

Unrated

Acquire Two Schools in Guangdong, Expansion in Process

June 19th, 2018

Market Data

Date	2018.6.15
Closing Price (HKD)	14.82
Total shares (in billion shares)	2.0
Market Cap (in billion HKD)	31.7
Net Asset (in billion RMB)	5.6
Total Asset (in billion RMB)	6.7
Net asset per share (RMB)	2.8

Source: Wind

Related Report

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Event:

- The company acquired target company Guangzhou Bangrui education 100% equity and 100% liability. Total cash payment is 1.28 billion RMB, 11.8x 2017 unaudited EV/EBITDA. Target company has two schools and the equity of two schools was owned by Songtian company. Songtian Company owns 100% Co-sponsorship of Guangzhou university Songtian College and 100% sponsorship Songtian Polytechnic college. The total student enrollment for two schools is 12,050 people. After the acquisition completed, the company will own 7 schools in 4 provinces with 133,000 students.

Opinion:

- **Our opinion:** China Education is a leading higher education group by student enrollment. This acquisition involves a university and a junior college in Guangzhou, located in the same city as the company's Baiyun University and Baiyun technician school. We expect the company can effectively integrate in 1) management 2) school-enterprise resource 3) faculty team development. The company is expected to improve the two schools' management and operation efficiency by its "100-day improvement plan" and 8 specific improvement plans. The company takes the following action: 1) increasing enrollment plan, expect to increase 500 university student count in September 2018. 2) increasing tuition, according to 18/19 admission plan, both school has increased their tuition 3) improve registration rate to improve the company's financial. In fiscal year 2017, the unaudited net income for the two schools counts for 17.6% of company net income. We expect that after the deal is completed, two schools will improve company's net income after their financials are consolidated, we recommend investors to follow the development of the deal.
- **Guangzhou University Songtian College:** Guangzhou University Songtian College was built in September 2000 in Guangzhou Zengcheng. In 2004, it was upgraded to independent college from junior college with Ministry of Education's approval. In January 2005, Songtian University passed Ministry of Education's special inspection. In 2011, Songtian University passed Guangdong Degree Committee's assessment for its declared 15 majors and Songtian University was granted the right to give bachelor's degree. Now Songtian University is a full-time university and it can enroll students nation-wide for four-year university program. In 2017, the school has more than 8,700 students and 400 faculty.
- **Guangzhou Songtian Polytechnic College:** Opened in 2007, located in Guangzhou Zengcheng, It is a government approved full-time higher professional education institution. In 2018, there are 3,330 students and 200+ faculty.
- **11.8x EV/EBITDA Valuation:** The company expected to pay 1.28 billion RMB cash for 100% equity and 100% liability of target company, calculated by Songtian company's unaudited 2017 EBITDA, the valuation is 11.8x EV/EBITDA.
- **Co-Sponsorship dispute:** Sontan Company is Sontan college's co-sponsor now. During 2015-2016, Sontan Company signed multiple contracts with another party to change Sontan College's Co-sponsor's name to the other party. The deal is off due to the equity dispute. Now the party applies for arbitration in 2017-2018. The target company, selling party, selling party's controlling interest, Sontan Company and the school promise to investor that Sontan Company is the legal co-sponsor of Sontan College and Sontan company shall not lose its co-sponsor status and school equity due to the dispute. The selling party signed an agreement with investor that if the school lose the sponsorship dispute, the selling party will compensate China Education Group twice the acquisition deposit and compensate according to the agreement.

- **Risk:** 1) Target School's Co-sponsor equity dispute; 2) Integration doesn't meet expectation; 3) China's education policy change; 4) Student enrollment doesn't meet expectation; 5) Revenue comes from limited cities in China; 6) VIE Structure policy risk.

