

Xinhua Education (2779 HK)

Waiting for next acquisition

FY19 adjusted net profit rose 14% YoY to RMB296mn, 6% above our estimates (mainly due to higher other income) and in line with consensus. We cut our FY20/21E adjusted net profit by 25%/29% as we took Kunming schools away from our forecast. Valuation is attractive given that the stock trades at 9.6x FY20E P/E, at the low-end of its P/E band (9x). Maintain Buy and lowered TP from HK\$4.50 to HK\$2.85, based on 12.8x FY20E P/E. Next catalyst is M&A.

- **FY19 results in line with consensus.** Revenue climbed 13% led by 12% ASP growth. Revenue of Xinhua University rose 11% YoY to RMB348mn (representing 90% of total revenue), driven by 13% ASP growth. In 2019/20 school year, new student enrollment rose 10% to 6,790 and average tuition fee of new student jumped 15.5%. GPM was flat at 59.7% with 2H19 GPM +1.0ppt to 54.7%. Operational income of Hongshan College was around RMB19mn, while operation loss of School of Clinical Medicine was around RMB9mn. SG&A expenses ratio gained 6.7ppt to 23.3%, arising from increase of equity-settled payment, recruitment of talents and expenses for M&A activities. Adjusted NPM widened 0.6ppt to 67.6%.
- **TimeLine of independent colleges unpegging.** Construction of the new campus of School of Clinical Medicine began and phase I is expected to operate before 1 Sep 2021. Unpegging timetable is 2021 at earliest. On the other hand, construction work of new campus of Hongshan College work would start before 30 Jun 2020.
- **Kunming schools acquisition stalled.** Because of uncertainties in the timing of transformation of Haiyuan College to a wholly privately-owned college, we take Kunming schools away from our forecast.
- **Abundant resources for M&A.** As at 31 Dec 2019, the Company had RMB1.4bn cash balance or RMB1.1bn net cash. The Company signed strategic operation agreement with ICBC Heifei Branch which intentionally to provide RMB5bn credit line for the Company next five years. Management plans to have 1-2 acquisitions per year which focus on universities with medical or finance majors in Yangtze River Delta.
- **Valuation.** We cut our adjusted net profit in FY20/21E by 25%/ 29% to take Kunming schools away from our forecast. Our TP is cut from HK\$4.50 to HK\$2.85, based on 12.8x FY20E P/E which is at historical average (vs. 17.9x P/E previously). **Catalysts:** (1) M&A; (2) policy overhang removes. **Risk:** surge of teachers' costs.

Earnings Summary

| (YE 31 Dec) | FY18A | FY19A | FY20E | FY21E | FY22E |
|--------------------------|-------|-------|-------|-------|-------|
| Revenue (RMB mn) | 386 | 438 | 500 | 557 | 606 |
| YoY growth (%) | 14.3 | 13.4 | 14.3 | 11.3 | 8.8 |
| Net profit (RMB mn) | 256 | 271 | 321 | 356 | 388 |
| Adj. net profit (RMB mn) | 259 | 296 | 321 | 356 | 388 |
| Adj. EPS (RMB) | 0.171 | 0.184 | 0.200 | 0.222 | 0.241 |
| YoY growth (%) | na | 7.6 | 8.4 | 11.0 | 9.0 |
| Consensus EPS (RMB) | na | na | 0.223 | 0.252 | 0.252 |
| Adj. P/E (x) | 10.5 | 10.2 | 9.6 | 8.6 | 7.9 |
| Yield (%) | 2.7 | 2.6 | 3.1 | 3.5 | 3.8 |
| P/B (x) | 1.2 | 1.2 | 1.1 | 1.0 | 0.9 |
| Net cash (RMB mn) | 1,862 | 1,053 | 1,029 | 991 | 1,072 |

Source: Company data, CMBIS estimates

BUY (Maintain)

| | |
|---------------|-----------|
| Target Price | HK\$2.85 |
| (Previous TP | HK\$4.50) |
| Up/Downside | +34% |
| Current Price | HK\$2.13 |

China Education Sector

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Stock Data

| | |
|--------------------------|-------|
| Mkt Cap (HK\$ mn) | 3,426 |
| Avg 3 mths t/o (HK\$ mn) | 2.93 |
| 52w High/Low (HK\$) | 43864 |
| Total Issued Shares (mn) | 1,609 |

Source: Bloomberg

Shareholding Structure

| | |
|---------------|-------|
| Mr. Wu Junbao | 71.5% |
|---------------|-------|

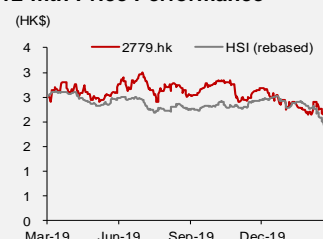
Source: HKEx

Share Performance

| | Absolute | Relative |
|-------|----------|----------|
| 1-mth | -0.9% | -12.3% |
| 3-mth | -20.8% | -16.8% |
| 6-mth | -16.5% | -9.5% |

