

# Xinhua Education (2779 HK)

## Strong earnings growth in FY20E

1H19 adjusted net profit +12%, in line but margins below our expectation. That said, management expects the financials of Kunming schools could be consolidated in 4Q19. We estimate this would boost earnings growth to 53% YoY in FY20E. Maintain Buy.

- 1H19 results inline but margins below.** Adjusted net profit rose 12% YoY to RMB154mn, representing 53% of our FY19E estimates (vs 54% in 1H18). Revenue climbed 14%, primarily driven by ASP growth. GPM narrowed by 0.9ppt to 64.3% due to employment of more teachers and enhanced teachers' training. SG&A expenses ratio gained 0.8ppt to 15.5%, arising from increase of management expenses and expenses for requirement of listed company. The margin decline was offset by increase of interest income.
- Quota and tuition fee increased in 2019/20 school year.** Admission quota of Xinhua University and School of Clinical Medicine increased by 15% and >100%, respectively. For tuition fee, Xinhua University and Xinhua School raised its tuition fees by 13-15% and 13%, respectively.
- Kunming schools key growth driver in FY20E.** Management expects Haiyuan Collge and Kunming Health School could be financially consolidated in 4Q19 (we assume this can be done on 31 Dec 2019). These schools recorded RMB312m revenue and RMB124mn profit after tax in FY18. We expect its revenue and net profit to grow by double digit in FY19-21E.
- Abundant resources for M&A.** As at 30 Jun 2019, the Company had RMB1.2bn cash balance with zero debt. Coupled with >RMB1bn credit line secured, management plans to have 1-2 acquisitions per year which focus on universities with medical or finance majors in Yangtze River Delta, Pearl River Delta or Southwestern region.
- Valuation.** We change our adjusted net profit in FY19/20/21E by -4%/ 26%/ 28% to factor in lower margins, higher interest income and contribution from Kunming schools. Our TP is lifted from HK\$3.71 to HK\$4.50, based on 16.2x FY20E P/E (still at historical average plus 1sd) as we rolled forward our valuation basis (vs. 17.9x FY19E P/E previously). **Catalysts:** (1) policy overhang removes; (2) M&A; (3) complete financial consolidation of Kunming schools. **Risk:** surge of teachers' costs.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	338	386	445	862	973
YoY growth (%)	11	14	15	94	13
Net profit (RMB mn)	172	256	278	427	504
Adj. net profit (RMB mn)	198	256	279	427	504
YoY growth (%)	15	29	9	53	18
Adj. EPS (RMB)	na	0.172	0.174	0.252	0.297
YoY growth (%)	na	na	1	45	18
Adj. P/E (x)	na	13.4	14.1	9.7	8.2
Yield (%)	na	2.1	2.1	3.1	3.6
P/B (x)	na	1.6	1.4	1.3	1.2
Net cash (RMB mn)	293	1,862	418	715	1,003

Source: Company data, CMBIS estimates

## BUY (Maintain)

Target Price	HK\$4.50
(Previous TP)	HK\$3.71)
Up/Downside	+65%
Current Price	HK\$2.73

### China Education Sector

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#### Stock Data

Mkt Cap (HK\$ mn)	4,391
Avg 3 mths t/o (HK\$ mn)	4.42
52w High/Low (HK\$)	3.12/1.65
Total Issued Shares (mn)	1,608.6

Source: Bloomberg

#### Shareholding Structure

Mr. Wu Junbao	71.5%
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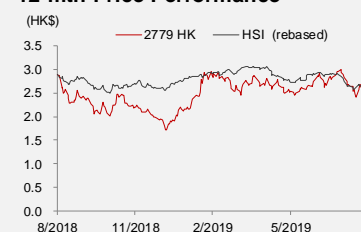
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	-6.4%	3.5%
3-mth	9.5%	16.4%
6-mth	-3.8%	7.8%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

