are in compliance with PRC laws and regulations and are legally enforceable. However, uncertainties in the PRC legal system could limit the Company's ability to enforce the contractual arrangements. If the legal structure and contractual arrangements were found to be in violation of PRC laws and regulations, the PRC government could:

revoke the business and operating licenses of the Company's PRC subsidiaries, New Oriental China and its schools and subsidiaries;

discontinue or restrict the operations of any related-party transactions among the Company's PRC subsidiaries, New Oriental China and its schools and subsidiaries;

limit the Group's business expansion in China by way of entering into contractual arrangements;

impose fines or other requirements with which the Company's PRC subsidiaries, New Oriental China and its schools and subsidiaries may not be able to comply;

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require the Company or the Company's PRC subsidiaries, New Oriental China and its schools and subsidiaries to restructure the relevant ownership structure or operations; or

restrict or prohibit the Company's use of the proceeds of the additional public offering to finance the Group's business and operations in China.

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**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued**

**The VIE arrangements - continued**

*Risks in relation to the VIE structure - continued*

The Company's ability to conduct its education business may be negatively affected if the PRC government were to carry out any of the aforementioned actions. As a result, the Company may not be able to consolidate New Oriental China and its schools and subsidiaries in its consolidated financial statements as it may lose the ability to exert effective control over New Oriental China and its schools and subsidiaries and its shareholder, and it may lose the ability to receive economic benefits from New Oriental China and its schools and subsidiaries. The Company, however, does not believe such actions would result in the liquidation or dissolution of the Company, the WFOEs or New Oriental China or its schools or subsidiaries.

Mr. Yu is the controlling shareholder of Century Friendship, which owns all of the equity interests in New Oriental China and Mr. Yu is also a beneficial owner of the Company. The interests of Mr. Yu as the beneficial owner of New Oriental China may differ from the interests of the Company as a whole, since Mr. Yu is only one of the beneficial shareholders of the company, holding 15.1% of the total common shares issued and outstanding as of May 31, 2012. The Company cannot assure that when conflicts of interest arise, Mr. Yu will act in the best interests of the Company or that conflicts of interests will be resolved in the Company's favor. Currently, the Company does not have existing arrangements to address potential conflicts of interest Mr. Yu may encounter in his capacity as a beneficial owner and director of New Oriental China, on the one hand, and as a beneficial owner and director of the Company, on the other hand. The Company believes Mr. Yu will not act contrary to any of the contractual arrangements and the exclusive option agreement provides the Company with a mechanism to remove Mr. Yu as a beneficial shareholder of New Oriental China should he act to the detriment of the Company. The Company relies on Mr. Yu, as a director and executive officer of the Company, to fulfill his fiduciary duties and abide by laws of the PRC and Cayman Islands and act in the best interest of the Company. If the Company cannot resolve any conflicts of interest or disputes between the Company and Mr. Yu, the Company would have to rely on legal proceedings, which could result in disruption of its business, and there is substantial uncertainty as to the outcome of any such legal proceedings.

In addition, the current sole shareholder of the New Oriental China is also a beneficial owner of the Company and therefore has no current interest in seeking to act contrary to the contractual arrangements. However, to further protect the investors' interest from any risk that the shareholders of the New Oriental China may act contrary to the contractual arrangements, the Company, through the five WFOEs, Beijing Hewstone, Beijing Decision, Beijing Pioneer, Beijing Smart Wood and Shanghai Smart Words, entered into five revocable powers of attorney with Century Friendship on April 23, 2002. Through these powers of attorney, Century Friendship entrusted the five WFOEs as its proxy to exercise its rights as the shareholder of New Oriental China with respect to an aggregate of 100% of the equity interests in New Oriental China. The term of the powers of attorney is unspecified.

The following financial statement balances and amounts of the VIE were included in the accompanying consolidated financial statements:

As of May 31,

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	2011 US\$	2012 US\$
Total current assets	358,294	466,827
Total non-current assets	178,967	215,306
Total assets	537,261	682,133
Total current liabilities	276,918	373,581
Total non-current liabilities	1,081	112
Total liabilities	277,999	373,693

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**1. ORGANIZATION AND PRINCIPAL ACTIVITIES - continued****The VIE arrangements - continued***Risks in relation to the VIE structure - continued*

	Year ended May 31,		
	2010	2011	2012
	US\$	US\$	US\$
Net revenues	382,189	542,043	750,384
Net income	105,511	131,249	158,796
Net cash provided by operating activities	86,467	156,088	238,037
Net cash used in investing activities	(69,794)	(152,840)	(150,401)
Net cash provided by financing activities			

The VIE contributed an aggregate of 98.9%, 97.2% and 97.2% of the consolidated net revenues for the year ended May 31, 2010, 2011 and 2012, respectively. The Company's operations not conducted through contractual arrangements with the VIE primarily consist of its kindergarten programs and the leasing of its commercial property. As of the fiscal years ended May 31, 2011 and 2012, the VIE accounted for an aggregate of 62.2% and 60.4%, respectively, of the consolidated total assets, and 96.2% and 85.2%, respectively, of the consolidated total liabilities. The assets not associated with the VIE primarily consist of cash and cash equivalent, term deposits and short-term investments.

There are no consolidated VIE's assets that are collateral for the VIE's obligations and can only be used to settle the VIE's obligations. There are no creditors (or beneficial interest holders) of the VIE that have recourse to the general credit of the Company or any of its consolidated subsidiaries. There are no terms in any arrangements, considering both explicit arrangements and implicit variable interests, that require the Company or its subsidiaries to provide financial support to the VIE. However, if the VIE ever needs financial support, the Company or its subsidiaries may, at its option and subject to statutory limits and restrictions, provide financial support to its VIE through loans to the shareholder of the VIE or entrustment loans to the VIE.

Relevant PRC laws and regulations restrict the VIE from transferring a portion of its net assets, equivalent to the balance of its statutory reserve and its share capital, to the Company in the form of loans and advances or cash dividends. Please refer to Note 23 for disclosure of restricted net assets.

**2. SIGNIFICANT ACCOUNTING POLICIES****Basis of presentation**

The consolidated financial statements of the Group have been prepared in accordance with the accounting principles generally accepted in the United States of America ( US GAAP ).

Basis of consolidation

The consolidated financial statements include the financial statements of the Company, its WFOEs and its VIE. The Company and its WFOEs have entered into contractual arrangements with the VIE and its shareholder, which enables the Company to (1) have power to direct activities that most significantly affects the economic performance of the VIE, and (2) receive the economic benefits of the VIE that could be significant to the VIE. Accordingly, the Company is considered the primary beneficiary of the VIE and has consolidated the VIE's financial results of operations, assets and liabilities in the Company's consolidated financial statements. All inter-company transactions and balances have been eliminated upon consolidation.

Use of estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and revenue and expenses in the financial statements and accompanying notes. Significant accounting estimates reflected in the Group's consolidated financial statements include the valuation allowance for deferred tax assets, allowance for accounts receivable and other current assets, economic lives and impairment of property and equipment, impairment of trademark and goodwill, and fair value of share-based awards. Actual results could differ from those estimates.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

**Business combinations**

Business combinations are recorded using the acquisition method of accounting. The purchase price of the acquisition is allocated to the tangible assets, liabilities, identifiable intangible assets acquired and non-controlling interest, if any, based on their estimated fair values as of the acquisition date. The excess of the purchase price over those fair values is recorded as goodwill. Acquisition-related expenses and restructuring costs are expensed as incurred.

Where the consideration in an acquisition includes contingent consideration and the payment of which depends on the achievement of certain specified conditions post-acquisition, the contingent consideration is recognized and measured at its fair value at the acquisition date and if recorded as a liability, it is subsequently carried at fair value with changes in fair value reflected in earnings. For contingent consideration related to acquisitions made prior to June 1, 2009, contingent consideration was not recorded until the contingency was resolved.

**Cash and cash equivalents**

Cash and cash equivalents consist of cash on hand and highly liquid investments which are unrestricted as to withdrawal or use, and which have remaining maturities of three months or less when purchased.

**Term deposits**

Term deposits consist of deposits placed with financial institutions with original maturities of greater than three months and less than one year.

**Short-term investments**

Short term investments consist of held-to-maturity investment with the maturity of less than one year. All of the Group's held-to-maturity investments are classified as short-term investments on the consolidated balance sheets based on their contractual maturity dates which are less than one year and are stated at their amortized costs.

The Group reviews its held-to-maturity investments for other-than-temporary impairment ( OTTI ) based on the specific identification method. The Group considers available quantitative and qualitative evidence in evaluating the potential impairment of its short-term investments. If the cost of an investment exceeds the investment's fair value, the Group considers, among other factors, general market conditions, expected future performance of the investees, the duration and the extent to which the fair value of the investment is less than the cost, and the Group's intent and ability to hold the investments. OTTI below cost is recognized as a loss in the income statement.

