

Hope Education (1765 HK)

Solid 1H19 results; 31% EPS CAGR in FY20-21E

1H19 results was solid as adjusted net profit +34% and GPM widened 3.8ppt. The Company announced to acquire 100% equity interests of Yinchuan schools at total consideration of RMB1,450mn. We expect this acquisition to be a key growth driver in FY20-21E. Hope Education remains our sector top pick.

- **1H19 results beat.** Adjusted net profit rose 34% YoY to RMB256mn, representing 57% of our FY19E estimates (vs 54% in 1H18). Revenue climbed 13%, driven by 14% student growth. GPM surprisingly widened by 3.8ppt to 53.1% due to cost control. SG&A expenses ratio dropped 9.4ppt to 13.6% primarily because of decreasing share option expense and one-off listing fee in 1H18. Finance cost fell 31%.
- **Acquisition of Yinchuan schools.** The Company announced to purchase 100% equity interests of the schools (University of Energy and five other schools) at a total consideration of RMB1.45bn (RMB550mn for equity interests, RMB400mn for debt repayment, RMB500mn for bidding the fixed assets of the new campus). The schools now have 15,108 students. In FY18, the schools recorded RMB201mn revenue and RMB30mn net profit. Management plans to improve its profitability to group level in 2-3 years by enhancing student enrollment capabilities, cost control and replacement of high cost borrowing. More than 10 parties competed for the acquisition targets. Management attributed its success to the recognition of Hope Education by local government authorities and MOE. We expect Yinchuan schools to be a key growth driver in FY20-21E.
- **Abundant resources for M&A.** As at 30 Jun 2019, the Company had RMB2.6bn cash balance. Management expects FY19 cash payment for acquisitions to be less than RMB1bn. With around RMB1.6bn tuition and boarding fees to be received in Sep 2019, we expect the Company still has financial resources to make acquisitions.
- **Valuation.** We raised our adjusted net profit in FY19/20/21E by 5%/12%/14% to factor in better margins and recent acquisitions of Yinchuan schools, Kunshan schools and Hebi College. Now we forecast a 31% EPS CAGR in FY20-21E (vs peers' average of 24%). Our TP is lifted from HK\$1.65 to HK\$1.96, based on 18.0x FY20E P/E (still at historical average plus 1sd) as we rolled forward our valuation basis (vs. 21.0x FY19E P/E previously). **Catalysts:** (1) policy overhang removes; (2) better-than-expected student enrollment number; (3) M&A. **Risk:** surge of teachers' costs.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	752	1,030	1,329	1,784	2,053
YoY growth (%)	22	37	29	34	15
Net profit (RMB mn)	212	168	454	653	819
Adj. net profit (RMB mn)	183	315	474	653	819
YoY growth (%)	2	72	50	38	25
Adj. EPS (RMB)	na	0.056	0.071	0.098	0.123
YoY growth (%)	na	na	28.0	37.6	25.5
Adj. P/E (x)	na	20.5	17.0	12.4	9.9
Yield (%)	na	1.3	1.8	2.6	3.2
P/B (x)	na	1.8	1.8	1.6	1.4
Net cash (RMB mn)	(2,327)	907	705	1,015	1,609

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	HK\$1.96
(Previous TP	HK\$1.65
Up/Downside	+45%
Current Price	HK\$1.35

China Education Sector

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Stock Data

Mkt Cap (HK\$ mn)	9,000
Avg 3 mths t/o (HK\$ mn)	9.38
52w High/Low (HK\$)	1.75/0.75
Total Issued Shares (mn)	6,666.7

Source: Bloomberg

Shareholding Structure

Hope Education Investment	62.1%
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Source: HKEx

Share Performance

	Absolute	Relative
1-mth	9.5%	19.8%
3-mth	27.8%	35.4%
6-mth	15.0%	28.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: EY

