

Equity Research | China | Education

19 September 2018

## Strong M&A-driven growth

- China New Higher Education Group (CNHEG) announced to acquire three schools in Guangxi Province, at a total consideration of RMB146.7mn, representing FY17 15.7x PER.
- The acquisition is solid proof that the latest regulations would have limited adverse impact on M&As of listed private higher education companies. We reiterate our positive view on solid growth of the industry through organic and external expansion.
- We have trimmed our FY18/19E EPS estimates by -0.3/2.6% respectively and derived our new DCF-based PT of HKD7.31, implying 43.9% upside potential. Maintain BUY.

**New acquisition with a favourable valuation.** CNHEG announced to acquire 51% interest of three schools in Guangxi province, including a college, a vocational school and a high school. The total consideration of RMB146.7mn, representing FY17 15.7x PER, is undemanding, considering the future growth prospects of the acquisition target, in our view.

**Room for profit improvement of the target.** In SY18/19, the total student enrolment of the three schools is expected to reach c.10,000, compared to 8,434 in SY17/18, of which c.1,600 students are in high school. We see great room for improvement of the acquisition targets post the acquisition, including 1) the college will most likely be upgraded to one that offers undergraduate degrees by the end of the "13th Five-Year Plan" period; 2) student enrolment is foreseen to grow by c.10-15% YoY; 3) tuition fees are expected to increase by c.5-10% YoY annually going forward albeit they have been hiked from RMB6,000-7,500 in SY17/18 to RMB7,000-8,500 in SY18/19 as tuition fees are still deemed to be relatively low; and 4) margin improvement, as the acquisition targets' GPM, which are currently c.32%, are significantly lower than CNHEG's 56%, due to the high student recruitment costs (c.RMB4,000 per student), lack of experienced talents and low brand power.

**Rising gearing, still at healthy level.** Although CNHEG's net gearing had risen to 54.7%, with total net debts amounting to RMB1.0bn, as of end-1H18, we anticipate its net gearing will come down by end-FY18E. CNHEG is expected to continue to seek co-operations with third parties, like industry funds, in their future M&A executions in order to lower initial investment outlays. Meanwhile, we believe its net gearing will also be driven lower by further consolidation of its schools and collection of tuition fees in 2H18.

**Limited impacts from the 2<sup>nd</sup> Draft Amendment.** The acquisition is solid proof that impact from the latest regulations on the external expansion of listed private higher education companies would be limited, in particular for CNHEG on the back of the continuous support from the provincial government throughout the acquisition of the schools. CNHEG will choose for-profit after the transition period. For Guangxi Schools, CNHEG may need to pay c.RMB12.5mn (c.RMB50,000/mu on average) for the entire c.250mu of land that currently belong to the allocated land.

**Maintain BUY and raise PT to HKD7.31.** We have revised our FY18E/19E revenue and earnings estimates by 0.0/9.2% and -0.3/2.6% respectively to primarily factor in the new acquisition (Assume to be consolidated in Jan-19). Our DCF generated a new PT of HKD7.31 (Previous: HKD7.1), implying 43.9% potential upside. CNHEG currently trades at 20.6/14.6x FY18E/19E PER respectively, which is attractive, given the high visibility of strong revenue and earnings growth, in our view.

### China New Higher Education Group (2001 HK)

## Buy

(unchanged)

<b>Price Target</b>	<b>HK\$7.31</b>
(Revision)	(3.0%)
(Upside)	(43.9%)

EPS revision	2018E (-0.3%)	2019E (+2.6%)
Close price	HKD5.08	
Market cap.	HKD7.3bn	
Free float	41.2%	
52-week range	HKD3.90 – HKD8.52	
3-mth ave. T/O	HKD65.3mn	

Price as of 18 September, 2018

Stock rel HSI performance (%)



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**Figure 1: Student enrolment**