**Restricted cash**

Restricted cash represents Renminbi ( RMB ) deposits in bank accounts as deposits for establishing new schools and subsidiaries.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**Allowance for doubtful accounts

Accounts receivable represent amounts due from corporate customers of the Group's various schools and subsidiaries. The Group provides an allowance for doubtful accounts equal to the estimated uncollectible amounts. The Group's estimates are based on historical collection experience and a review of the current status of accounts receivable and advances to suppliers. Accounts receivable and advances to suppliers are presented net of an allowance for doubtful accounts.

Changes in the allowance for doubtful accounts were as follows:

	As of May 31,	
	2011	2012
	US\$	US\$
Beginning balance	69	60
Charge during the year	47	52
Written-off	(56)	(64)
Ending balance	60	48

Inventory

Inventory is stated at the lower of cost or market value.

Land use rights

Land use rights are recorded at cost and amortized on a straight-line basis over the 50 year term of the land certificate.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization is calculated on a straight line basis over the following estimated economic lives:

Buildings	20-50 years
Transportation equipment	10 years
Furniture and education equipment	5 years
Computer equipment and software	3 years
Leasehold improvements	Shorter of the lease term or estimated economic life



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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

Construction in progress

The Group constructs certain of its property and equipment. In addition to cost under the construction contracts, interest cost and external costs directly related to the construction of such facilities, including equipment installation and shipping costs, are capitalized. Depreciation is recorded at the time assets are ready for the intended use.

Impairment of long-lived assets

The Group reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. When these events occur, the Group measures impairment by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from the use of the assets and their eventual disposition. If the sum of the expected undiscounted cash flow is less than the carrying amount of the assets, the Group would recognize an impairment loss based on the fair value of the assets. The Group did not record impairment losses on long-lived assets during the years ended May 31, 2010, 2011 and 2012.

Impairment of goodwill and indefinite-lived intangible assets

The Group reviews the carrying value of intangible assets not subject to amortization, including goodwill, to determine whether impairment may exist, whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable at least annually.

Specifically, goodwill impairment is determined using a two-step process. The first step compares the fair values of each reporting unit to its carrying amount, including goodwill. If the fair value of each reporting unit exceeds its carrying amount, goodwill is not considered to be impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of goodwill to the carrying value of a reporting unit's goodwill. The implied fair value of goodwill is determined in a manner similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. Estimating fair value is performed by utilizing various valuation techniques, with the primary technique being a discounted cash flow.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

Impairment of goodwill and indefinite-lived intangible assets - continued

The impairment test for other intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying value. If the carrying value of the intangible asset exceeds its fair value, an impairment loss is recognized in an amount equal to that excess.

The Group performs the annual impairment tests on May 31 of each year. The Group recognized an impairment loss of US\$76, nil and nil on goodwill and other intangible assets not subject to amortization during the years ended May 31, 2010, 2011 and 2012, respectively.

Acquired intangible assets with definite lives

Acquired intangible assets with definite lives consist of trademark, license and coursewares, and are carried at cost, less accumulated amortization and impairment. Amortization of acquired intangible assets is calculated on a straight-line basis over the shorter of the contractual terms or the expected economic lives of the acquired assets. The weighted average amortization periods by major intangible assets class are as follows:

Trademark	10 years
License	20 years
Courseware	1 year

Long-term investments

Long-term investments consist of investments in the stock of investees for which the Group does not have the ability to exercise significant influence over operating and financial policies of an investee. These investments are carried at cost and are adjusted for other-than-temporary declines in fair value of the investment and distributions of earnings. The Group periodically reviews its long-term investments for other-than-temporary impairment. The Group considers available quantitative and qualitative factors, such as reviewing the investee's cash position, recent financings, projected and historical financial performance, cash flow forecasts and financing needs, in evaluating the potential impairment of its long-term investments. The Group did not record impairment losses on its long-term investments during the years ended May 31, 2010, 2011 and 2012.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

**Revenue recognition**

Revenue is recognized when persuasive evidence that an arrangement exists, delivery of the product or service has occurred, the selling price is both fixed and determinable and collection is reasonably assured. Revenue is reported net of business taxes, scholarships, and refunds. Business tax amounted to US\$14,619, US\$18,966 and US\$26,692 for the years ended May 31, 2010, 2011 and 2012, respectively. The primary sources of the Group's revenues are as follows:

(a) Educational programs and services

The educational programs and services consist of language training and test preparation courses, primary and secondary school education and college admission examination retaking training service. Tuition is generally paid in advance and is initially recorded as deferred revenue. Tuition revenue for educational programs and services is recognized proportionately as the instructions are delivered, and is reported net of scholarships, business taxes and related surcharges, and tuition refunds. Students are entitled to a short term course trial period which commences on the date the course begins. Tuition refunds are provided to students if they decide within the trial period that they no longer want to take the course. Tuition refunds have been insignificant in fiscal years 2010, 2011 and 2012. After the trial period, if a student withdraws from a class, usually no refunds will be provided and any collected but unearned portion of the fee is recognized at that time.

The Group also sells online-learning cards primarily to distributors at fixed price after deducting a pre-determined fixed discount to the face value of the cards. Online-learning card sales represent prepaid service fees received from students for e-learning services. The prepaid service fee is recorded as deferred revenue upon receiving the upfront payment. Revenue is recognized upon actual usage of the cards by the students based on the number of minutes the students use the e-learning services, of which the actual usage is tracked by the Group on an individual basis. Upon the expiration of the online-learning card, which ranges from six months to one year from the date of sale of the card to the distributor, the Group will recognize the remaining unused minutes as revenue.

(b) Books and others

The Group sells educational books or other educational materials either through its book stores or websites or through third party distributors. Revenue from sales made through the Group's book stores is recognized upon sales to customers. Revenue through distributors is recognized once the products are sold to the end customers.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases are charged to the consolidated statements of operations on a straight-line basis over the shorter of the lease term or estimated economic life.

Advertising costs

The Group expenses advertising costs as they are incurred. Total advertising expenses were US\$17,942, US\$21,376 and US\$28,960 for the years ended May 31, 2010, 2011 and 2012, respectively, and have been included as part of selling and marketing expenses.

Government subsidies

The Group recognizes government subsidies as miscellaneous income when they are received because they are not subject to compliance with any past or future conditions, there are no performance conditions or conditions of use, and are not subject to future return. Government subsidies received and recognized as miscellaneous income totaled US\$251, US\$1,028 and US\$971 for the years ended May 31, 2010, 2011 and 2012, respectively.

Foreign currency translation

The Company's functional and reporting currency is the United States dollars ( U.S. dollars ). The financial records of the Company's subsidiaries, New Oriental China and its schools and subsidiaries located in the PRC are maintained in its local currency, RMB which is the functional currency of these entities. The financial records of the Company's subsidiaries located in Hong Kong are maintained in U.S. dollars, which is the functional currency of these entities. The functional currency of the Company's subsidiaries in Hong Kong is the U.S. dollars.

Monetary assets and liabilities denominated in currencies other than the applicable functional currencies are translated into the reporting currency at the rates of exchange ruling at the balance sheet date. Equity accounts are translated at historical exchange rates, and revenues and expenses are translated using the average rate of exchange in effect during the reporting period. Translation adjustments are reported and shown as a separate component of other comprehensive income in the consolidated statements of changes in equity and comprehensive income.

Transactions in currencies other than the functional currencies during the year are converted into the applicable functional currencies at the applicable rates of exchange prevailing at the dates of the transactions. Transaction gains and losses are recognized in the consolidated statements of operations.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

**Foreign currency risk**

The RMB is not a freely convertible currency. The State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of RMB into other currencies. The value of the RMB is subject to changes in central government policies and to international economic and political developments affecting supply and demand in the China Foreign Exchange Trading System market. The Group's cash and cash equivalents, restricted cash, and term deposits denominated in RMB amounted to US\$383,572 and US\$400,183 at May 31, 2011 and 2012, respectively.

**Fair value**

Fair value is the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Group considers the principal or most advantageous market in which it would transact and it considers assumptions that market participants would use when valuing the asset or liability. Authoritative literature provides a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The level in the hierarchy within which the fair value measurement in its entirety falls is based upon the lowest level of input that is significant to the fair value measurement as follows:

**Level 1**

Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

**Level 2**

Level 2 applies to assets or liabilities for which there are inputs other than quoted prices included within Level 1 that are observable for the asset or liability such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical assets or liabilities in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**Fair value - continued

## Level 3

Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

The Group did not have any financial assets and liabilities or nonfinancial assets and liabilities that were measured at fair value on a non-recurring basis as of May 31, 2011 and 2012.

The Group had the following financial assets and liabilities or nonfinancial assets and liabilities that were measured at fair value on a recurring basis as of May 31, 2011:

	Level 1	May 31, 2011		Total
	US\$	Level 2	Level 3	US\$
		US\$	US\$	
<b>Liabilities:</b>				
Contingent consideration for acquisition of Newave			4,243	4,243
<b>Total</b>			<b>4,243</b>	<b>4,243</b>

The Group did not have any financial assets and liabilities or nonfinancial assets and liabilities that were measured at fair value on a recurring basis as of May 31, 2012.

