

# Xinhua Education (2779 HK)

## Valuation undemanding; lifted TP to HK\$2.97

1H20 adj. NP +17%, ~56% of our FY20E adj. NP (vs 52-53% in past two years), above our expectation. The Company got 18% degree quota growth in 2020-21 school year and began providing value-added services. Hence, we lifted FY20-22E adj. NP by 5-6% and raised TP from HK\$2.85 to HK\$2.97, still at 12.8x FY20E P/E which is at historical average. Valuation is undemanding given that the stock trades at 9.5x FY20E P/E, at the low-end of its P/E band (9x) and 45% below sector average P/E of 19.3x. Maintain Buy on its leading position in Yangtze River Delta region and expanding new revenue sources.

- 1H20 results.** Revenue climbed 8% led by 15% tuition fees growth (incl. 3% full-time student growth) while boarding fees fell 58% due to refund amid epidemic. Revenue growth would be 14% if no refund happened. GPM widened 6.7ppt to 71.0% as teaching-related expenses were reduced due to epidemic. Other income jumped 52% as two entrusted independent colleges contributed RMB25mn gain. NP growth was flat due to increase of share based payment and forex loss. Adj NP increased 17% if such expenses were excluded.
- 2020-21 school year quota and tuition fee.** Admission quota of the Company's three colleges increased 7%. That said, degree quota impressively jumped 18% to 10,764 led by 865% growth from diploma to degree. Average tuition fees of Xinhua University increased by ~6% (vs 12.5% growth last year), while tuition fees for the two independent colleges maintained.
- Expect conversion of two independent colleges in 2021.** The phase one of new campuses of Hongshan College and School of Clinical Medicine would commence operation in Sep 2021, which satisfies a key condition for conversion. The Company is not required to pay any termination fees for conversion. The Company expects to complete their conversion in 2021. If successful, we estimate this would enhance FY22E adj. NP by 10%.
- Diversify revenue source.** The Company established a department to provide value-added services for students such as professional qualification exams, practical training and other areas with the orientation of employment.
- M&A.** The Company had RMB1.1bn cash balance as at 30 Jun. It will look for opportunities from conversion of independent colleges as well as private colleges in regions attractive for talents or with low gross enrollment rate.
- Upped estimates.** We lifted our adj. NP in FY20-22E by 5-6% to factor in better quota growth & value-added services revenue source. **Catalysts:** (1) M&A; (2) conversion of independent colleges. **Risk:** surge of teachers' costs.

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	386	438	499	579	633
YoY growth (%)	14.3	13.4	17.4	12.6	9.5
Net profit (RMB mn)	256	271	308	375	410
Adj. net profit (RMB mn)	259	296	335	375	410
Adj. EPS (RMB)	0.171	0.184	0.209	0.233	0.255
YoY growth (%)	na	7.6	13.3	11.9	9.2
Consensus EPS (RMB)	na	na	0.201	0.228	0.263
Adj. P/E (x)	12.2	11.9	10.7	9.5	8.7
Yield (%)	2.3	2.2	2.6	3.1	3.4
P/B (x)	1.4	1.3	1.3	1.1	1.0
Net cash (RMB mn)	1,862	1,053	988	974	1,071

Source: Company data, CMBIS estimates

**BUY (Maintain)**

Target Price	HK\$2.97
(Previous TP)	HK\$2.85)
Up/Downside	+20%
Current Price	HK\$2.48

### China Education Sector

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### Stock Data

Mkt Cap (HK\$ mn)	3,989
Avg 3 mths t/o (HK\$ mn)	3.72
52w High/Low (HK\$)	2.90/ 1.93
Total Issued Shares (mn)	1,608.6

Source: Bloomberg

### Shareholding Structure

Mr. Wu Junbao	71.5%
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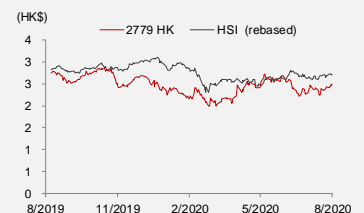
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	9.2%	6.2%
3-mth	3.7%	-4.4%
6-mth	16.3%	23.2%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: KPMG**