Related Reports

1. "Hope Education – Undemanding valuation at 25% 3-YR EPS CAGR" – 26 Mar 2019
2. "China Education Sector – Undemanding valuation; higher education segment more preferred" – 22 Mar 2019

Acquisition of Yinchuan schools

Background information

On 29 Aug 2019, the Company agreed to purchase the Yinchuan schools (University of Energy, a vocational school, a technician school, a training center, an auto repair factory and a driving school) from the vendors, Baota Group, Yinchuan Holdings and Mr. Shi Xingjia, at a total consideration of RMB1.45bn (RMB550mn for equity interests, RMB400mn for debt repayment, RMB500mn for bidding the fixed assets of the new campus). The Company can pay a first instalment of RMB165mn to the vendors and then consolidate the schools financially, which is expected in Sep 2019. The schools now have 15,108 students (6,751 degree students and 4,491 diploma students in University of Energy at old campus, 3,703 students in vocational school at new campus). In FY18, the schools recorded RMB201mn revenue, RMB79mn EBITDA and RMB30mn net profit.

Old campus has sufficient land resources to expand capacity

The new campus (buildings and land with site area of 469mu) will be publicly auctioned because the assets, as securities, are subject to the debt of certain creditors. The Company will provide financing support of RMB500mn to participate the auction. If the Company fails to bid the new campus, the Company can expand its capacity in the old campus (site area of 1,002mu) to accommodate the students in the new campus. Then, total acquisition consideration will decrease from RMB1,450mn to RMB950mn.

Key success factor of the acquisition is the recognition by authorities

More than 10 parties competed for the acquisition targets. The bidding price of the Company was not the highest among the bidders. Management attributed its success to the recognition of Hope Education by local government authorities and the MOE.

Huge growth potential of Yichuan schools

University of Energy is a selected higher education institution in the Ministry of Education - ZTE ICT Integrated Innovation Base of Industry and Education (教育部-中兴通讯 ICT 产教融合创新基地), an intended partner institution under the State's "Internet + Made in China 2025" Plan for the Integration and Promotion of Industry and Education (国家"互联网+中国制造 2025"产教融合促进计划项目), and the only private higher institution in Ningxia that recruits international students.

Management plans to improve the profitability of the schools by enhancing student enrollment capabilities, cost control and replacement of high cost borrowing. It targets to double the number of student enrollment in 5 years and improve the profitability of Yinchuan schools to its level in 2-3 years.

Figure 1: 1H19 results review

Y/E Dec (RMB mn)	1H19	1H18	change (%)	Remarks
Revenue	595	528	13%	average student enrollment 14% growth
tuition fees	504	452	12%	
boarding fees	44	42	4%	
others	47	34	38%	
Cost of sales	(279)	(268)	4%	
Gross profit	316	260	21%	Teachers' salaries remained stable
Other income	45	72	-38%	
Selling expenses	(12)	(9)	30%	increase headcount in response to increase in admission quota
Administrative expenses	(69)	(112)	-39%	decrease in equity-settled share option exp, no listing fees in 1H19
Other expenses	(3)	(1)	431%	
Operating profit	276	210	31%	
Finance income	56	34	67%	
Finance costs	(74)	(107)	-31%	Decreased borrowing and waiver of put option rights by CEL
Share profit of associates	0	(2)	-100%	
Profit before tax	258	135	91%	provision in respect of tax for certain non-formal education revenue
Tax expense	(15)	(2)	619%	
Profit after tax	243	133	83%	
Non-controlling interests	0	(1)	-128%	
Net profit	243	134	82%	
Adj. net profit	256	192	34%	
Margin & Ratio (%)				
Gross margin	53.1	49.3	3.8	
Operating margin	46.4	39.9	6.6	
SG&A expense/revenue	13.6	23.0	(9.4)	
Net margin	40.9	25.3	15.6	
Adj. net margin	43.1	36.3	6.8	
Effective tax rate	5.7	1.5	4.2	
Payout ratio (%)	na	na	na	
	1H19	FY18	change (%)	
Net cash (RMB mn)	482	907	-47%	