Fair value of financial instruments

The Group's financial instruments consist primarily of cash and cash equivalents, term deposits, restricted cash, short term investments and accounts receivable. The carrying amounts of cash and cash equivalents, term deposits, restricted cash, accounts receivable and amount due from/to related parties approximate their fair values due to the short-term maturities of these instruments.

Net income per share

Basic net income per share is computed by dividing income attributable to holders of common shares by the weighted average number of common shares outstanding during the year. Diluted net income per common share reflects the potential dilution that could occur if securities or other contracts to issue common shares were exercised into common shares. Common share equivalents are excluded from the computation of the diluted net income per share in years when their effect would be anti-dilutive.



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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

**Income taxes**

The Group accounts for income taxes using the asset and liability approach. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial reporting and tax bases of assets and liabilities using enacted tax rates that will be in effect for the period in which the differences are expected to reverse. The effect on deferred taxes of a change in tax rates is recognized in the consolidated statements of operations in the period of change. Deferred tax assets are reduced by a valuation allowance when it is considered more likely than not that some portion or all of the deferred tax assets will not be realized.

The Group accounts for uncertain tax positions by reporting a liability for unrecognized tax benefits resulting from uncertain tax positions taken or expected to be taken in a tax return. Tax benefits are recognized from uncertain tax positions when the Group believes that it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. The Group recognizes interest and penalties, if any, related to unrecognized tax benefits in income tax expense.

**Comprehensive income**

Comprehensive income includes net income and foreign currency translation adjustments. Comprehensive income is reported as a component of the consolidated statements of changes in equity and comprehensive income.

**Share-based compensation**

Share-based payments to employees and directors are measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense net of a forfeiture rate on a straight-line basis over the requisite service period, with a corresponding addition to paid-in capital. The Group uses the binomial option pricing model to measure the fair value of options granted and the quoted market price of the Company's equity shares to measure the fair value of NES granted to employees at each measurement date. The binomial option pricing model is adopted because the Group believes that considering the possibility of exercise of an option over the life of the option, as affected by the reality of changing stock prices and non-constant risk free rates, would better reflect the measurement objective of relevant accounting literature.

The amount of compensation expense recognized at any date is at least equal to the portion of the fair value of the awards that are vested as of that date. The estimate of forfeitures is based on historical turnover rate and will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will impact the amount of share-based compensation expense to be recognized in future periods.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

**Concentration of credit risk**

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of cash and cash equivalents, term deposits, restricted cash, and accounts receivable. As of May 31, 2012, substantially all of the Group's cash and cash equivalents, and term deposits were deposited with financial institutions with high-credit ratings and quality. Accounts receivable are typically unsecured and are derived from revenues earned from customers in PRC. The Group performs periodic credit evaluations and provides an allowance for doubtful accounts to reduce the accounts receivable balance to its net realizable value. The Group did not have any customers constituting 10% or more of the consolidated net revenues and accounts receivable in fiscal years 2010, 2011 and 2012.

**Recently adopted accounting pronouncements**

In December 2010, the FASB issued an authoritative pronouncement on disclosure of supplementary pro forma information for business combinations. The objective of this guidance is to address diversity in practice regarding the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The amendments in this update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments affect any public entity as defined by Topic 805-Business Combinations that enters into business combinations that are material on an individual or aggregate basis. The Group applied the disclosure requirements of this pronouncement for business combinations consummated in periods beginning June 1, 2011, which did not have significant impact on its consolidated financial condition or results from operations.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

Recently issued accounting pronouncements not yet adopted

In May 2011, the FASB issued an authoritative pronouncement on fair value measurement. The guidance is the result of joint efforts by the FASB and IASB to develop a single, converged fair value framework. The guidance is largely consistent with existing fair value measurement principles in U.S. GAAP. The guidance expands the existing disclosure requirements for fair value measurements and makes other amendments, mainly including:

Highest-and-best-use and valuation-premise concepts for nonfinancial assets - the guidance indicate that the highest-and-best-use and valuation-premise concepts only apply to measuring the fair value of nonfinancial assets.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk - the guidance permits an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk when several criteria are met. When the criteria are met, an entity can measure the fair value of the net risk position.

Premiums or discounts in fair value measure - the guidance states that premiums or discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement.

Fair value of an instrument classified in a reporting entity's shareholders' equity - the guidance prescribes a model for measuring the fair value of an instrument classified in shareholders' equity; this model is consistent with the guidance on measuring the fair value of liabilities.

Disclosures about fair value measurements - the guidance expands disclosure requirements, particularly for Level 3 inputs. Required disclosures include:

For fair value measurements categorized in level 3 of the fair value hierarchy: (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation process in place (e.g., how the entity decides its valuation policies and procedures, as well as changes in its analyses of fair value measurements, from period to period), and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.

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The level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**

Recently issued accounting pronouncements not yet adopted - continued

The guidance is to be applied prospective and effective for interim and annual periods beginning after December 15, 2011. Early application by public entities is not permitted. The Group does not expect the adoption of this pronouncement to have a significant impact on its consolidated financial condition or results from operations.

In June 2011, the FASB issued an authoritative pronouncement to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity. These amendments do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The guidance should be applied retrospectively. The amendments are effective for fiscal years and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. In December 2011, the FASB issued an authoritative pronouncement related to deferral of the effective date for amendments to the presentation of reclassifications of items out of accumulated other comprehensive income. This guidance allows the FASB to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. The Group does not expect the adoption of these pronouncements to have a significant impact on its consolidated financial condition or results from operations.

In September 2011, the FASB has issued an authoritative pronouncement related to testing goodwill for impairment. The guidance is intended to simplify how entities, both public and nonpublic, test goodwill for impairment. The pronouncement permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Group does not expect the adoption of this pronouncement to have a significant impact on its consolidated financial condition or results from operations.

In December 2011, the FASB issued an authoritative pronouncement related to disclosures about offsetting assets and liabilities. The guidance requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The Group does not expect the adoption of this pronouncement to have a significant impact on its consolidated financial condition or results from operations.

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**2. SIGNIFICANT ACCOUNTING POLICIES - continued**Recently issued accounting pronouncements not yet adopted - continued

In July 2012, the FASB issued an authoritative pronouncement related to testing indefinite-lived intangible assets, other than goodwill, for impairment. Under the pronouncement, entities testing indefinite-lived intangible assets for impairment would have the option of performing a qualitative assessment before calculating the fair value of the asset. If an entity determines, on the basis of qualitative factors, that the indefinite-lived intangible asset is not more likely than not impaired, a quantitative fair value calculation would not be needed. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. The Group does not expect the adoption of this pronouncement to have a significant impact on its consolidated financial condition or results from operations.

**3. BUSINESS ACQUISITION AND DECONSOLIDATION OF NEWAVE**

On September 1, 2010, the Group acquired a 100% equity interest in Shanghai Huangpu District Newave Education Training Center, a Shanghai based private school that specialized in tutoring English for K-12 students. The acquisition further extended the Group's market position in Shanghai. The acquisition was recorded using the acquisition method of accounting and, accordingly, the acquired assets and liabilities were recorded at their fair market value at the date of acquisition. The purchase price was allocated as at the date of acquisition as follows:

	US\$	Amortization period
Cash	72	
Other current assets	448	
Property and equipment	525	
Intangible assets		
Trademark	1,430	Indefinite
Courseware	9	1 year
Student base	2,897	5 years
License	7	3 years
Goodwill	5,537	
Deferred revenue	(2,595)	
Other current liabilities	(1,209)	
Deferred tax liabilities	(1,086)	
<b>Total</b>	<b>6,035</b>	

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**3. BUSINESS ACQUISITION AND DECONSOLIDATION OF NEWAVE - continued**

Of the total consideration of US\$6,035, US\$4,243 was contingent consideration that was subject to adjustment based on Newave achieving certain performance targets during the period from September 1, 2010 to August 31, 2011. The contingent consideration was recognized as a liability and measured at its fair value at the acquisition date. When settled, the contingent consideration amount can range between nil to US\$11,577. There was no change in the fair value of the contingent consideration from the acquisition date and as of May 31, 2011.

For the year ended May 31, 2011, Newave contributed US\$4,757 to consolidated net revenues and had a net loss of US\$15. The unaudited pro forma information of the acquisition as if the acquisition had occurred on June 1, 2011 and 2010 is not presented because the Group believes it is impracticable to do so.

Due to breach of contract by the seller of Newave, the Group lost its control over Newave and submitted an arbitration petition to the China International Economic and Trade Arbitration Commission ( CTETA ) seeking for full refund of the purchase consideration paid in August 2011. As a result, the Group deconsolidated Newave in August 2011. In December 2011, a conciliatory agreement was reached between the Group and the seller under the mediation of CTETA that the seller shall return to the Group the full investment of US\$2,200 which was collected before May 31, 2012. A gain on deconsolidation of Newave of US\$408 was recognized as the carrying amount of Newave at the time of deconsolidation was less than the original investment cost.