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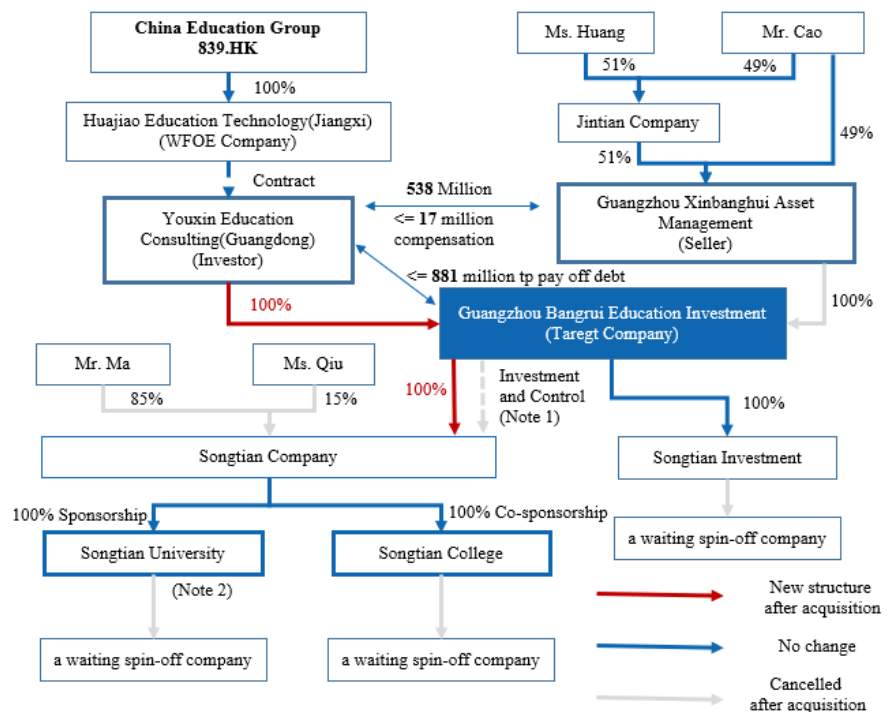


Context

● **Acquire a university and a junior college with 1.28 billion RMB :**

China Education Group’s consolidated affiliated entity Youxin education consulting (Guangzhou) limited company acquired target company Guangzhou Bangrui education 100% equity and 100% liability. Total cash payment 1.28 billion RMB, 11.8x 2017 EV/EBITDA. Target company has two schools and the equity of two schools was owned by Songtian company. Songtian Company owns 100% Co-sponsorship of Guangzhou university Songtian College and 100% sponsorship Songtian Polytechnic college. The total student enrollment for two schools is 12,050 people. After the acquisition completed, the company will own 7 schools in 4 provinces and 133,000 students.

G1、Acquisition Structure



Source: Company announcement、 school website、 Industrial Securities

Note1 : Songtian Company’s equity is frozen by court as its debt is not settled. Songtian Company’s equity is 100% frozen as collateral. China Education Group is expected to provide funding for debt payment.

Note2: Songtian University has sponsorship dispute, now Songtian company has sponsorship. Investor and Seller signed agreement that if the dispute arbitrament failed. Seller will compensate 2 times security deposit and other compensation according to agreement.

C1、Acquisition Payment amount and condition

Item	Amount(RMB)	Time	Condition
Deposit	169 million	Paid	
First instalment	50 million (cash)	10 business days after condition accomplished	Entering employment contracts with target company 1. Investor become the sole shareholder of target company 2. Target company become the sole shareholder of Songtian company
Second instalment	50 million (cash)	10 business days after condition accomplished	3. Board composition and legal representative change 4. Settlement of outside liabilities 5. transfer liability and equity to investor
Third instalment	50 million (cash)	10 business days after condition accomplished	Discharge of encumbrances over land and other properties used by the Schools settlement of liabilities of the Target and the Registered Shareholders with their creditors such that the relevant outstanding amount shall not exceed RMB125 million
Fourth instalment	50 million (cash)	10 business days after condition accomplished	
Fifth instalment	169 million (cash)	2019.12.31 or 10 business days after condition accomplished (the later one)	1. Completion of the disposal of the Disposal Companies 2. settle off all liabilities of target company and shareholder and investor register as sole shareholder before 2019.12.31
Total Cost reimbursement	538 million less than 17 million (cash)	Paid with first round	
Capital injection	Less than 881 million (capital injection/shareholder loan)	After becoming the sole shareholder of target company	
Total include:	Less than 1.44 billion		
China Education Group	1.28 billion(cash)		
Sontan School	158million(cash)		