SYE - As the end of Aug	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	2018-2019E	2019-2020E	2020-2021E
<b>Yunan School</b>	<b>14,616</b>	<b>17,082</b>	<b>17,965</b>	<b>19,490</b>	<b>23,642</b>	<b>25,982</b>	<b>28,782</b>	<b>31,482</b>
Four-year undergraduate program	5,704	7,694	8,081	8,568	8,891	9,211	10,011	10,811
Three-year junior college program	8,566	9,258	9,878	10,922	12,958	13,278	14,078	14,878
Other programs	346	130	6	-	1,793	3,493	4,693	5,793
<b>Guizhou School</b>	<b>3,974</b>	<b>7,958</b>	<b>11,751</b>	<b>13,972</b>	<b>15,584</b>	<b>17,084</b>	<b>18,834</b>	<b>20,634</b>
Three-year junior college program	3,946	7,930	11,723	13,972	15,584	17,084	18,834	20,634
Other programs	28	28	28	-	-	-	-	-
<b>Northeast School</b>	<b>9,550</b>	<b>9,663</b>	<b>9,547</b>	<b>9,518</b>	<b>9,355</b>	<b>9,365</b>	<b>9,375</b>	<b>9,385</b>
Four-year undergraduate program	9,020	9,101	9,203	9,232	9,224	9,234	9,244	9,254
Three-year junior college program	530	562	344	286	131	131	131	131
<b>Central China School</b>	-	-	-	<b>3,480</b>	<b>5,709</b>	<b>9,109</b>	<b>10,459</b>	<b>11,309</b>
Four-year undergraduate program	-	-	-	2,308	4,328	4,828	5,128	5,328
Three-year junior college program	-	-	-	506	1,070	3,770	4,770	5,370
Pre-undergraduate program	-	-	-	666	311	511	561	611
<b>Xinjiang School</b>	-	-	-	<b>1,702</b>	<b>3,746</b>	<b>5,546</b>	<b>7,346</b>	<b>9,146</b>
<b>Henan School</b>	-	-	-	<b>13,289</b>	<b>18,243</b>	<b>23,243</b>	<b>25,243</b>	<b>27,243</b>
<b>Gansu School</b>	-	-	-	<b>8,372</b>	<b>8,218</b>	<b>8,318</b>	<b>9,318</b>	<b>10,318</b>
<b>Guangxi Schools</b>	-	-	-	<b>8,022</b>	<b>8,434</b>	<b>10,000</b>	<b>10,840</b>	<b>11,764</b>
<b>Total</b>	<b>18,590</b>	<b>25,040</b>	<b>29,716</b>	<b>46,460</b>	<b>76,279</b>	<b>108,647</b>	<b>120,197</b>	<b>131,281</b>
Addition		6,450	4,676	16,744	29,819	32,368	11,550	11,084
YoY %		34.7	18.7	56.3	64.2	42.4	10.6	9.2

Source: Company, CSCI Research estimates

Remark: Northeast, Central China, Xinjiang, Henan, Gansu and Guangxi schools are included in our calculation since SY16/17, SY16/17, SY17/18, SY17/18, SY18/19 and SY18/19, respectively.

**Figure 2: Forecast changes**

FY End: 31 Dec	Previous			Revised			Changes		
	2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E
<b>Financials (FY)</b>									
Total revenue (RMBmn)	631	1,065	1,283	631	1,163	1,392	0.0%	9.2%	8.5%
Gross profit (RMBmn)	332	548	680	332	580	715	0.0%	5.8%	5.1%
Net profit to common equity (RMBmn)	312	426	558	311	438	566	-0.3%	2.6%	1.5%
EPS (RMB)	0.22	0.30	0.39	0.22	0.31	0.40	-0.3%	2.6%	1.5%
DPS (RMB)	0.07	0.09	0.12	0.07	0.09	0.12	-0.3%	2.6%	1.5%
<b>Overall margins (%)</b>									
GPM	52.6	51.4	53.0	52.6	49.8	51.3	-	(1.6)	(1.7)
OPM	64.6	54.9	58.2	64.6	53.2	56.3	-	(1.7)	(1.9)
NPM	49.4	40.0	43.5	49.2	37.6	40.7	(0.2)	(2.4)	(2.8)