**4. DISPOSAL OF SUBSIDIARIES**Disposal of Mingshitang

In April 2011, the Company sold 60% equity interest in Mingshitang to Mr. Ma Yonggang, the noncontrolling shareholder of Mingshitang, for a cash consideration of US\$460, resulting in a loss of US\$1,177. The loss on disposal was derived as follows:

	US\$
Cash consideration	460
Less:	
Assets	2,738
Liabilities	(1,484)
Noncontrolling interest	383
Disposal loss	(1,177)

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**4. DISPOSAL OF SUBSIDIARIES - continued**Disposal of Tomorrow Oriental

In May 2011, the Company sold 100% equity interest in Tomorrow Oriental to Mr. Huang Binliang, the general manager of Tomorrow Oriental, for a cash consideration of US\$1,127, resulting in a loss of US\$360. The loss on disposal was derived as follows:

	US\$
Cash consideration	1,127
Less:	
Assets	1,969
Liabilities	(482)
Disposal loss	(360)

**5. SHORT-TERM INVESTMENTS**

Short-term investments consist of various fixed-income financial products purchased from Chinese banks and trusts and are classified as held-to-maturity investments as the Group has the positive intent and ability to hold the investments to maturity. The maturities of these financial products range from one month to less than one year, with interest rates ranging from 3.35% to 8.5%. They are classified as short-term investments on the consolidated balance sheets as their contractual maturity dates are equal to or less than one year. The repayment of most of the financial products is guaranteed by the Chinese banks from which the fixed income financial products were purchased. Historically, the Group has received the principal and accrued interest in full upon maturity of these investments.

All of the Group's held-to-maturity investments are stated at amortized costs. While these fixed-income financial products are not publicly traded, the Group estimated that their fair value approximate their amortized costs considering their short term maturities and high credit quality. Therefore, there is no unrecognized holding gain or loss. The Group reviews its held-to-maturity investments for other-than-temporary impairment based on specific identification. No other-than-temporary impairment was recognized for the year ended May 31, 2012.

Short-term investments consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
Held-to-maturity investments	143,704	321,182



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**6. INVENTORY**

Inventory consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
Course materials in schools	6,218	6,620
Publications in bookstores	11,793	13,454
	<b>18,011</b>	<b>20,074</b>

A valuation allowance was not considered necessary because inventory was marked down to the lower of cost or market value, in the amount of US\$526 and US\$449, for the years ended May 31, 2011 and 2012, respectively.

**7. PREPAID EXPENSES AND OTHER CURRENT ASSETS**

Prepaid expenses and other current assets consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
Prepaid rent	11,659	23,646
Advances to suppliers	6,952	12,157
Interest receivable	5,980	5,321
Receivable from the settlement bank for the proceeds of exercise of options	155	3,852
Prepaid advertising fees	1,314	3,318
Staff advances (a)	2,888	3,082
Rental deposit	1,408	1,184
Value added taxes recoverable	1,076	1,139
Prepaid property taxes and other taxes	194	686
Receivable from disposal of Mingshitang	310	314
Refundable deposit for school construction	154	179
Others (b)	1,158	5,668
	<b>33,248</b>	<b>60,546</b>

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- (a) Staff advances are provided to staff for traveling and related use which are expensed as incurred.
- (b) Others primarily included insurance fees, recruiting fees, maintenance fees, and other miscellaneous prepayments.

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**8. INTANGIBLE ASSETS**

Intangible assets consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
<b>Costs:</b>		
Intangible assets with indefinite lives:		
Trademark	1,756	257
Intangible assets with finite lives:		
Trademark	310	315
Courseware	57	49
Student base	3,045	
License	422	415
	5,590	1,036
<b>Accumulated amortization:</b>		
Trademark	(85)	(118)
Courseware	(55)	(49)
Student base	(457)	
License	(17)	(36)
	(614)	(203)
<b>Net carrying amount:</b>		
Intangible assets with indefinite lives:		
Trademark	1,756	257
Intangible assets with finite lives:		
Trademark	225	197
Courseware	2	
Student base	2,588	
License	405	379
	4,976	833

In connection to the deconsolidation of Newwave during the year ended May 31, 2012, an indefinite life trademark, courseware, student base and license intangible assets with net balances of US\$1,527, US\$2, US\$2,630 and US\$5, respectively, were deconsolidated.

Amortization expenses for the intangible assets for the years ended May 31, 2010, 2011 and 2012 were US\$79, US\$529 and US\$52, respectively. As of May 31, 2012, the Group expects to record amortization expenses related to intangible assets US\$52 for each of the next five years and US\$316 thereafter.



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**9. GOODWILL**

	As of May 31,	
	2011	2012
	US\$	US\$
<b>Costs:</b>		
Beginning balance	2,894	7,588
Payment of contingent consideration associated with acquisition of Tongwen	193	
Acquisition of Newave	5,537	
Disposal of Mingshitang	(1,378)	
Deconsolidation of Newave		(5,820)
Exchange of difference	342	30
Ending balance	7,588	1,798
<b>Accumulated goodwill impairment loss:</b>		
Beginning balance	76	
Disposal of Mingshitang	(76)	
Ending balance		
<b>Goodwill, net</b>	<b>7,588</b>	<b>1,798</b>

Goodwill is associated with entities included in the language training and test preparation courses segment.

**10. PROPERTY AND EQUIPMENT**

Property and equipment consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
Buildings	104,994	118,830
Transportation equipment	6,177	7,051
Furniture and education equipment	38,794	50,106
Computer equipment and software	15,210	20,525
Leasehold improvements	56,961	90,739
	222,136	287,251
Less: accumulated depreciation and amortization	(64,523)	(88,255)

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Construction in-process	2,808	5,346
	160,421	204,342

Depreciation and amortization expense for the years ended May 31, 2010, 2011 and 2012 was US\$12,190, US\$16,407 and US\$26,219, respectively.

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**11. LAND USE RIGHTS**

Land use rights consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
Land use rights	3,980	3,980
Less: accumulated amortization	(660)	(747)
Exchange differences	182	243
Land use rights, net	3,502	3,476

Amortization expense for land use rights for the years ended May 31, 2010, 2011 and 2012 was US\$81, US\$83 and US\$87, respectively. The Group expects to recognize US\$87 in amortization expense for each of the next five years and US\$3,041 thereafter.

**12. PREPAYMENT FOR AN ACQUISITION**

In April 2012, we signed an agreement with a third party to acquire a 100% equity interest in China Management Software Institute, a software teaching school, for US\$18,000. A deposit of US\$3,279 has been paid as of May 31, 2012. The consummation of the acquisition was subject to the regulatory approval of the transfer of the teaching permit and business license, which was received in September 2012, at which time the acquisition was closed.

**13. LONG TERM INVESTMENT**

Long term investments consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
Talent Boom Group Ltd. ( Talent Boom )	2	2
Dajie.com Ltd. ( Dajie.com )		2,000
	2	2,002

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In December 2006, the Group acquired 20% interest in Talent Boom. The Group has no representation on Talent Boom's board of directors or its management and does not have the ability to exercise significant influence over the operating and financial policies of Talent Boom. Accordingly, the investment in Talent Boom was accounted for as a cost-method investment.

In September 2011, the Group signed a share subscription agreement to invest US\$2,000 for 5% equity ownership interest in Dajie.com. The fair value of Dajie.com's equity ownership interest is not readily determinable and the Group does not have the ability to exercise significant influence over the operating and financial policies of Dajie.com. Accordingly, the investment in Dajie.com has been accounted for as a cost-method investment.

**14. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consisted of the following:

	As of May 31,	
	2011	2012
	US\$	US\$
Accrued payroll	36,143	51,537
Refundable incidental expenses received from students	5,865	8,338
Payable for purchase of property and equipment	7,475	7,069
Business taxes payable	5,221	5,639
Individual taxes withholding	2,299	5,060
Amounts reimbursable to employees (a)	3,030	3,747
Rent payable	2,531	3,279
Accrued advertising fees	1,861	2,314
Refundable deposit (b)	1,203	2,157
Welfare payable	1,892	1,952
Royalty fees payable (c)	464	1,771
Accrued professional service fees	628	1,140
Other taxes payable	353	897
Value added taxes payable	623	796
Contingent consideration associated with acquisition of Tongwen	193	
Contingent consideration associated with acquisition of Newave	4,243	
Others (d)	2,978	4,077
Total	77,002	99,773

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- (a) Amounts reimbursable to employees included traveling and the related expenses incurred by employees on behalf of the Group.  
 (b) Refundable deposits represent student deposits for dormitory or other fees that will be refunded upon graduation.  
 (c) Royalty fees payable related to payments to content providers for on-line learning programs.  
 (d) Others primarily included transportation expenses, utility fees, property management fees, and other miscellaneous expenses payable.