Source: Company announcement、school website、Industrial Securities

- **Guangzhou University Songtian College (“Songtian University”)**

History: Guangzhou University Songtian College was built in September 2000 in Guangzhou Zengcheng. In 2004, it was upgraded to independent college from junior college with Ministry of Education’s approval. In January 2005, Songtian University passed Ministry of Education’s special inspection. In 2011, Songtian University passed Guangdong Degree Committee’s assessment for its declared 15 majors and Songtian University was granted the right to give university degree. Now Songtian University is a full-time university and it can enroll students nation-wide for four-year university program.

Major: Songtian University has 8 sub-colleges and 3 departments, they are electronic and car engineering, computer science and technology, management, economics, law, foreign language, art and media, sports, general knowledge, social science and English. Songtian University has 28 undergraduate majors, covering literature, law, economics, management, education, engineering, art. The University has total 8,718 students, full-time faculty more than 400 people, of which more than 100 people are professor and associate professor.

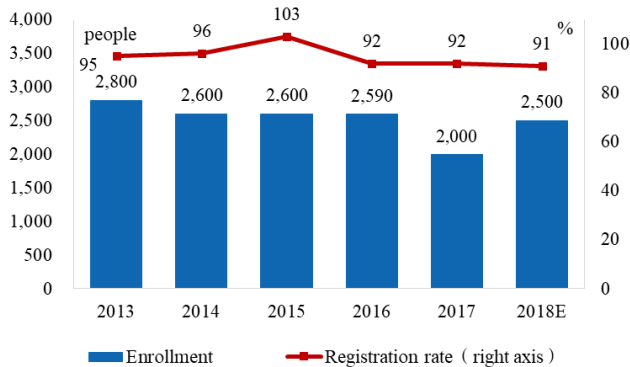
Co-Sponsorship dispute: Songtian Company is Songtian university's co-sponsor now. During 2015-2016, Songtian Company signed multiple contracts with another party to change Songtian College's Co-sponsor's name to the other party. Due to disputes, Songtian Company has terminated the said transaction. Between 2017 and 2018 the other party applied for arbitration in which it seeks, among others, to change the co-sponsor of Songtian University from Songtian Company to itself. The target company, selling party, selling party's ultimate owner, Songtian Company and the schools have warranted and represented to the Investor that Songtian Company is the lawful cosponsor or sponsor of the Schools and that Songtian Company will not lose its sponsor status or interest in the Schools as a result of the Co-Sponsorship Dispute and that there are no matters which will or could result in Songtian Company losing its sponsor status or interest in the Schools.

C2、 Songtian University's Operation and Financial

Item	
Student	8,718 people
Faculty	More than 400 people
Land area	540Mu
Building area	217,000m ²
Founding year	September 2000
School level	Second batch of bachelor, admission point are 20-40 points higher than the second batch line in past three years
registration rate	92%
Employment rate	95.6% (national average 77%)
Admission headcount	2000 people (2017), 2500 people (2018E)
Advantage Major	Car engineering, electronic (Matches Guangdong Baiyun College)
Tuition	2017/18 school year: Liberal arts/science 19,500/year
	2018/19 school year: Liberal arts/science 23,000/year
	Sports Major 19,500/year
	Sports Major 23,000/year
Revenue	Art Major 21,500/year
	Art Major 25,000/year
Gross profit (Gross profit margin)	Boarding fee 1,500/year
	Boarding fee 1,500/year
Net profit (Net profit margin)	180 million RMB
Guangzhou University Service fee	83 million RMB (46%)
	59 million RMB (33%)
	18%

Source: Company announcement, school website, Industrial Securities

G2、Songtian University student enrollment and registration rate



Source: Company announcement、Industrial Securities

G3、Songtian University View



Source: School website、Industrial Securities

● **Guangzhou Songtian Polytechnic College (“Songtian College”)**

History: Songtian college is a Guangdong Government approved、Ministry of Education registered full-time higher professional education institution. It has 190Mu land and building area 110 thousand square meter. The new campus in process occupies 367Mu land. The new campus project is approved by Guangdong Development and Reform Commission. The school started admission in 2007 and enrollment number keeps growing. In 2018, the school has 3,330 full-time students.