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Related Reports

1. "Xinhua Education – Strong earnings growth in FY20E" – 29 Aug 2019
2. "Xinhua Education – FY18 results beat; target two acquisitions in FY19E" – 28 Mar 2019
3. "China Education Sector – Undemanding valuation; higher education segment more preferred" – 22 Mar 2019

Figure 1: 1H19 results review

| Y/E Dec (RMB mn) | FY19 | FY18 | change (%) | Remarks |
|-------------------------------|-------------|-------------|-------------------|--|
| Revenue | 438 | 386 | 13% | Student enrollment +1% to 34,439 |
| tuition fees | 392 | 342 | 15% | |
| boarding fees | 46 | 45 | 3% | |
| Cost of sales | (177) | (156) | 13% | |
| Gross profit | 261 | 230 | 13% | |
| Other income | 85 | 74 | 14% | Operational income/loss of Hongshan College/School of Clinical Medicine was RMB19mn/RMB9mn, respectively |
| Selling expenses | (8) | (6) | 27% | |
| Administrative expenses | (94) | (58) | 63% | Equity-settled exp RMB17mn; employment of talents; increased expenses related to acquisitions |
| Operating profit | 244 | 241 | 1% | |
| Finance income | 30 | 17 | 75% | |
| Finance costs | (1) | (0) | na | |
| Profit before tax | 274 | 258 | 6% | |
| Tax expense | (3) | (2) | 56% | |
| Net profit | 271 | 256 | 6% | |
| Adj. net profit | 296 | 259 | 14% | |
| EPS (RMB) | 0.18 | 0.17 | 8% | |
| DPS (RMB) | 0.05 | 0.05 | na | |
| Margin & Ratio (%) | | | | |
| Gross margin | 59.7 | 59.7 | 0.0 | |
| Operating margin | 55.8 | 62.4 | (6.6) | |
| SG&A expense/revenue | 23.3 | 16.6 | 6.7 | |
| Net margin | 61.8 | 66.3 | (4.5) | |
| Adj. net margin | 67.6 | 67.0 | 0.6 | |
| Effective tax rate | 1.1 | 0.8 | 0.3 | |
| Payout ratio (%) | 30.0 | 30.0 | 0.0 | |
| | FY19 | FY18 | change (%) | |
| Net cash (RMB mn) | 1,053 | 1,862 | -43% | |

Source: Company data

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

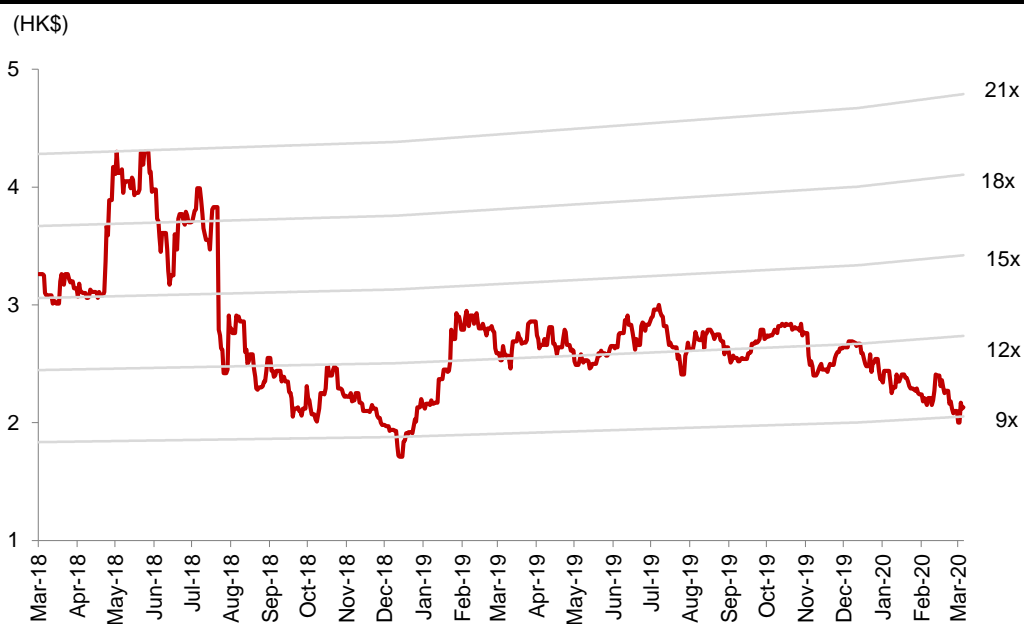
| (RMB) | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|--|----------------|----------------|----------------|----------------|
| Tuition Fees | | | | |
| Xinhua University | | | | |
| Four-year undergraduate program | ↑12,100-20,000 | ↑15,100-25,000 | ↑16,500-25,000 | ↑19,800-23,800 |
| Three-year junior 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 |
| Xinhua School | | | | |
| 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 |
| School of Clinical Medicine | | | | |
| Four-year undergraduate program | | | 13,200-15,900 | 13,200-15,900 |
| Five-year undergraduate program | | | 15,900 | 15,900 |
| Hongshan College | | | | |
| Four-year undergraduate program | | | 14,000 | 14,000 |
| Boarding fees | | | | |
| Xinhua University | 1,000-1,500 | ↑1,300-1,500 | ↑1,500-2,000 | 1,500-2,000 |
| Xinhua School | 600 | ↑1,200 | ↑1,500 | 1,500 |
| School of Clinical Medicine | | | 1,000 | 1,000 |
| Hongshan College | | | | 800-1,500 |