#### Auditor: KPMG

#### Related Reports

- "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: 1H19 results review**

Y/E Dec (RMB mn)	1H19	1H18	change (%)	Remarks
<b>Revenue</b>	<b>228</b>	<b>200</b>	<b>14%</b>	Student enrollment increased 1% to 35,330
tuition fees	204	179	14%	
boarding fees	24	21	12%	
Cost of sales	(81)	(70)	16%	Employed more teachers and enhanced salary system
Gross profit	146	131	12%	
Other income	23	34	-32%	RMB6.6mn operation loss of School of Clinical Medicine; decreased gain from financial assets
Selling expenses	(4)	(2)	106%	Xinhua School and promotion of international students exchange
Administrative expense:	(32)	(28)	14%	growth and higher cost related requirement of listed company
Operating profit	134	135	-1%	
Finance income	19	3	564%	RMB1.9bn cash balance as at 31 Dec 2018
Finance costs	0	(0)	na	
Profit before tax	153	138	11%	
Tax expense	(0)	(1)	-45%	
<b>Net profit</b>	<b>152</b>	<b>137</b>	<b>11%</b>	
<b>Adj. net profit</b>	<b>154</b>	<b>137</b>	<b>12%</b>	
EPS (RMB)	0.10	0.10	-1%	
DPS (RMB)	na	na	na	
<b>Margin &amp; Ratio (%)</b>				
Gross margin	64.3	65.2	(0.9)	
Operating margin	59.0	67.6	(8.6)	
SG&A expense/revenue	15.5	14.7	0.8	
Net margin	66.9	68.6	(1.6)	
Adj. net margin	67.8	68.6	(0.8)	
Effective tax rate	0.2	0.5	(0.2)	
Payout ratio (%)	na	na	na	
	<b>1H19</b>	<b>FY18</b>	<b>change (%)</b>	
Net cash (RMB mn)	1,168	1,862	-37%	

Source: Company data

**Figure 2: Tuition and boarding fees increased in 2019/20 school year**

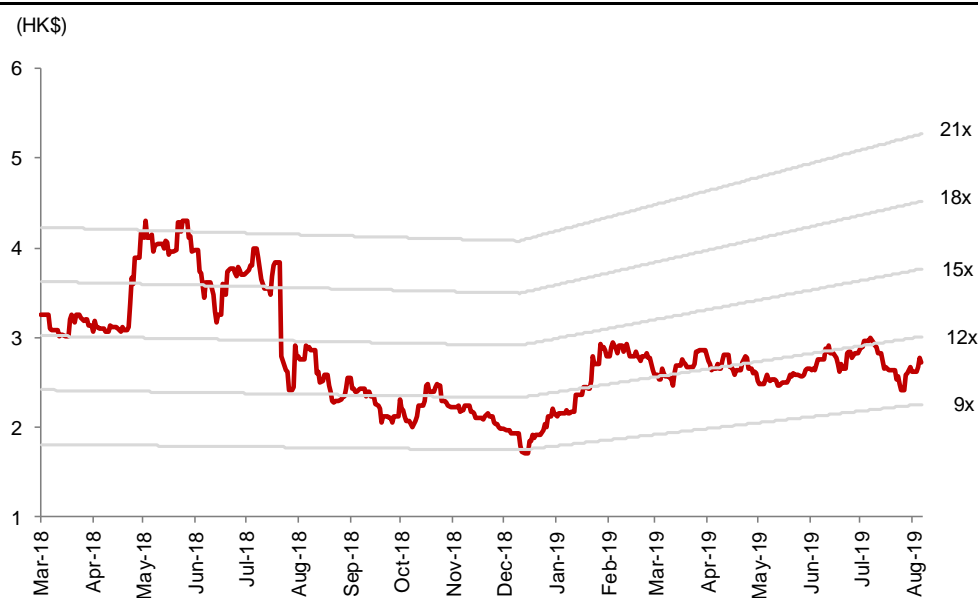
(RMB)	2016/17	2017/18	2018/19	2019/20
<b>Tuition Fees</b>				
<b>Xinhua University</b>				
Four-year undergraduate program	↑12,100-20,000	↑15,100-25,000	↑16,500-25,000	↑19,800-23,800
Three-year junior college program	↑7,700-18,000	↑10,700-21,000	10,700-21,000	10,700-12,000
Continuing education program	1,200-8,900	1,200-8,900	↑2,400-9,900	↑2,400-11,900
<b>Xinhua School</b>				
General secondary vocational program	↑5,200-7,600	5,200-7,600	↑5,200-10,400	↑9,000-11,400
Undergraduate oriented secondary vocational program	↑8,000	8,000	↑10,400	↑11,400
Five-year junior college oriented secondary vocational program	↑8,000	8,000	↑10,400	↑11,400
<b>School of Clinical Medicine</b>				
Four-year undergraduate program			13,200-15,900	13,200-15,900
Five-year undergraduate program			15,900	15,900
<b>Hongshan College</b>				
Four-year undergraduate program			14,000	14,000
<b>Haiyuan College</b>				
Four-year undergraduate program				17,000-23,000
Five-year undergraduate program				25,000
<b>Health School</b>				
Three-year junior college program				8,000
<b>Boarding fees</b>				
<b>Xinhua University</b>	1,000-1,500	↑1,300-1,500	↑1,500-2,000	1,500-2,000
<b>Xinhua School</b>	600	↑1,200	↑1,500	1,500
<b>School of Clinical Medicine</b>			1,000	1,000
<b>Hongshan College</b>				800-1,500
<b>Haiyuan College</b>				1,650-3,300
<b>Health School</b>				800-1,600