Source: CSCI Research estimates

**Figure 3: Peers valuation**

			Close Px	Mkt Cap	Fiscal	EPS Growth (%)		Gross margin (%)			ROE (%)			ROA (%)			PER (x)			PBR (x)			Yield (%)	
Company	Ticker	Ccy	(Local\$)	(Local\$bn)	Y/E	18E	19E	17A	18E	19E	17A	18E	19E	17A	18E	19E	18E	19E	20E	18E	19E	18E	19E	
<b>Hong Kong listed</b>																								
CHINA EDU	839 HK	HKD	9.95	20.1	Dec	54.1	31.1	59.0	56.5	56.7	10.5	11.2	12.9	8.1	8.9	10.1	26.5	19.8	17.0	2.7	2.4	0.8	1.3	
HOPE EDU	1765 HK	HKD	1.12	7.5	Dec	36.4	80.4	47.8	49.4	51.0	38.1	8.0	12.3	4.2	10.8	13.2	21.5	12.4	9.9	1.6	1.5	-	-	
CHINA NEW HIGHER EDU	2001 HK	HKD	5.08	7.3	Dec	29.9	34.8	54.9	54.1	53.4	17.9	16.0	18.4	10.2	9.8	10.4	21.2	15.8	12.1	3.1	2.7	1.4	1.9	
MINSHENG EDU	1569 HK	HKD	1.68	6.7	Dec	31.1	24.7	58.3	55.9	57.0	11.3	10.7	12.1	8.1	7.9	8.9	17.1	13.7	12.1	1.7	1.6	0.7	1.1	
XINHUA EDU	2779 HK	HKD	2.35	3.8	Dec	40.8	21.1	57.0	58.1	59.5	n.a.	12.8	11.9	14.6	11.9	10.5	13.6	11.5	9.5	1.5	1.3	1.5	1.8	
CHUNLAI EDU	1969 HK	HKD	1.73	2.1	Aug	n.a.	n.a.	63.1	n.a.	n.a.	41.1	n.a.	n.a.	9.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	
TOP EDU	1752 HK	HKD	0.35	0.9	Jun	n.a.	n.a.	52.8	n.a.	n.a.	32.8	n.a.	n.a.	18.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	
CHINA YUHUA EDU	6169 HK	HKD	3.60	11.8	Aug	63.1	31.8	51.5	53.6	56.2	18.5	16.7	18.8	11.6	11.2	12.3	20.0	15.5	13.5	3.2	2.8	2.4	3.2	
MAPLELEAF EDU	1317 HK	HKD	3.65	10.9	Aug	28.8	25.8	49.8	49.9	50.6	18.4	18.8	20.2	10.7	11.2	12.0	17.3	14.1	12.0	2.9	2.6	2.4	2.9	
VIRSCEND EDU	1565 HK	HKD	4.68	14.5	Dec	26.3	30.2	47.7	46.6	49.0	11.8	14.1	17.5	7.1	9.3	11.7	31.6	24.4	19.4	4.4	4.0	1.3	1.8	
WISDOM EDU	6068 HK	HKD	4.21	8.6	Aug	53.8	31.9	45.9	45.8	46.2	15.5	16.2	18.9	6.9	8.6	9.8	23.6	17.9	14.2	3.8	3.3	1.8	2.4	
TIANLU EDU	1773 HK	HKD	1.75	3.6	Dec	36.2	38.5	42.3	43.9	42.3	20.2	14.8	14.8	7.7	7.6	7.5	16.1	12.1	7.9	1.4	1.3	n.a.	n.a.	
BOJUN EDU	1758 HK	HKD	2.12	1.7	Aug	n.a.	n.a.	32.6	n.a.	n.a.	10.1	n.a.	n.a.	5.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	
21CE EDU	1598 HK	HKD	0.97	1.2	Dec	60.8	18.2	45.0	45.1	45.0	33.4	13.0	14.6	15.6	10.1	11.5	16.7	13.9	11.9	n.a.	n.a.	n.a.	n.a.	
Average						41.9	33.5	50.6	50.8	51.5	21.5	13.8	15.7	9.8	9.8	10.7	20.5	15.5	12.7	2.6	2.3	1.4	1.8	
<b>US listed</b>																								
TAL EDUCATIO-ADR	TAL US	USD	25.04	14.2	Feb	95.3	46.9	48.6	48.0	50.5	21.6	24.5	17.8	8.1	9.3	7.7	64.9	46.0	29.2	12.8	7.5	-	-	
NEW ORIENTAL-ADR	EDU US	USD	67.58	10.7	May	26.5	36.6	56.5	56.4	57.1	17.8	17.1	19.4	10.4	8.8	9.4	30.8	23.2	17.4	5.3	4.2	0.7	1.0	
HARTFORD FINL SV	HIG US	USD	50.10	18.0	Dec	(155.6)	2.8	n.a.	n.a.	n.a.	(20.6)	12.7	13.0	(1.4)	11.1	11.5	10.6	10.0	9.2	1.3	1.2	2.2	2.5	
TARENA INTER-ADR	TEDU US	USD	8.62	0.5	Dec	(205.0)	(206.5)	69.6	63.9	65.8	11.4	(17.7)	1.9	8.5	(11.9)	1.5	n.a.	20.0	9.9	2.3	2.2	0.9	0.9	
CHINA DISTAN-ADR	DL US	USD	7.89	0.3	Sep	n.a.	n.a.	56.2	n.a.	n.a.	31.8	n.a.	n.a.	8.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	
CHINA ONLINE-ADR	COE US	USD	7.64	0.2	Dec	n.a.	n.a.	63.0	n.a.	n.a.	n.a.	n.a.	n.a.	(74.5)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	
BRIGHT SCHOL-ADR	BEDU US	USD	11.64	1.5	Aug	58.9	50.5	35.2	n.a.	n.a.	22.4	12.9	13.3	8.8	n.a.	n.a.	33.8	22.9	19.2	n.a.	n.a.	-	-	
RISE EDUCAT-ADR	REDU US	USD	11.09	0.7	Dec	(471.7)	39.4	53.3	n.a.	n.a.	n.a.	43.0	39.9	n.a.	n.a.	n.a.	24.5	18.0	13.8	9.0	6.1	n.a.	n.a.	
RYB EDUCATION-AD	RYB US	USD	20.95	0.6	Dec	37.1	160.8	21.0	n.a.	n.a.	13.3	7.8	20.3	4.3	n.a.	n.a.	93.9	30.1	22.5	6.0	5.1	n.a.	n.a.	
Average						(87.8)	18.6	50.4	56.1	57.8	14.0	14.3	17.9	(3.5)	4.3	7.5	43.1	24.3	17.3	6.1	4.4	0.8	0.9	