### Related Reports

- "Xinhua Education – Waiting for next acquisition" – 30 Mar 2020
- "Xinhua Education – Strong earnings growth in FY20E" – 29 Aug 2019
- "Xinhua Education – FY18 results beat; target two acquisitions in FY19E" – 28 Mar 2019
- "China Education Sector – Undemanding valuation; higher education segment more preferred" – 22 Mar 2019

Figure 1: 1H20 results review

Y/E Dec (RMB mn)	1H20	1H19	change (%)	Remarks
<b>Revenue</b>	<b>245</b>	<b>228</b>	<b>8%</b>	student enrollment +3.4% to 29,074
tuition fees	235	204	15%	
boarding fees	10	24	-58%	refunded RMB14.6mn due to COVID-19
Cost of sales	(71)	(81)	-13%	reduced social security fees, utilities and teaching activities
Gross profit	174	146	19%	
Other income	35	23	52%	RMB25mn operating gain from the School of Clinical Medicine and Hongshan College
Selling expenses	(2)	(4)	-33%	restricted promotion activities due to epidemic and adoption of new enrollment model combining online and offline
Administrative expenses	(63)	(32)	98%	increase of share based payment and forex loss
Operating profit	144	134	7%	
Finance income	13	19	-30%	
Finance costs	(4)	0	na	
Profit before tax	153	153	0%	
Tax expense	(0)	(0)	-92%	
<b>Net profit</b>	<b>153</b>	<b>152</b>	<b>0%</b>	
<b>Adj. net profit</b>	<b>180</b>	<b>154</b>	<b>17%</b>	add back share based payment and forex loss
EPS (RMB)	0.11	0.10	17%	
DPS (RMB)	0.00	0.00	na	
<b>Margin &amp; Ratio (%)</b>				
Gross margin	71.0	64.3	6.7	
Operating margin	58.9	59.0	(0.1)	
SG&A expense/revenue	26.5	15.5	11.0	
Net margin	62.4	66.9	(4.5)	
Adj. net margin	73.6	67.8	5.8	
Effective tax rate	0.0	0.2	(0.2)	
Payout ratio (%)	0.0	0.0	0.0	
	<b>1H20</b>	<b>FY19</b>	<b>change (%)</b>	
Net cash (RMB mn)	740	1,053	-30%	

Source: Company data

Figure 2: Tuition and boarding fees increased in 2020/21 school year

(RMB)	2017/18	2018/19	2019/20	2020/21
<b>Tuition Fees</b>				
<b>Xinhua University</b>				
Four-year undergraduate program	↑15,100-25,000	↑16,500-25,000	↑19,800-23,800	↑19,800-23,800
Three-year junior college program	↑10,700-21,000	10,700-21,000	10,700-12,000	10,700-12,000
Continuing education program	1,200-8,900	↑ 2,400-9,900	↑ 2,400-11,900	2,400-6,000
<b>Xinhua School</b>				
General secondary vocational program	5,200-7,600	↑ 5,200-10,400	↑ 9,000-11,400	↑ 9,000-16,000
Undergraduate oriented secondary vocational program	8,000	↑ 10,400	↑ 11,400	11,400
Five-year junior college oriented secondary vocational program	8,000	↑ 10,400	↑ 11,400	11,400
<b>School of Clinical Medicine</b>				
Four-year undergraduate program		13,200-15,900	13,200-15,900	13,200-15,900
Five-year undergraduate program		15,900	15,900	15,900
<b>Hongshan College</b>				
Four-year undergraduate program		14,000	14,000	14,000
<b>Boarding fees</b>				
<b>Xinhua University</b>	↑ 1,300-1,500	↑ 1,500-2,000	1,500-2,000	1,500-2,000
<b>Xinhua School</b>	↑ 1,200	↑ 1,500	1,500	↑ 1,500-2,000
<b>School of Clinical Medicine</b>		1,000	1,000	1,000
<b>Hongshan College</b>			800-1,500	800-1,500