Source: Company data

**Figure 3: 36% CAGR of revenue in FY19-21E**

Revenue (RMB mn)	FY17	FY18	FY19E	FY20E	FY21E	3-yr CAGR
<b>Revenue</b>	<b>338</b>	<b>386</b>	<b>445</b>	<b>862</b>	<b>973</b>	<b>36%</b>
<b>Tuition fees</b>	<b>301</b>	<b>342</b>	<b>398</b>	<b>780</b>	<b>882</b>	<b>37%</b>
Xinhua University	272	308	356	403	447	13%
Xinhua School	29	33	42	49	56	19%
Kunming schools				325	375	na
American College			1	3	5	na
<b>Boarding fees</b>	<b>37</b>	<b>45</b>	<b>46</b>	<b>82</b>	<b>91</b>	<b>27%</b>

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	445	862	973	456	538	620	-2.5%	60.1%	57.0%
Gross Profit	263	503	567	276	332	387	-4.6%	51.3%	46.4%
Operating Profit	250	501	591	275	325	376	-9.1%	54.3%	57.1%
Net profit	279	427	504	290	340	392	-3.7%	25.8%	28.4%
Gross Margin	59.2%	58.3%	58.3%	60.5%	61.8%	62.5%	-1.3ppt	-3.5ppt	-4.2ppt
Operating Margin	56.2%	58.2%	60.7%	60.3%	60.4%	60.7%	-4.1ppt	-2.2ppt	flat
Net Margin	62.9%	49.6%	51.8%	63.6%	63.1%	63.3%	-0.7ppt	-13.5ppt	-11.5ppt

Source: Company data, CMBIS

**Figure 6: CMBI estimates vs consensus**

US\$ mn	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	445	862	973	475	577	668	-6.4%	49.2%	45.6%
Gross Profit	263	503	567	286	350	406	-7.8%	43.4%	39.6%
Operating Profit	250	501	591	292	356	406	-14.5%	41.0%	45.6%
Net profit	279	427	504	299	365	424	-6.5%	17.2%	18.7%
Gross Margin	59.2%	58.3%	58.3%	60.1%	60.7%	60.8%	-0.9ppt	-2.4ppt	-2.5ppt
Operating Margin	56.2%	58.2%	60.7%	61.6%	61.6%	60.7%	-5.4ppt	-3.4ppt	flat
Net Margin	62.9%	49.6%	51.8%	63.0%	63.1%	63.5%	-0.1ppts	-13.5ppt	-11.7ppt