Source: Bloomberg, CSCI Research, prices as of 18 September, 2018

**Figure 4: Financial table**

<b>Income statement (RMBmn)</b>					
Year end: Dec	2016	2017	2018E	2019E	2020E
Revenue	341	414	631	1,163	1,392
Cost of sales	(177)	(187)	(299)	(584)	(677)
<b>Gross profit</b>	<b>164</b>	<b>228</b>	<b>332</b>	<b>580</b>	<b>715</b>
Selling and distribution expenses	(3)	(4)	(4)	(5)	(5)
Administrative expenses	(60)	(58)	(59)	(62)	(63)
Other expenses	(12)	(5)	(5)	(5)	(5)
Other income and gains	59	126	144	111	143
<b>EBITDA</b>	<b>179</b>	<b>318</b>	<b>455</b>	<b>685</b>	<b>857</b>
Depreciation & Amortization	31	31	47	66	74
<b>EBIT</b>	<b>148</b>	<b>287</b>	<b>407</b>	<b>619</b>	<b>783</b>
Net financial expenses/ (income)	35	37	58	80	63
<b>Pretax profit</b>	<b>113</b>	<b>250</b>	<b>349</b>	<b>539</b>	<b>721</b>
Taxation	(2)	(17)	(24)	(40)	(58)
Discontinued operations	2	-	-	-	-
Minority interests	0	(0)	14	61	97
<b>Net profit</b>	<b>112</b>	<b>233</b>	<b>311</b>	<b>438</b>	<b>566</b>
Basic EPS (RMB)	0.10	0.17	0.22	0.31	0.40
Basic EPS (HKD)	0.11	0.21	0.25	0.35	0.45
DPS (RMB)	-	0.05	0.07	0.09	0.12
DPS (HKD)	-	0.06	0.07	0.10	0.13

  

<b>Cash flow statement (RMBmn)</b>					
Year end: Dec	2016	2017	2018E	2019E	2020E
<b>EBIT</b>	<b>148</b>	<b>287</b>	<b>407</b>	<b>619</b>	<b>783</b>
Depreciation & amortisation	31	31	47	66	74
Net interest expenses/ (income)	35	37	58	80	63
Taxes paid	(3)	(1)	(24)	(40)	(57)
Changes in working capital	54	(33)	85	69	40
Others	(38)	(34)	(52)	(73)	(58)
<b>Cash flow from operations</b>	<b>225</b>	<b>287</b>	<b>522</b>	<b>721</b>	<b>845</b>
Capex	(731)	(638)	(973)	(531)	(336)
Others	65	(60)	(6)	(7)	(9)
<b>Cash flow from investing</b>	<b>(667)</b>	<b>(697)</b>	<b>(979)</b>	<b>(538)</b>	<b>(344)</b>
Dividends	-	(30)	(36)	(93)	(131)
Issue of shares	-	703	-	-	-
Change in debt	138	(244)	1072	(385)	(150)
Others	400	(79)	(64)	(86)	(68)
<b>Cash flow from financing</b>	<b>537</b>	<b>350</b>	<b>973</b>	<b>(564)</b>	<b>(349)</b>
<b>Change in cash</b>	<b>96</b>	<b>(60)</b>	<b>515</b>	<b>(381)</b>	<b>152</b>
<b>Free cash flow</b>	<b>(502)</b>	<b>(372)</b>	<b>(462)</b>	<b>177</b>	<b>498</b>

  