Source: Company data

**Figure 3: 13% CAGR of revenue in FY19-22E**

Revenue (RMB mn)	FY18	FY19	FY20E	FY21E	FY22E	3-yr CAGR
Revenue	386	438	514	579	633	13%
Tuition fees	342	392	449	502	550	12%
Xinhua University	308	348	398	442	485	12%
Xinhua School	33	44	52	60	66	14%
Others	45	46	64	77	83	22%

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 (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	499	579	633	500	557	606	0%	4%	5%
Gross Profit	310	343	375	300	334	364	3%	3%	3%
Operating Profit	304	373	407	320	356	388	-5%	5%	5%
Net profit	335	375	410	321	356	388	5%	5%	6%
Gross Margin	62.2%	59.3%	59.2%	60.0%	60.0%	60.0%	+2.2ppt	-0.7ppt	-0.8ppt
Operating Margin	60.9%	64.4%	64.3%	63.9%	63.9%	64.1%	-3.0ppt	+0.5ppt	+0.2ppt
Net Margin	67.2%	64.9%	64.7%	64.1%	64.0%	64.1%	+3.1ppt	+0.9ppt	+0.6ppt

Source: Company data, CMBIS estimates

**Figure 6: CMBIS estimates vs consensus**

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	499	579	633	497	585	688	0%	-1%	-8%
Gross Profit	310	343	375	300	350	411	3%	-2%	-9%
Operating Profit	304	373	407	310	355	435	-2%	5%	-6%
Net profit	335	375	410	312	362	415	8%	4%	-1%
Gross Margin	62.2%	59.3%	59.2%	60.4%	59.8%	59.8%	+1.8ppt	-0.5ppt	-0.6ppt
Operating Margin	60.9%	64.4%	64.3%	62.3%	60.6%	63.2%	-1.4ppt	+3.8ppt	+1.1ppt
Net Margin	67.2%	64.9%	64.7%	62.7%	61.8%	60.3%	+4.5ppt	+3.1ppt	+4.4ppt