**15. SHARE-BASED COMPENSATION**

The following tables summarize information regarding share options and non-vested equity shares ( NES ):

Share options	Shares granted	Grant-date fair value US\$	Exercise price US\$
<b>Grant date:</b>			
February 28, 2006	7,099,500	1.00	2.02
July 21, 2006	1,620,000	1.15	2.38
September 7, 2006	100,000	2.38	3.75
March 5, 2007	3,946,500	4.09	8.75
January 17, 2012	3,060,000	10.33	22.00
<b>Total</b>	<b>15,826,000</b>		

NES	Shares granted	Grant-date fair value and intrinsic value US\$
<b>Grant date:</b>		
January 24, 2008	2,720,000	12.75
March 11, 2008	152,000	14.00
July 1, 2008	278,500	13.75
Oct 28, 2008	3,200	12.65
May 15, 2009	205,548	12.75
June 15, 2009	316,200	15.13
May 26, 2010	556,848	21.75
June 10, 2011	811,020	25.11
<b>Total</b>	<b>5,043,316</b>	



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**15. SHARE-BASED COMPENSATION - continued**

In February 2007, October 2007, October 2008, March 2009 and January 2011, the Company transferred 4,000,000, 2,000,000, 3,000,000, 4,000,000 and 3,000,000 common shares, respectively, to its depository bank, to be issued to employees and non-employees upon the exercise of their vested share options or upon the vesting of non-vested equity shares ( NES ). As of May 31, 2012, 9,453,095 common shares out of these 16,000,000 common shares had been issued to employees and non-employees upon the exercise of their share options and 3,659,524 NES had been issued to employees upon the vesting of their shares. 2,887,381 common shares remain for future issuance.

**2006 Share Incentive Plan**

On January 20, 2006, the Company adopted 2006 Share Incentive Plan, under which the Company may grant share options to purchase up to 8,000,000 common shares of the Group, to its employees, directors and consultants. The number of common shares available for grant under the 2006 Share Incentive Plan may be increased annually by (i) an additional 5,000,000 shares on January 1, 2007, (ii) an additional 5,000,000 shares on January 1, 2008, and (iii) an annual increase in common shares to be added on the first business day of each calendar year beginning in 2009 equal to the lesser of (x) 3,000,000 shares, (y) two percent (2%) of total common shares outstanding as of such date, or (z) a lesser number of shares as determined by the Group's management. In the event the aggregate number of shares that may be issued in any given year under all share compensation plans has reached the maximum number of shares allowed in that year, the Company may grant additional awards up to 2,000,000 shares, or extra shares. The number of shares granted in excess of the annual maximum in any given year will result in the reduction of the maximum shares available for grant in the next year.

The exercise price of share options is at least 100% of the fair value of the common shares on the date of the grant. The term of a share option is up to ten years from the date of grant. The share options generally vest over three years at six-month vesting increments per year.

The Company recorded share-based compensation of US\$16,183, US\$15,045 and US\$24,125 during the years ended May 31, 2010, 2011 and 2012, respectively.

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**15. SHARE-BASED COMPENSATION - continued**Share options

A summary of share options activity under 2006 Share Incentive Plan as of May 31, 2011 and 2012 was as follows:

	Number of options	Weighted average exercise prices US\$	Weighted average remaining contractual life years	Aggregated intrinsic value US\$
Options outstanding at June 1, 2009	6,279,816	5.01		
Exercised	(2,761,980)	4.50		
Forfeited	(24,844)	7.71		
Options outstanding at May 31, 2010	3,492,992	5.40	6.22	61,200
Exercised	(1,235,700)	5.33		
Forfeited	(1,800)	2.02		
Options outstanding at May 31, 2011	2,255,492	5.44	5.20	53,046
Granted	3,060,000	22.00		
Exercised	(179,195)	4.41		
Forfeited				
Options outstanding at May 31, 2012	5,136,297	15.34	7.43	57,371
Options vested and expect to vest at May 31, 2012	4,965,855	15.11	7.36	56,603
Options exercisable at May 31, 2012	2,076,297	5.53	4.20	43,571

The total intrinsic value of share options exercised during the years ended May 31, 2010, 2011 and 2012 were US\$40,084, US\$25,114 and US\$4,121, respectively. The weighted average grant date fair value of share options granted during the years ended May 31, 2010, 2011 and 2012 was nil, nil and US\$10.33, respectively. As of May 31, 2012, total unrecognized compensation expense relating to unvested share options of US\$26,497 is expected to be recognized over a weighted average period of 2.63 years.

The fair value of share options granted on January 17, 2012 was estimated on the date of grant using the binomial option pricing model with the following assumptions:

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Risk-free interest rate of return	1.83%
Volatility	56%
Dividend yield	0%
Fair value of the underlying ordinary shares	US\$22.36
Exercise price	US\$22.00
Exercisable date	1/6 of options vests semi-annually through December 31, 2014
Expiry date	January 17, 2017
Life of option (years)	5
Exercise multiple	2.8
Turnover rate	5.57%
Number of nodes	200

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**15. SHARE-BASED COMPENSATION - continued**

Share options - continued

*(a) Volatility*

The volatility of the underlying ordinary shares during the life of the share options was estimated based on the Company's historical stock price volatility over a period commensurate to the expected term of the share options.

*(b) Risk-free interest rate*

Risk-free interest rate was estimated based on the yield to maturity of US\$ denominated China international government bonds with a maturity period commensurate with the contractual life of the share options.

*(c) Dividend yield*

The dividend yield was estimated based on the Company's expected dividend distributions during a period commensurate with the contractual life of the share options.

*(d) Exercise price*

The exercise price of the share options was determined by the Company's board of directors, which is generally quoted market price of the Company's ordinary shares on the date of grant.

*(e) Fair value of underlying ordinary shares*

The fair value of the ordinary shares underlying the share options is the quoted market price of the Company's ordinary shares on the date of grant.

*(f) Life of option*

The life of the share option is based on the stated contractual life of the share options.

*(g) Number of nodes*

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This number divides the life to expiration into a number of equal time slots. It determines the number of level in the binomial tree.

*(h) Exercise multiple*

A ratio of the stock price to the contractual strike price at which point it is assumed that the share option will be exercised prior to expiration

*(i) Forfeiture rate*

The Company's estimate based on historical employee turnover.

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**15. SHARE-BASED COMPENSATION - continued****NES**

In June 2009, the Company granted 316,200 NES to employees which vested between November 2009 to August 30, 2010.

In May 2010, the Company granted 556,848 NES to employees which will vest between June 2010 to June 2015.

In June 2011, the Company granted 811,020 NES to employees which will vest between November 2011 to May 2014.

	Number of NES	Weighted- average grant date fair value and intrinsic value US\$
NES outstanding at June 1, 2009	1,840,248	12.90
Granted	873,048	19.35
Vested	(647,364)	13.13
Forfeited	(13,124)	12.75
NES outstanding at May 31, 2010	2,052,808	15.57
Vested	(914,080)	13.61
Forfeited	(35,360)	19.93
NES outstanding at May 31, 2011	1,103,368	17.05
Granted	811,020	25.11
Vested	(1,353,548)	20.35
Forfeited	(39,840)	24.25
NES outstanding at May 31, 2012	521,000	20.47
NES vested and expect to vest at May 31, 2012	491,125	20.41

The total fair value of shares vested during the year ended May 31, 2012 was US\$27,547. The weighted average grant date fair value of NES granted during the years ended May 31, 2010, 2011 and 2012 was US\$19.35, \$nil and US\$25.11, respectively. As of May 31, 2012, total unrecognized compensation expense for NES of US\$8,446 is expected to be recognized over a weighted average period of 0.99 years.

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**16. INCOME TAXES**

Significant components of provision for income taxes for the years ended May 31, 2010, 2011 and 2012 were as follows:

	Years ended May 31,		
	2010 US\$	2011 US\$	2012 US\$
<b>Current:</b>			
PRC	7,845	9,390	14,027
<b>Deferred:</b>			
PRC	(1,871)	(1,154)	(3,255)
<b>Total provision for income taxes</b>	<b>5,974</b>	<b>8,236</b>	<b>10,772</b>

The Company is incorporated in the Cayman Islands. Under the current laws of the Cayman Islands, the Company is not subject to income or capital gains taxes. In addition, dividend payments are not subject to withholdings tax in the Cayman Islands.

The Company's subsidiaries Smart Shine, Winner Park and Elite Concept are located in Hong Kong and are subject to an income tax rate of 16.5% for taxable income earned in Hong Kong. These subsidiaries recorded income tax expense of US\$208, US\$300 and US\$11 during the years ended May 31, 2010, 2011 and 2012, respectively.