Source: Company data

Figure 2: 24% CAGR of student enrolment from 2018/19 to 2021/22 school year

Student enrolment (school year)	2016/2017	2017/2018	2018/2019	2019/2020E	2020/2021E	2021/2022E	3-yr CAGR
Universities							
Southwest Jiaotong University Hope College							
Bachelor's degree program	9,767	10,855	12,049	13,254	13,917	14,473	6%
Junior college diploma program	4,783	4,268	5,219	6,211	7,142	8,071	16%
Subtotal:	14,550	15,123	17,268	19,465	21,059	22,544	9%
Business College of Guizhou University of Finance and Econon	10,642	14,356	15,548	16,636	17,302	18,340	6%
Jinci College of Shanxi Medical University	3,621	4,801	5,953	7,441	8,185	8,676	13%
College of Science and Technology of Guizhou University *				9,325	9,604	9,892	na
Yinchuan schools				19,908	25,008	27,108	na
Junior colleges							
Sichuan Tianyi University	10,716	11,765	10,971	13,055	14,361	15,223	12%
Sichuan Hope Automotive Vocational College	3,642	4,559	4,373	5,904	7,379	8,486	25%
Sichuan Vocational College of Culture&Communication	5,959	7,371	8,920	11,150	12,823	13,977	16%
Guizhou Vocational Institute of Technology	1,177	2,989	5,903	9,091	11,363	11,931	26%
Sichuan TOP IT Vocational Institute		12,548	12,869	13,641	14,323	15,039	5%
Hebi Automotive College				5,400	6,200	7,000	na
Suzhou Top Institute				5,000	6,000	7,000	na
Technician education services							
Sichuan Hope Automotive Technician College	1,365	2,127	4,193	4,822	5,545	6,377	15%
Kunshan Technician School				500	500	500	na
Total:	51,672	75,639	85,998	132,013	150,049	162,202	24%
Total students - degree	24,030	30,012	33,550	57,240	64,412	68,598	27%
Total students - others	27,642	45,627	52,448	74,773	85,637	93,604	21%

Source: Company data, CMBIS estimates

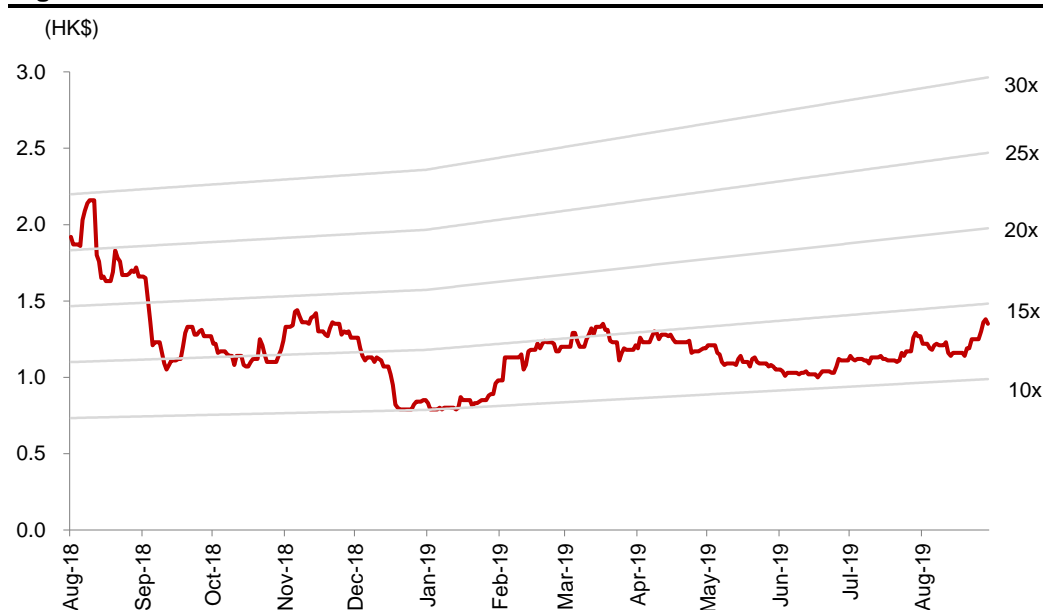
*Assume the investment of the school is financially consolidated by equity method.