Source: Company data

Figure 3: 11% CAGR of revenue in FY19-22E

| Revenue (RMB mn) | FY18 | FY19 | FY20E | FY21E | FY22E | 3-yr CAGR |
|----------------------|------------|------------|------------|------------|------------|------------|
| Revenue | 386 | 438 | 500 | 557 | 606 | 11% |
| Tuition fees | 342 | 392 | 449 | 501 | 549 | 12% |
| Xinhua University | 308 | 348 | 397 | 441 | 483 | 12% |
| Xinhua School | 33 | 44 | 52 | 60 | 65 | 14% |
| Boarding fees | 45 | 46 | 51 | 56 | 58 | 8% |

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 | 500 | 557 | 606 | 862 | 973 | na | -42% | -43% | na |
| Gross Profit | 300 | 334 | 364 | 503 | 567 | na | -40% | -41% | na |
| Operating Profit | 320 | 356 | 388 | 501 | 591 | na | -36% | -40% | na |
| Net profit | 321 | 356 | 388 | 427 | 504 | na | -25% | -29% | na |
| Gross Margin | 60.0% | 60.0% | 60.0% | 58.3% | 58.3% | na | +1.7ppt | +1.7ppt | na |
| Operating Margin | 63.9% | 63.9% | 64.1% | 58.2% | 60.7% | na | +5.7ppt | +3.2ppt | na |
| Net Margin | 64.1% | 64.0% | 64.1% | 49.6% | 51.8% | na | +14.5ppt | +12.2ppt | na |

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 | 500 | 557 | 606 | 645 | 726 | 663 | -22% | -23% | -9% |
| Gross Profit | 300 | 334 | 364 | 380 | 416 | 369 | -21% | -20% | -1% |
| Operating Profit | 320 | 356 | 388 | 322 | 375 | 360 | -1% | -5% | 8% |
| Net profit | 321 | 356 | 388 | 358 | 406 | 406 | -10% | -12% | -4% |
| Gross Margin | 60.0% | 60.0% | 60.0% | 58.9% | 57.4% | 55.6% | +1.1ppt | +2.6ppt | +4.4ppt |
| Operating Margin | 63.9% | 63.9% | 64.1% | 50.0% | 51.7% | 54.2% | +13.9ppt | +12.2ppt | +9.9ppt |
| Net Margin | 64.1% | 64.0% | 64.1% | 55.6% | 56.0% | 61.2% | +8.5ppts | +8.0ppt | +2.9ppt |

Source: Company data, CMBIS estimates

Financial Summary

Income statement

| YE 31 Dec (RMB mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|----------------------------|------------|------------|------------|------------|------------|
| Revenue | 386 | 438 | 500 | 557 | 606 |
| Tuition fees | 342 | 392 | 449 | 501 | 549 |
| Boarding fees | 45 | 46 | 51 | 56 | 58 |
| Cost of sales | (156) | (177) | (200) | (223) | (242) |
| Gross profit | 230 | 261 | 300 | 334 | 364 |
| Other income | 74 | 85 | 118 | 129 | 141 |
| Selling expenses | (6) | (8) | (9) | (9) | (11) |
| Administrative expenses | (58) | (94) | (90) | (98) | (105) |
| EBIT | 241 | 244 | 320 | 356 | 388 |
| Finance income | 17 | 30 | 25 | 24 | 25 |
| Finance costs | (0) | (1) | (20) | (20) | (20) |
| Pre-tax profit | 258 | 274 | 325 | 360 | 393 |
| Income tax | (2) | (3) | (4) | (4) | (4) |
| Less: Minority interests | 0 | 0 | 0 | 0 | 0 |
| Net profit | 256 | 271 | 321 | 356 | 388 |
| Adjusted net profit | 259 | 296 | 321 | 356 | 388 |