On March 16, 2007, the National People's Congress adopted the Enterprise Income Tax Law (the New EIT Law), which became effective on January 1, 2008 and replaced the existing separate income tax laws for domestic enterprises and foreign-invested enterprises. Since January 1, 2008, the Company's PRC subsidiaries, New Oriental China and its schools and subsidiaries are subject to the 25% standard enterprise income tax except for those accepted as deemed profit method enterprises, or qualified for small-scale enterprises, or granted preferential tax treatment.

Enterprises that qualify as a high and new technology enterprise (HNTE) after January 1, 2008 are subject to a tax rate of 15% as long as they continue to qualify as HNTE. Beijing Decision, Beijing Hewstone and Xuncheng enjoyed a 3-year half rate since January 1, 2008, and qualified as HNTE in Beijing for three years commencing from January 1, 2008. As a result, they were subject to a 7.5% tax rate from January 1, 2008 through December 31, 2010 and 15% thereafter.

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**16. INCOME TAXES - continued**

Enterprises that qualify as the newly established software enterprise ( NESE ) are exempt from EIT for two years beginning the enterprise's first profitable year followed by a tax rate of 12.5% for the succeeding three years. Beijing Pioneer and Shanghai Smart Words qualified as NESE and were exempt from income taxes from January 2010 through December 31, 2011, and from January 2011 through December 31, 2012, respectively, and a tax rate of 12.5% through December 31, 2014, and through December 31, 2015, respectively. Beijing Smart Wood satisfies the criteria to be considered a NESE but this status is subject to the approval respective tax authorities scheduled for the end of calendar year ending December 31, 2012; upon approval, Beijing Smart Wood would be exempt from income taxes from January 1, 2012 through December 31, 2013 followed by a 12.5% tax rate through December 31, 2016.

Beijing Haidian School was not required by the governing tax bureau to pay any EIT since its establishment through May 31, 2012. If Beijing Haidian School is required to pay EIT in future, this could have material impact to the financial statements. However, the Group believes that it is more likely than not that any change to the tax treatment of Beijing Haidian School shall be prospectively applied.

Significant components of the Group's deferred tax assets and liabilities were as follows:

	As of May 31,	
	2011	2012
	US\$	US\$
<b>Current deferred tax assets</b>		
Allowance doubtful accounts	52	49
Accrued expenses	5,451	7,847
<b>Total current deferred tax assets</b>	<b>5,503</b>	<b>7,896</b>
Less: valuation allowance	(166)	(580)
<b>Current deferred tax assets, net</b>	<b>5,337</b>	<b>7,316</b>
<b>Non-current deferred tax assets</b>		
Net operating loss carry-forwards	2,718	6,581
Pre-operating expenses	3	1
<b>Total non-current deferred tax assets</b>	<b>2,721</b>	<b>6,582</b>
Less: valuation allowance	(1,724)	(5,344)
<b>Non-current deferred tax assets, net</b>	<b>997</b>	<b>1,238</b>
<b>Non-current deferred tax liabilities</b>		
Acquired intangible assets	(1,147)	(112)

Total non-current deferred tax liabilities	(1,147)	(112)
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The Group does not file combined or consolidated tax returns, therefore, losses from individual subsidiaries or the VIE may not be used to offset other subsidiaries' earnings within the Group.

The Group determined the valuation allowance on an entity by entity basis. The valuation allowance, which is primarily related to entities with net operating loss carry-forwards for which the Company does not believe will ultimately be realized, was US\$5,344 as of May 31, 2012, or an increase of US\$3,620 from US\$1,724 as of May 31, 2011.

As of the year ended May 31, 2012, the Group had net operating loss carried forward of US\$27,583 from New Oriental China and its schools and subsidiaries, which will expire on various dates from May 31, 2013 to May 31, 2017.

A reconciliation of the effective tax rates from the 25% statutory tax rates was as follows for the years ended May 31, 2010, 2011 and 2012:

	Years ended May 31,		
	2010 %	2011 %	2012 %
Statutory tax rate	25.00	25.00	25.00
Effect of expenses not deductible for tax purposes	4.96	5.99	3.58
Effect of differential tax rate other than tax holiday	(0.56)	(0.83)	0.11
Effect of tax holiday	(23.43)	(22.63)	(23.99)
Changes in valuation allowance	1.18	(0.03)	2.81
Total provision for income taxes	7.15	7.50	7.51

If the tax holidays granted to Beijing Decision, Beijing Hewstone, Beijing Smart Wood, Shanghai Smart Words, Beijing Pioneer and current tax treatments on certain schools and subsidiaries of New Oriental China were not available, the Group's income tax expense would have increased by US\$19,498, US\$24,842 and US\$34,416, the basic net income per share attributable to the Company would decrease by US\$0.13, US\$0.16 and US\$0.22 for the years ended May 31, 2010, 2011 and 2012, respectively, and the diluted net income per share attributable to the Company would decrease by US\$0.12, US\$0.16 and US\$0.22 for the years ended May 31, 2010, 2011 and 2012, respectively.

Under the New Income Tax Law effective from January 1, 2008, the rules for determining whether an entity is resident in the PRC for tax purposes have changed and the determination of residence depends among other things on the place of actual management. If the Group, or its non-PRC subsidiaries, were to be determined as a PRC resident for tax purposes, they would be subject to a 25% income tax rate on its worldwide income including the income arising in jurisdictions outside the PRC. The Group does not believe that its legal entities organized outside of the PRC are considered PRC residents.

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**16. INCOME TAXES - continued**

If the Company were to be a non-resident for PRC tax purposes, dividends paid to it out of profits earned after January 1, 2008 would be subject to a withholding tax. In the case of dividends paid by PRC schools and subsidiaries to their foreign investors, the withholding tax would be 10%, unless any such foreign investor's jurisdiction of incorporation has a tax treaty with China that provides for a different withholding arrangement.

Aggregate undistributed earnings of the Company's PRC subsidiaries and VIE that are available for distribution was US\$395,534 and US\$483,100 as of May 31, 2011 and May 31, 2012, respectively. Upon distribution of such earnings, the Company will be subject to PRC EIT taxes, the amount of which is impractical to estimate. The Company did not record any tax on any of the aforementioned undistributed earnings because the relevant subsidiaries and VIE does not intend to declare dividends and the Company intends to permanently reinvest it within the PRC. Additionally, no deferred tax liability was recorded for taxable temporary differences attributable to the undistributed earnings because the Company believes the undistributed earnings can be distributed in a manner that would not be subject to income tax.

The Group did not identify any significant unrecognized tax benefits for the years ended May 31, 2010, 2011 and 2012. The Group did not incur any significant interest and penalties related to potential underpaid income tax expenses and also does not anticipate any significant increases or decreases in unrecognized tax benefits in the next twelve months. The Group has no material unrecognized tax benefits which would favorably affect the effective income tax rate in future periods.

According to the PRC Tax Administration and Collection Law, the tax authority may require the taxpayer or the withholding agent to make delinquent tax payment within three years if the underpayment of taxes is resulted from the tax authority's act or error. No late payment surcharge will be assessed under such circumstances. The statute of limitation will be three years if the underpayment of taxes is due to the computational errors made by the taxpayer or the withholding agent. Late payment surcharge will be assessed in such case. The statute of limitation will be extended to five years under special circumstances which are not clearly defined (but an underpayment of tax liability exceeding US\$16 (RMB0.1 million) is specifically listed as a special circumstance). The statute of limitation for transfer pricing related issue is ten years. There is no statute of limitation in the case of tax evasion. Therefore, the Group's PRC domiciled entities are subject to examination by the PRC tax authorities based on the above.

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**17. NET INCOME PER SHARE**

The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	2010 US\$	Years ended May 31, 2011 US\$	2012 US\$
<b>Numerator used in basic and diluted net income per share:</b>			
Net income attributable to shareholders of the Company	77,789	101,774	132,688
Net income available for future distribution	77,789	101,774	132,688
<b>Shares (denominator):</b>			
Weighted average common shares outstanding used in computing basic net income per share	150,952,249	153,253,065	154,627,784
Plus incremental weighted average common shares from assumed exercise of share options and vesting of NES using the treasury stock method	3,879,384	2,818,768	2,244,657
Weighted average common shares outstanding used in computing diluted net income per share	154,831,633	156,071,833	156,872,441
Net income per share attributable to shareholders of the Company - basic	0.52	0.66	0.86
Net income per share attributable to shareholders of the Company - diluted	0.50	0.65	0.85

As of May 31, 2012, the Company has transferred 16,000,000 common shares to a depository bank reserved for employees and non-employees upon the exercise of their vested share options or upon the vesting of their NES, of which 13,112,619 common shares have been issued and 2,887,381 common shares are reserved for future issuance. The 2,887,381 common shares have been excluded in computing basic and diluted net income per share.

Nil, nil and 3,060,000 employee stock options have been excluded from the dilutive share calculation for the years ended May 31, 2010, 2011 and 2012, respectively, as their effects were anti-dilutive.