Source: Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>386</b>	<b>438</b>	<b>499</b>	<b>579</b>	<b>633</b>
Tuition fees	342	392	449	502	550
Boarding fees	45	46	64	77	83
Cost of sales	(156)	(177)	(189)	(235)	(258)
<b>Gross profit</b>	<b>230</b>	<b>261</b>	<b>310</b>	<b>343</b>	<b>375</b>
Other income	74	85	116	139	149
Selling expenses	(6)	(8)	(11)	(13)	(15)
Administrative expenses	(58)	(94)	(111)	(96)	(103)
EBIT	241	244	304	373	407
Finance income	17	30	25	24	25
Finance costs	(0)	(1)	(17)	(17)	(17)
Pre-tax profit	258	274	311	380	415
Income tax	(2)	(3)	(4)	(4)	(5)
Less: Minority interests	0	0	0	0	0
<b>Net profit</b>	<b>256</b>	<b>271</b>	<b>308</b>	<b>375</b>	<b>410</b>
<b>Adjusted net profit</b>	<b>259</b>	<b>296</b>	<b>335</b>	<b>375</b>	<b>410</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19E	FY20E	FY21E	FY22E
<b>Profit before tax</b>	<b>258</b>	<b>274</b>	<b>311</b>	<b>380</b>	<b>415</b>
Depreciation and amortization	56	60	63	66	69
Change in working capital	(5)	(611)	45	37	31
Others	(15)	(28)	14	13	13
<b>Net cash from operating</b>	<b>294</b>	<b>(305)</b>	<b>433</b>	<b>496</b>	<b>527</b>
Capex & investments	(40)	(500)	(400)	(400)	(300)
Acquisitions	0	(1,222)	0	0	0
Others	187	55	0	0	0
<b>Net cash from investing</b>	<b>147</b>	<b>(1,667)</b>	<b>(400)</b>	<b>(400)</b>	<b>(300)</b>
Equity raised	1,038	0	0	0	0
Change of borrowings	0	330	31	0	0
Dividend paid	0	(77)	(81)	(92)	(113)
Others	(0)	(1)	(17)	(17)	(17)
<b>Net cash from financing</b>	<b>1,038</b>	<b>252</b>	<b>(67)</b>	<b>(110)</b>	<b>(130)</b>
<b>Net change in cash</b>	<b>1,478</b>	<b>(1,720)</b>	<b>(34)</b>	<b>(14)</b>	<b>97</b>
Cash at the beginning of the year	293	1,862	1,383	1,349	1,335
Exchange difference	90	0	0	0	0
<b>Cash at the end of the year</b>	<b>1,862</b>	<b>142</b>	<b>1,349</b>	<b>1,335</b>	<b>1,432</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>768</b>	<b>1,420</b>	<b>1,757</b>	<b>2,091</b>	<b>2,322</b>
PPE	476	468	810	1,150	1,386
Prepaid lease payments	88	0	0	0	0
Right-of-use assets	0	85	83	80	78
Deposits	204	207	204	201	198
Others	0	660	660	660	660
<b>Current assets</b>	<b>1,935</b>	<b>1,874</b>	<b>1,852</b>	<b>1,848</b>	<b>1,954</b>
Cash	1,862	1,383	1,349	1,335	1,432
Account receivables	0	3	3	4	4
Prepayments	13	488	500	509	518
Others	60	0	0	0	0
<b>Current liabilities</b>	<b>319</b>	<b>675</b>	<b>452</b>	<b>500</b>	<b>539</b>
Contract liabilities	213	239	279	311	337
Other payables	101	102	120	135	148
Others	2	0	0	0	0
Current income tax	3	4	4	4	4
Borrowing	0	330	50	50	50
<b>Non-current liabilities</b>	<b>0</b>	<b>0</b>	<b>311</b>	<b>311</b>	<b>311</b>
Deferred income	0	0	0	0	0
Borrowing	0	0	311	311	311
<b>Total net assets</b>	<b>2,385</b>	<b>2,618</b>	<b>2,845</b>	<b>3,128</b>	<b>3,426</b>
<b>Shareholders' equity</b>	<b>2,385</b>	<b>2,618</b>	<b>2,845</b>	<b>3,128</b>	<b>3,426</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Tuition & boarding fees	88.5	89.5	90.0	86.7	86.9
Ancillary services	11.5	10.5	12.9	13.3	13.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>P&amp;L ratios (%)</b>					
Gross profit margin	59.7	59.7	62.2	59.3	59.2
EBIT margin	62.4	55.8	60.9	64.4	64.3
Effective tax rate	0.8	1.1	1.1	1.1	1.1
Net profit margin	66.3	61.8	61.7	64.9	64.7
Adj. net profit margin	67.0	67.6	67.2	64.9	64.7
Payout ratio	30.0	30.0	62.2	59.3	59.2
<b>Balance sheet ratios</b>					
Current ratio (x)	6.1	2.8	4.1	3.7	3.6
Asset turnover (x)	0.1	0.1	0.1	0.1	0.1
Total asset/total equity (x)	1.1	1.3	1.3	1.3	1.2
<b>Returns (%)</b>					
Adj. ROAE	15.3	11.8	12.3	12.6	12.5
Adj. ROAA	12.8	9.9	9.7	9.9	10.0
<b>Per share data</b>					
Adj. EPS (RMB)	0.171	0.184	0.209	0.233	0.255
DPS (RMB)	0.048	0.049	0.057	0.070	0.076
BVPS (RMB)	1.482	1.628	1.769	1.945	2.130

Source: Company data, CMBIS estimates

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