Source: Company data, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>338</b>	<b>386</b>	<b>445</b>	<b>862</b>	<b>973</b>
Tuition fees	301	342	398	780	882
Boarding fees	37	45	46	82	91
Cost of sales	(145)	(156)	(181)	(359)	(406)
<b>Gross profit</b>	<b>192</b>	<b>230</b>	<b>263</b>	<b>503</b>	<b>567</b>
Other income	53	74	60	131	155
Selling expenses	(5)	(6)	(8)	(12)	(13)
Administrative expenses	(67)	(58)	(65)	(121)	(119)
<b>EBIT</b>	<b>173</b>	<b>241</b>	<b>250</b>	<b>501</b>	<b>591</b>
Finance income	1	17	31	12	15
Finance costs	0	(0)	0	0	0
Pre-tax profit	174	258	281	514	606
Income tax	(2)	(2)	(2)	(4)	(5)
Less: Minority interests	0	0	0	(83)	(98)
<b>Net profit</b>	<b>172</b>	<b>256</b>	<b>278</b>	<b>427</b>	<b>504</b>
<b>Adjusted net profit</b>	<b>198</b>	<b>260</b>	<b>279</b>	<b>427</b>	<b>504</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Profit before tax</b>	<b>174</b>	<b>258</b>	<b>281</b>	<b>514</b>	<b>606</b>
Depreciation and amortization	52	56	59	98	103
Change in working capital	46	(5)	104	171	111
Others	(15)	(15)	(31)	1	(1)
<b>Net cash from operating</b>	<b>257</b>	<b>294</b>	<b>412</b>	<b>783</b>	<b>819</b>
Capex & investments	(59)	(40)	(554)	(400)	(400)
Acquisitions	0	0	(1,222)	0	0
Others	(72)	187	(3)	(3)	(3)
<b>Net cash from investing</b>	<b>(131)</b>	<b>147</b>	<b>(1,779)</b>	<b>(403)</b>	<b>(403)</b>
Equity raised	0	1,038	0	0	0
Change of borrowings	0	0	0	0	0
Dividend paid	0	0	(77)	(84)	(128)
Others	61	(0)	0	0	0
<b>Net cash from financing</b>	<b>61</b>	<b>1,038</b>	<b>(77)</b>	<b>(84)</b>	<b>(128)</b>
<b>Net change in cash</b>	<b>187</b>	<b>1,478</b>	<b>(1,444)</b>	<b>297</b>	<b>288</b>
Cash at the beginning of the year	106	293	1,862	418	715
Exchange difference	0	90	0	0	0
<b>Cash at the end of the year</b>	<b>293</b>	<b>1,862</b>	<b>418</b>	<b>715</b>	<b>1,003</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>786</b>	<b>768</b>	<b>3,403</b>	<b>3,705</b>	<b>4,002</b>
PPE	492	476	2,052	2,362	2,668
Prepaid lease payments	90	88	539	532	525
Deposits	5	204	202	201	199
Others	198	-	610	610	610
<b>Current assets</b>	<b>541</b>	<b>1,935</b>	<b>493</b>	<b>805</b>	<b>1,097</b>
Cash	293	1,862	418	715	1,003
Account receivables	0	0	0	1	1
Prepayments	12	13	15	29	33
Others	236	60	60	60	60
<b>Current liabilities</b>	<b>326</b>	<b>319</b>	<b>582</b>	<b>769</b>	<b>885</b>
Contract liabilities	192	213	462	538	624
Other payables	131	101	116	225	255
Amt due to related parties	1	0	0	0	0
Current income tax	2	3	2	4	5
Others	1	2	2	2	2
<b>Non-current liabilities</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Deferred income	1	0	0	0	0
<b>Total net assets</b>	<b>1,000</b>	<b>2,385</b>	<b>3,314</b>	<b>3,740</b>	<b>4,214</b>
<b>Shareholders' equity</b>	<b>1,000</b>	<b>2,385</b>	<b>2,892</b>	<b>3,236</b>	<b>3,611</b>
<b>Minority Interest</b>	<b>0</b>	<b>0</b>	<b>422</b>	<b>505</b>	<b>602</b>

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Tuition & boarding fees	89.0	88.5	89.5	90.5	90.6
Ancillary services	11.0	11.5	10.5	9.5	9.4
<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	57.0	59.7	59.2	58.3	58.3
EBIT margin	51.3	62.4	56.2	58.2	60.7
Effective tax rate	1.2	0.8	0.8	0.8	0.8
Net profit margin	50.9	66.3	62.6	49.6	51.8
Adj. net profit margin	58.6	67.3	62.9	49.6	51.8
Payout ratio	na	30.0	30.0	30.0	30.0
<b>Balance sheet ratios</b>					
Current ratio (x)	1.7	6.1	0.8	1.0	1.2
Asset turnover (x)	0.3	0.1	0.1	0.2	0.2
Total asset/total equity (x)	1.3	1.1	1.2	1.2	1.2
<b>Returns (%)</b>					
Adj. ROAE	22.4	15.4	10.6	13.9	14.7
Adj. ROAA	14.6	12.7	8.4	10.2	10.5
<b>Per share data</b>					
Adj. EPS (RMB)	NA	0.172	0.174	0.252	0.297
DPS (RMB)	NA	0.048	0.052	0.076	0.089
BVPS (RMB)	NA	1.482	1.798	1.908	2.130

Source: Company data, CMBIS estimates

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