<b>Balance sheet (RMBmn)</b>					
Year end: Dec	2016	2017	2018E	2019E	2020E
Cash and cash equivalents	179	19	634	253	405
Pledged deposits	53	30	36	43	52
Prepayments, deposits and other receivables	51	89	98	107	118
Amounts due from related parties	-	-	-	-	-
Available-for-sale Investments	-	-	-	-	-
Other current assets	3	6	7	7	8
<b>Total current assets</b>	<b>285</b>	<b>243</b>	<b>774</b>	<b>411</b>	<b>583</b>
PP&E	867	985	1,897	2,699	2,863
Investment properties	32	47	46	45	43
Prepaid land lease payments	99	97	95	93	90
Prepayment for investments	680	1,020	1,035	700	800
Other prepayments	41	166	167	167	167
Other non-current assets	8	11	13	14	15
<b>Total long term assets</b>	<b>1,727</b>	<b>2,327</b>	<b>3,253</b>	<b>3,717</b>	<b>3,979</b>
<b>Total assets</b>	<b>2,013</b>	<b>2,570</b>	<b>4,027</b>	<b>4,128</b>	<b>4,562</b>
Short term debt	103	208	800	600	500
Deferred revenue	217	250	324	389	428
Other payables and accruals	240	193	211	225	235
Deferred income	2	4	4	5	5
Income tax payable	2	14	14	15	16
<b>Total current liabilities</b>	<b>563</b>	<b>668</b>	<b>1,354</b>	<b>1,233</b>	<b>1,183</b>
Long term debt	476	144	624	440	390
Other long term liabilities	31	33	34	36	38
<b>Total long term liabilities</b>	<b>507</b>	<b>177</b>	<b>659</b>	<b>476</b>	<b>428</b>
<b>Total liabilities</b>	<b>1,070</b>	<b>845</b>	<b>2,013</b>	<b>1,709</b>	<b>1,611</b>
<b>Shareholders' funds</b>	<b>888</b>	<b>1,725</b>	<b>2,000</b>	<b>2,344</b>	<b>2,779</b>
Minority Interests	54	-	14	76	172
<b>Total liabilities and equity</b>	<b>2,013</b>	<b>2,570</b>	<b>4,027</b>	<b>4,128</b>	<b>4,562</b>
<b>Net cash / (debt)</b>	<b>(400)</b>	<b>(234)</b>	<b>(790)</b>	<b>(787)</b>	<b>(485)</b>

  

<b>Key ratios</b>					
Year end: Dec	2016	2017	2018E	2019E	2020E
<b>Operating ratios</b>					
Gross margin (%)	48.0	54.9	52.6	49.8	51.3
EBIT margin (%)	43.3	69.2	64.6	53.2	56.3
EBITDA margin (%)	52.4	76.8	72.1	58.8	61.6
Net profit margin (%)	32.8	56.3	49.2	37.6	40.7
Effective tax rate (%)	2.1	6.7	7.0	7.5	8.0
Revenue growth (%)	24.5	21.5	52.2	84.4	19.7
Net income growth (%)	7.6	108.8	33.1	40.9	29.4
Basic EPS growth (%)	7.6	77.4	25.3	40.9	29.4
<b>Efficiency ratios</b>					
ROE (%)	18.1	17.9	16.7	20.1	22.1
ROA (%)	7.1	10.2	9.8	12.2	15.3
Asset turnover (x)	211	18.1	19.1	28.5	32.0
Op cash / EBIT (x)	15	10	13	12	11
Depreciation / CAPEX (x)	0.0	0.0	0.0	0.1	0.2
<b>Leverage ratios</b>					
Net gearing (%)	45.0	13.5	39.5	33.6	17.4
Debt / Equity (%)	614	20.4	70.7	43.0	30.1
Net debt / EBITDA (x)	2.2	0.7	1.7	1.1	0.6
Interest cover (x)	4.3	7.8	7.0	7.8	12.5
Current ratio (x)	0.5	0.4	0.6	0.3	0.5
<b>Valuation</b>					
PER (x)	46.6	24.5	20.6	14.6	11.3
PBR (x)	0.0	3.7	3.2	2.7	2.3
EV/EBITDA (x)	19	20.8	16.7	10.4	8.0
Dividend yield (x)	-	12	15	2.1	2.7

Source: Company, CSCI Research estimates

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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

<b>Buy</b>	12-month absolute total return: $\geq 10\%$
<b>Hold</b>	12-month absolute total return: $> -10\%$ but $< 10\%$
<b>Sell</b>	12-month absolute total return: $\leq -10\%$

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