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**18. RELATED PARTY TRANSACTION**

The Group had the following balances and transaction with related parties:

	Notes	Relationship	Prepaid rent and deposit to a related party - non-current		Amounts due to a related party - current	
			As of May 31, 2011 US\$	2012 US\$	As of May 31, 2011 US\$	2012 US\$
Metropolis Holding China Limited	(1)	Company controlled by Chairman and CEO		1,449		164

	Notes	Relationship	Rental expense		
			For the year ended May, 31		
			2010 US\$	2011 US\$	2012 US\$
Metropolis Holding China Limited	(1)	Company controlled by Chairman and CEO			722

Since April 2010, the Group began renting a large portion of a building owned by Metropolis Holding China Limited for office space. In March 2012, Metropolis Holding China Limited was acquired by a company wholly owned by Mr. Michael Minhong Yu, the Group's chairman and chief executive officer. As a result, Metropolis Holding China Limited became a related party of the Group thereafter. As of May 31, 2012, the amounts due from Metropolis Holding China Limited were US\$1,400 which represented prepaid rent and deposit for the building, and amount due to Metropolis Holding China Limited was US\$200 which represented rental payment payable. The amount of the rental payments was determined based on the prevailing market rates and was duly approved by all of the directors. The amount due to Metropolis Holding China Limited is non-interest bearing and unsecured and has no fixed repayment terms.

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**19. COMMITMENTS****Operating leases**

The Group leases offices, classroom, and warehouse facilities under operating leases. The terms of substantially all of these leases are ten years or less. Future minimum lease payments under non-cancelable operating leases were as follows on May 31, 2012:

	Continuing operations US\$
Years ending May 31:	
2013	106,227
2014	96,411
2015	89,945
2016	65,005
2017	44,967
Thereafter	65,816
	468,371

Rent expense for the years ended May 31, 2010, 2011 and 2012 related to all cancelable and non-cancelable leases were US\$46,856, US\$73,509 and US\$107,384, respectively.

**Capital commitments**

As of May 31, 2012, future minimum capital commitments under non-cancelable construction contracts were as follows:

	US\$
Capital commitment for the purchase of property and equipment	1,266
Capital commitment for leasehold improvements	5,199
	6,465

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The Group's chief operating decision maker has been identified as the Chief Executive Officer who reviews financial information of operating segments based on US GAAP amounts when making decisions about allocating resources and assessing performance of the Group. The six operating segments are identified as language training and test preparation, primary and secondary school education, on-line education, content development and distribution, post-secondary education and overseas study consulting services. Language training and test preparation and primary and secondary education have been identified as reportable segments. Online education, content development and distribution, post-secondary education and overseas study consulting services operating segments were aggregated as others because individually they do not exceed the 10% quantitative threshold.

The Group's chief operating decision maker evaluates performance based on each reporting segment's net revenue, operating costs and expenses, and operating income. Net revenues, operating costs and expenses, operating income, and total assets by segment were as follows:

For the year ended May 31, 2010

	Language training and test preparation courses US\$	Primary and secondary education US\$	Others US\$	Consolidated US\$
Net revenues	337,209	9,860	39,238	386,307
Operating costs and expenses:				
Cost of revenues	(127,069)	(5,532)	(13,991)	(146,592)
Selling and marketing	(42,985)	(211)	(8,916)	(52,112)
General and administrative	(61,992)	(2,720)	(6,924)	(71,636)
Unallocated corporate expenses				(38,653)
Total operating costs and expenses	(232,046)	(8,463)	(29,831)	(308,993)
Operating income	105,163	1,397	9,407	77,314
Segment assets	229,900	43,542	61,708	335,150
Unallocated corporate assets				261,270
Total assets	229,900	43,542	61,708	596,420

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

**FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012**

**(In thousands, except share and per share data)**

**20. SEGMENT INFORMATION - continued**

For the year ended May 31, 2011

	Language training and test preparation courses US\$	Primary and secondary education US\$	Others US\$	Consolidated US\$
Net revenues	485,563	13,766	58,543	557,872
Operating costs and expenses:				
Cost of revenues	(191,375)	(6,398)	(23,952)	(221,725)
Selling and marketing	(62,320)	(637)	(13,469)	(76,426)
General and administrative	(104,391)	(4,145)	(10,672)	(119,208)
Unallocated corporate expenses				(43,475)
Total operating costs and expenses	(358,086)	(11,180)	(48,093)	(460,834)
Loss on disposal of subsidiaries				(1,537)
Operating income	127,477	2,586	10,450	95,501
Segment assets	312,198	47,821	76,227	436,246
Unallocated corporate assets				427,124
Total assets	312,198	47,821	76,227	863,370

For the year ended May 31, 2012

	Language training and test preparation courses US\$	Primary and secondary education US\$	Others US\$	Consolidated US\$
Net revenues	663,504	17,757	90,457	771,718
Operating costs and expenses:				
Cost of revenues	(256,132)	(8,160)	(39,519)	(303,811)
Selling and marketing	(78,646)	(1,335)	(19,481)	(99,462)

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General and administrative	(158,655)	(5,532)	(14,967)	(179,154)
Unallocated corporate expenses				(72,494)
<b>Total operating costs and expenses</b>	<b>(493,433)</b>	<b>(15,027)</b>	<b>(73,967)</b>	<b>(654,921)</b>
Operating income	170,071	2,730	16,490	116,797
Segment assets	436,403	52,839	159,321	648,563
Unallocated corporate assets				480,254
<b>Total assets</b>	<b>436,403</b>	<b>52,839</b>	<b>159,321</b>	<b>1,128,817</b>

The Group primarily operates in the PRC. All of the identifiable assets of the Group are located in the PRC.

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

**FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012**

**(In thousands, except share and per share data)**

**21. MAINLAND CHINA CONTRIBUTION PLAN**

The Group's full time employees of the Group in the PRC participate in a government-mandated multiemployer defined contribution plan pursuant to which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. PRC labor regulations require the Group to accrue for these benefits based on certain percentages of the employees salaries. The total contributions for such employee benefits were US\$9,439, US\$16,865 and US\$27,744 for the years ended May 31, 2010, 2011 and 2012, respectively.

**22. STATUTORY RESERVE**

Prior to payment of dividends, pursuant to the laws applicable to the PRC's Foreign Investment Enterprises, the Company's subsidiaries and VIE in the PRC must make appropriations from after-tax profit to non-distributable reserve funds as determined by the Board of Directors of each company. These reserves include (i) general reserve and (ii) the development fund.

Subject to certain cumulative limits, the general reserve requires annual appropriations of 10% of after-tax profits as determined under PRC laws and regulations at each year-end until the balance reaches 50% of the PRC entity registered capital; the other reserve appropriations are at the Company's discretion. These reserves can only be used for specific purposes of enterprise expansion and are not distributable as cash dividends. During the year ended May 31, 2012, \$2,453 was deducted from the general reserve to adjust for excess appropriations made in prior periods.

PRC laws and regulations require private schools that require reasonable returns to make annual appropriations of 25% of after-tax income prior to payments of dividend to its development fund, which is to be used for the construction or maintenance of the school or procurement or upgrading of educational equipment, while in the case of a private school that does not require reasonable return, this amount should be equivalent to no less than 25% of the annual increase of net assets of the school as determined in accordance with generally accepted accounting principles in the PRC. During the year ended May 31, 2012, appropriations to the development fund amounted to \$71,602, for which \$57,377 is attributed to periods prior to fiscal year 2012.

These reserves are included as statutory reserves in the consolidated statements of changes in equity and comprehensive income. The Group allocated US\$136, US\$3,097 and US\$69,149 to statutory reserves during the years ended May 31, 2010, 2011 and 2012, respectively. The statutory reserves cannot be transferred to the Company in the form of loans or advances and are not distributable as cash dividends except in the event of liquidation.

The Company did not make appropriations to the development fund reserves for the years ended May 31, 2010, 2011 or any periods prior to that; however, in the year ended May 31, 2012, all of the under-reserved amounts for all prior periods' development fund, together with the amount that shall have been appropriated for fiscal year 2012, have been appropriated. During the year ended May 31, 2012, appropriations to the development fund amounted to \$71,602, for which \$57,377 was attributed to periods prior to fiscal year 2012.

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**NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - continued**

**FOR THE YEARS ENDED MAY 31, 2010, 2011 AND 2012**

**(In thousands, except share and per share data)**

**23. RESTRICTED NET ASSETS**

Relevant PRC laws and regulations restrict the WFOEs and VIE from transferring a portion of their net assets, equivalent to the balance of their statutory reserves and their share capital, to the Company in the form of loans, advances or cash dividends. The balance of restricted net assets was \$159,253 and \$177,194, of which \$119,652 and \$135,517 was attributed to the paid in capital and statutory reserves of the VIE and \$39,601 and \$41,677 was attributed to the paid in capital and statutory reserves of the WFOEs, as of May 31, 2011 and 2012, respectively. The WFOEs accumulated profits may be distributed as dividends to the Company without the consent of a third party. The VIE's revenues and accumulated profits may be transferred to the Company through contractual arrangements without the consent of a third party. Under applicable PRC law, loans from PRC companies to their offshore affiliated entities require governmental approval, and advances by PRC companies to their offshore affiliated entities must be supported by bona fide business transactions.