Full-time junior college major: Songtian College has 7 departments with more than 17 majors, including accounting、online business、economics、business、marketing、finance、foreign language、art design、law、transportation. The faculty team focus on both industry experience and academic experience. Now the school has 224 faculty and 182 of them are full-time teacher.

Continuing Education

Partnership: Sun Yat-Sen University-School of Government、South China Agricultural University-College of Agriculture、Guangdong University of Foreign Studies-College of Continuing Education、South China Normal University、Guangdong University of Foreign Studies、Guangdong University of Finance& Economics

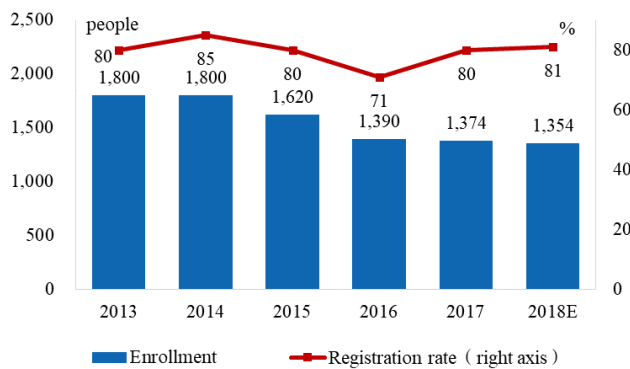
Major: Songtian College has self-study test program for upgrading associate degree to bachelor’s degree. The school provides more than 10 majors, including administrative management、rural area development、business management、human resource management、art design、law、finance、marketing、accounting、business English、Japanese、mobile business technology、Embedded technology.

C3、Songtian College’s operation and financial

Items	
Student	3,332 people
Faculty	More than 220 people
Land area	190Mu, Expected 367Mu expansion, Total 557 Mu
Building area	110,000 m ²
Founding year	Junior college、 continuing education
School level	2007
registration rate	80%
Employment rate	98.44% (national average 77%)
Admission headcount	1300 people (2017), 1300 people (2018E)
Advantage Major	Car engineering, electronic (Matches Guangdong Baiyun College)
Tuition	2017/18 school year: 2018/19 school year: Four majors 16,500/year Five majors 16,500/year Other 13,500/year Other 13,500/year Boarding fee 1,500/year Boarding fee 1,500/year
Revenue	52 million RMB
Gross profit (Gross profit margin)	19.7 million RMB (38%)
Net profit (Net profit margin)	15 million RMB (29%)

Source: Company announcement、 school website、 Industrial Securities

G4、 Songtian College’s student enrollment and registration rate



Source: Company announcement、 Industrial Securities

G5、 Songtian College’s view



Source: School website、 Industrial Securities

- **Our opinion:** China Education is a leading higher education group by student enrollment. This acquisition involves a university and a junior college in Guangzhou, located in the same city as the company’s Baiyun University and Baiyun technician school. We expect the company can effectively integrate in 1) management 2) school-enterprise resource 3) faculty team development. The company is expected to improve the two schools’ management and operation efficiency by its “100-day improvement plan” and 8 specific improvement plans. The company takes the following action: 1) increasing enrollment plan, expect to increase 500 university student count in September 2018. 2) increasing tuition, according to 18/19 admission plan, both school has increased their tuitions 3) improve registration rate to improve the company’s financial. In fiscal year 2017, the unaudited net income for the two schools counts for 17.6% of company net income. We expect that after the deal is completed, two schools will improve company’s net income after their financials are consolidated, we recommend investors to follow the development of the deal.
- **Risk:** 1) Target School’s Co-sponsor equity dispute; 2) Integration doesn’t meet expectation; 3) China’s education policy change; 4) Student enrollment doesn’t meet expectation; 5) Revenue comes from limited cities in China; 6) VIE Structure policy risk.

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- Underweight: Industry performs worse than that of the whole market

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- Outperform: With a markup 5% to 15% better than that of the market;
- Neutral: With a markup less than 5% better or worse than that of the market;
- Underperform: With a markup more than 5% worse than that of the market

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