Figure 3: 24% CAGR of revenue in FY20-21E

Revenue (RMB mn)	FY17	FY18	FY19E	FY20E	FY19E	2-yr CAGR
Tuition fees	621	856	1,120	1,517	1,751	25%
Regular higher education						
Southwest Jiaotong University Hope College	201	227	257	288	321	12%
Business College of Guizhou University of Finance and Economics	147	179	185	190	208	6%
Jinci College of Shanxi Medical University	61	82	102	122	138	16%
Yinchuan schools			75	248	295	99%
Sichuan Tianyi University	95	105	115	135	149	14%
Sichuan Hope Automotive Vocational College	32	37	46	63	79	31%
Sichuan Vocational College of Culture & Communication	62	70	93	124	153	28%
Guizhou Vocational Institute of Technology	18	30	53	75	90	31%
Sichuan Top IT Vocational Institute	0	116	140	154	170	10%
Hebi Automotive College			12	32	40	79%
Suzhou Top Institute			27	67	85	79%
<i>Subtotal</i>	616	846	1,104	1,497	1,728	25%
Technician education services						
Sichuan Hope Automotive Technician College	4	10	14	17	20	19%
Kunshan Technician School			1	3	3	57%
Boarding fees	63	85	115	166	191	29%
Others	68	90	94	99	104	5%
Total revenue	752	1,030	1,329	1,783	2,047	24%

Source: Company data, CMBIS estimates

Figure 4: P/E band chart



Source: Company data, CMBIS estimates

Figure 5: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	1,329	1,784	2,053	1,271	1,561	1,814	5%	14%	13%
Gross Profit	628	851	1,015	587	735	868	7%	16%	17%
Operating Profit	558	756	922	543	689	821	3%	10%	12%
Net profit	475	653	820	452	581	720	5%	12%	14%
Gross Margin	47.2%	47.7%	49.4%	46.2%	47.1%	47.8%	+1.0ppt	+0.6ppt	+1.6ppt
Operating Margin	42.0%	42.4%	44.9%	42.8%	44.1%	45.3%	-0.8ppt	-1.7ppt	-0.4ppt
Net Margin	35.7%	36.6%	39.9%	35.6%	37.2%	39.7%	+0.1ppt	-0.6ppt	+0.2ppt

Source: Company data, CMBIS estimates

Figure 6: CMBI estimates vs consensus

US\$ mn	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	1,329	1,784	2,053	1,271	1,540	1,799	5%	16%	14%
Gross Profit	628	851	1,015	597	748	880	5%	14%	15%
Operating Profit	558	756	922	517	683	839	8%	11%	10%
Net profit	475	653	820	440	566	689	8%	15%	19%
Gross Margin	47.2%	47.7%	49.4%	47.0%	48.6%	48.9%	+0.2ppt	-0.9ppt	+0.5ppt
Operating Margin	42.0%	42.4%	44.9%	40.7%	44.4%	46.6%	+1.3ppt	-2.0ppt	-1.7ppt
Net Margin	35.7%	36.6%	39.9%	34.6%	36.8%	38.3%	+1.1ppt	-0.2ppt	+1.6ppt