Cash flow summary

| YE 31 Dec (RMB mn) | FY18A | FY19E | FY20E | FY21E | FY22E |
|------------------------------------|--------------|----------------|--------------|--------------|--------------|
| Profit before tax | 258 | 274 | 325 | 360 | 393 |
| Depreciation and amortization | 56 | 60 | 63 | 66 | 69 |
| Change in working capital | (5) | (611) | 43 | 36 | 30 |
| Others | (15) | (28) | 16 | 16 | 15 |
| Net cash from operating | 294 | (305) | 447 | 478 | 507 |
| Capex & investments | (40) | (500) | (400) | (400) | (300) |
| Acquisitions | 0 | (1,222) | 0 | 0 | 0 |
| Others | 187 | 55 | 30 | 0 | 0 |
| Net cash from investing | 147 | (1,667) | (370) | (400) | (300) |
| Equity raised | 1,038 | 0 | 0 | 0 | 0 |
| Change of borrowings | 0 | 330 | 0 | 0 | 0 |
| Dividend paid | 0 | (77) | (81) | (96) | (107) |
| Others | (0) | (1) | (20) | (20) | (20) |
| Net cash from financing | 1,038 | 252 | (101) | (116) | (127) |
| Net change in cash | 1,478 | (1,720) | (24) | (38) | 80 |
| Cash at the beginning of the year | 293 | 1,862 | 1,383 | 1,359 | 1,321 |
| Exchange difference | 90 | 0 | 0 | 0 | 0 |
| Cash at the end of the year | 1,862 | 142 | 1,359 | 1,321 | 1,402 |

Balance sheet

| YE 31 Dec (RMB mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|
| Non-current assets | 768 | 1,420 | 1,727 | 2,061 | 2,292 |
| 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 | 630 | 630 | 630 |
| Current assets | 1,935 | 1,874 | 1,860 | 1,831 | 1,919 |
| Cash | 1,862 | 1,383 | 1,359 | 1,321 | 1,402 |
| Account receivables | 0 | 3 | 3 | 4 | 4 |
| Prepayments | 13 | 488 | 498 | 506 | 514 |
| Others | 60 | 0 | 0 | 0 | 0 |
| Current liabilities | 319 | 675 | 728 | 773 | 811 |
| Contract liabilities | 213 | 239 | 278 | 310 | 336 |
| Other payables | 101 | 102 | 117 | 130 | 141 |
| Others | 2 | 0 | 0 | 0 | 0 |
| Current income tax | 3 | 4 | 4 | 4 | 4 |
| Borrowing | 0 | 330 | 330 | 330 | 330 |
| Non-current liabilities | 0 | 0 | 0 | 0 | 0 |
| Deferred income | 0 | 0 | 0 | 0 | 0 |
| Total net assets | 2,385 | 2,618 | 2,858 | 3,118 | 3,400 |
| Shareholders' equity | 2,385 | 2,618 | 2,858 | 3,118 | 3,400 |

Key ratios

| YE 31 Dec | FY18A | FY19A | FY20E | FY21E | FY22E |
|------------------------------|--------------|--------------|--------------|--------------|--------------|
| Sales mix (%) | | | | | |
| Tuition & boarding fees | 88.5 | 89.5 | 89.7 | 89.9 | 90.5 |
| Ancillary services | 11.5 | 10.5 | 10.3 | 10.1 | 9.5 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| P&L ratios (%) | | | | | |
| Gross profit margin | 59.7 | 59.7 | 60.0 | 60.0 | 60.0 |
| EBIT margin | 62.4 | 55.8 | 63.9 | 63.9 | 64.1 |
| Effective tax rate | 0.8 | 1.1 | 1.1 | 1.1 | 1.1 |
| Net profit margin | 66.3 | 61.8 | 64.1 | 64.0 | 64.1 |
| Adj. net profit margin | 67.0 | 67.6 | 64.1 | 64.0 | 64.1 |
| Payout ratio | 30.0 | 30.0 | 30.0 | 30.0 | 30.0 |
| Balance sheet ratios | | | | | |
| Current ratio (x) | 6.1 | 2.8 | 2.6 | 2.4 | 2.4 |
| Asset turnover (x) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Total asset/total equity (x) | 1.1 | 1.3 | 1.3 | 1.2 | 1.2 |
| Returns (%) | | | | | |
| Adj. ROAE | 15.3 | 11.8 | 11.7 | 11.9 | 11.9 |
| Adj. ROAA | 12.8 | 9.9 | 9.3 | 9.5 | 9.6 |
| Per share data | | | | | |
| Adj. EPS (RMB) | 0.171 | 0.184 | 0.200 | 0.222 | 0.241 |
| DPS (RMB) | 0.048 | 0.049 | 0.060 | 0.066 | 0.072 |
| BVPS (RMB) | 1.482 | 1.628 | 1.777 | 1.938 | 2.114 |

Source: Company data, CMBIS estimates

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|-----------------------|---|
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