**24. SUBSEQUENT EVENTS**

In July 2012, the Group agreed to sell the assets and liabilities of Elite English, which operates high-end, personalized, advanced English language training for high-income working professionals and other adults in large developed cities, to Mr. Yunkai Weng, an employee and the head of Elite English for US\$5,500.

On July 13, 2012, the Company was informed that the U.S. Securities & Exchange Commission, ( the SEC ), had issued a formal order of investigation captioned "In the Matter of New Oriental Education & Technology Group Inc. ". The SEC's enforcement staff has requested documents and information concerning the basis for the consolidation of its wholly-owned subsidiaries, New Oriental China and its schools and subsidiaries into the Company's consolidated financial statements, and other issues related to certain allegations about the Group contained in a report issued on July 18, 2012 by Muddy Waters LLC, an entity unrelated to the Company. The Company is cooperating fully with the SEC in its investigation. The Company cannot predict the timing, outcome or consequences of the SEC investigation.

On July 24, 2012, the Company's board of directors authorized the reduction in the number of share options and a reduction in the exercise price of the share options granted to employees on January 17, 2012. The exercise price was reduced to US\$12.19 from US\$22.00 and the number of share options was reduced to 2,295,000 shares from 3,060,000 shares. Incremental compensation expenses, if any, are immaterial and will be immediately recognized upon modification.

Since July 2012, four federal securities class actions have been filed against the Company, its directors and certain of its officers. These class actions seek to recover damages caused by defendants' violations of the federal securities laws and to pursue remedies under the Securities Exchange Act of 1934 and Rule 10b-5. The Company will have to defend against the putative shareholder class action lawsuits, including any appeals of such lawsuits should the Company's initial defense be successful. The Company is currently unable to estimate the possible loss or possible range of loss, if any, associated with the resolution of these lawsuits.

**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****Additional Information - Financial Statement Schedule I****Condensed Financial Information of Parent Company****Balance Sheets****(In thousands, except share and share data)**

	As of May 31,	
	2011	2012
	US\$	US\$
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	53,887	62,994
Prepaid expense and other current assets	341	6,598
Amounts due from related parties	40,578	28,644
Total current assets	94,806	98,236
Long term investment		2,000
Investments in subsidiaries and VIE	480,503	645,675
Total assets	575,309	745,911
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accrued expenses and other current liabilities	330	3,447
Amounts due to related parties	756	2,062
Dividend payable		50,000
Total current liabilities	1,086	55,509
Equity:		
Common shares (US\$0.01 par value; 300,000,000 shares authorized as of May 31, 2011 and 2012, respectively; 158,379,387 and 158,379,387 shares issued and outstanding as of May 31, 2011 and 2012, respectively)	1,540	1,555
Additional paid-in capital	186,585	161,485
Retained earnings	339,536	472,224
Accumulated other comprehensive income	46,562	55,138
Total equity	574,223	690,402
Total liabilities and equity	575,309	745,911

**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****Additional Information - Financial Statement Schedule I****Condensed Financial Information of Parent Company****Statements of Operations****(In thousands)**

	Years ended May 31,		
	2010	2011	2012
	US\$	US\$	US\$
Operating costs and expenses:			
General and administrative	16,520	15,413	24,477
Total operating costs and expenses	16,520	15,413	24,477
Operating loss	(16,520)	(15,413)	(24,477)
Other income (expenses)	(250)		147
Interest income	98	241	422
Equity in earnings of subsidiaries and VIE	94,461	116,946	156,596
Net income	77,789	101,774	132,688

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**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****Additional Information - Financial Statement Schedule I****Condensed Financial Information of Parent Company Statements of Equity and Comprehensive Income****(In thousands, except share data)**

	Common shares Unrestricted shares	Amount US\$	Additional paid-in capital US\$	Retained earnings US\$	Accumulated other comprehensive income US\$	Total shareholders equity US\$	Comprehensive income US\$
Balance at June 1, 2009	153,004,707	1,500	166,370	159,973	23,403	351,246	
Common shares converted to ADS shares for futures exercise of employee share options or non-vested equity shares	4,000,000						
Issuance of ADS shares for the exercises of employee share options		28	12,408			12,436	
Non-vested equity shares vested		6	(6)				
Share based compensation expense			16,183			16,183	
Shares repurchase	(1,625,320)	(16)	(29,980)			(29,996)	
Comprehensive income:							
Net income				77,789		77,789	77,789
Foreign currency translation adjustment					(91)	(91)	(91)
Total comprehensive income							77,698
Balance at May 31, 2010	155,379,387	1,518	164,975	237,762	23,312	427,567	
Common shares converted to ADS shares for futures exercise of employee share options or non-vested equity shares	3,000,000						
Issuance of ADS shares for the exercises of employee share options		13	6,574			6,587	
Non-vested equity shares vested		9	(9)				
Share based compensation expense			15,045			15,045	
Comprehensive income:							
Net income				101,774		101,774	101,774
Foreign currency translation adjustment					23,250	23,250	23,250
Total comprehensive income							125,024
Balance at May 31, 2011	158,379,387	1,540	186,585	339,536	46,562	574,223	
Common shares converted to ADS shares for futures exercise of employee share options or non-vested equity shares							
Issuance of ADS shares for the exercises of employee share options		2	788			790	

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Non-vested equity shares vested	13	(13)				
Share based compensation expense		24,125			24,125	
Profit appropriation		(50,000)			(50,000)	
Comprehensive income:						
Net income		132,688			132,688	132,688
Foreign currency translation adjustment				8,576	8,576	8,576
Total comprehensive income						141,264
Balance at May 31, 2012	158,379,387	1,555	161,485	472,224	55,138	690,402

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**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****Additional Information - Financial Statement Schedule I****Condensed Financial Information of Parent Company****Statements of Cash Flows****(In thousands)**

	Years ended May 31,		
	2010	2011	2012
	US\$	US\$	US\$
<b>Cash flows from operating activities:</b>			
Net income	77,789	101,774	132,688
Adjustments to reconcile net income to net cash provided by (used in) operating activities			
Equity in earnings of subsidiaries and VIE	(94,461)	(116,946)	(156,596)
Share-based compensation expense	16,183	15,045	24,125
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	51	(31)	(6,412)
Accrued expenses and other current liabilities	(1,290)	303	3,117
Amounts due from/to related parties	1,613	(1,418)	(1,760)
Net cash provided by (used in) operating activities	(115)	(1,273)	(4,838)
<b>Cash flows from investing activities</b>			
Long term investment in Dajie.com			(2,000)
Loan to related parties		(3,000)	
Repayment from related parties	1,500		15,000
Net cash used in investing activities	1,500	(3,000)	13,000
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of common shares upon exercise of share option	12,436	6,432	945
Cash paid for shares repurchase	(29,996)		
Net cash used in financing activities	(17,560)	6,432	945
Net decrease in cash and cash equivalents	(16,175)	2,159	9,107
Cash and cash equivalents, beginning of year	67,903	51,728	53,887
Cash and cash equivalents, end of year	51,728	53,887	62,994

**Table of Contents****NEW ORIENTAL EDUCATION & TECHNOLOGY GROUP INC.****Additional Information-Financial Statement Schedule I****Condensed Financial Information of Parent Company****Note to the Financial Statements****1. BASIS FOR PREPARATION**

The condensed financial information of the Company has been prepared using the same accounting policies as set out in the Group's consolidated financial statements except that the Company used the equity method to account for investments in its subsidiaries and VIE.

**2. INVESTMENTS IN SUBSIDIARIES AND VIE**

The Company and its subsidiaries and VIE were included in the consolidated financial statements where the inter-company balances and transactions were eliminated upon consolidation. For purpose of the Company's stand-alone financial statements, its investments in subsidiaries and VIE were reported using the equity method of accounting. The Company's share of income and losses from its subsidiaries and VIE were reported as equity in earnings of subsidiaries and VIE in the accompanying parent company financial statements.

**3. INCOME TAXES**

The Company is a Cayman Islands company, therefore, is not subjected to income taxes for all years presented.

**4. RELATED PARTY TRANSACTIONS**

The following represented related party balances as of May 31, 2011 and 2012:

	May 31,	
	2011	2012
	US\$	US\$
<b>Amount due from related parties:</b>		
Beijing Judgment	16,474	7,328
Beijing Hewstone	5,862	2,807
Beijing Decision	7,341	4,271
Winner Park	8	10
Smart Shine	8,007	8,510
Elite Concept Holdings Limited	2,886	5,718
	40,578	28,644
<b>Amount due to related parties:</b>		
New Oriental China	756	2,062
	756	2,062

All related party balances were non-interest bearing and unsecured.