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	752	1,030	1,329	1,784	2,053
Tuition fees	621	854	1,120	1,518	1,757
Boarding fees	63	85	115	167	192
Others	68	90	94	99	104
Cost of sales	(392)	(562)	(701)	(932)	(1,038)
Gross profit	360	467	628	851	1,015
Other income	78	101	117	150	171
Selling expenses	(29)	(21)	(33)	(41)	(43)
Administrative expenses	(79)	(111)	(149)	(200)	(216)
Other expenses	(3)	(5)	(5)	(5)	(5)
EBIT	328	431	558	756	922
Finance income	19	79	93	55	51
Finance costs	(145)	(201)	(171)	(179)	(172)
Share of JV	(2)	(2)	15	41	43
Non-operating items	29	(148)	(20)	-	-
Pre-tax profit	229	159	474	673	845
Income tax					
Less: Minority interests	(20)	8	(20)	(20)	(25)
Net profit	(2)	(1)	0	0	0
Adjusted net profit	212	168	454	653	819

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Profit before tax	229	159	474	673	845
Depreciation and amortization	121	161	220	276	284
Change in working capital	80	249	(15)	191	172
Others	70	233	118	103	87
Net cash from operating	501	802	798	1,243	1,387
Capex & investments	(925)	(624)	(300)	(400)	(400)
Acquisitions	(750)	(15)	(499)	(515)	(50)
Others	710	(100)	70	306	38
Net cash from investing	(965)	(739)	(729)	(609)	(412)
Equity raised	-	2,705	-	-	-
Change of borrowings	207	259	200	(20)	(20)
Dividend paid	-	-	(100)	(145)	(209)
Others	296	(595)	(171)	(179)	(172)
Net cash from financing	503	2,369	(71)	(345)	(401)
Net change in cash	39	2,432	(2)	289	575
Cash at the beginning of the year	143	181	3,039	3,037	3,326
Exchange difference	181	2,614	3,037	3,326	3,901
Cash at the end of the year	181	3,039	3,037	3,326	3,901

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	4,551	5,119	6,418	6,583	6,743
PPE	3,195	3,448	5,062	5,209	5,348
Prepaid lease payments	595	590	566	551	537
JV	143	-	163	204	247
Others	618	1,081	628	619	610
Current assets	1,044	3,172	3,631	3,486	4,077
Cash	181	3,039	3,037	3,326	3,901
Prepayments	121	129	142	156	171
Others	741	4	452	4	4
Current liabilities	2,098	1,851	2,397	2,422	2,609
Contract liabilities	535	591	892	1,048	1,191
Other payables	732	637	701	750	795
Borrowings	614	527	527	527	527
Current income tax	54	34	34	34	34
Others	163	62	242	62	62
Non-current liabilities	2,817	2,280	3,118	2,606	2,557
Deferred income	629	658	685	708	729
Borrowings	1,265	1,605	1,805	1,785	1,765
Others	922	17	628	113	63
Total net assets	679	4,160	4,535	5,043	5,653
Shareholders' equity	649	4,157	4,532	5,039	5,649
Minority Interest	30	3	3	3	4

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Tuition & boarding fees	82.5	83.0	84.3	85.1	85.6
Ancillary services	8.4	8.3	8.6	9.3	9.4
Others	9.1	8.7	7.1	5.6	5.1
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross profit margin	47.8	45.4	47.2	47.7	49.4
EBIT margin	43.5	41.9	42.0	42.4	44.9
Effective tax rate	24.3	30.6	35.7	36.6	39.9
Adj. net profit margin	8.6	(4.9)	4.2	3.0	3.0
Payout ratio	NA	31.7	32.0	32.0	32.0
Balance sheet ratios					
Current ratio (x)	0.5	1.7	1.5	1.4	1.6
Asset turnover (x)	0.1	0.1	0.1	0.2	0.2
Net cash (RMBmn)	(2,327)	907	705	1,015	1,609
Returns (%)					
Adj. ROAE	32.9	13.1	10.9	13.6	15.3
Adj. ROAA	3.6	4.6	5.2	6.5	7.8
Per share data					
Adj. EPS (RMB)	NA	0.056	0.071	0.098	0.123
DPS (RMB)	NA	0.015	0.022	0.031	0.039
BVPS (RMB)	NA	0.624	0.680	0.756	0.847

Source: Company data, CMBIS estimates

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