

China East Education (667 HK)

Earnings cut could be priced in

FY19 adj. NP (+64%) in line but revenue was 4%/9% below our estimate/consensus. We cut FY20/21E adj. NP by 10%/4% to factor in lower-than-expected revenue and COVID-19 impact. That said, earnings cut could be priced in as the stock fell 11% over past two days. Our TP is adjusted from HK\$16.30 to HK\$15.80. Trading at 20.8x 1-yr forward P/E and near its low-end P/E range of 20x, we think valuation is attractive. Maintain Buy.

- Revenue below expectation.** Adj. NP +64% to RMB900mn, in line with our estimate and consensus. Revenue rose 20% (vs 27% in 1H19), led by 10% ASP growth and 9% growth of average students enrolled. GPM widened 6.2ppt to 58.4%, 3.8/1.9ppt above our estimate/consensus, because of ramp-up of newly established schools in FY17-18 and costs control. SG&A expenses ratio (excluding RMB116mn share-based expenses) fell 3.3ppt thanks to moderated school expansion and operating leverage. In 2H19, revenue climbed 14% YoY, GPM +4.6ppt to 56.3% (+2.3ppt if excl. HKFRS 16 impact by our est.), adj. NP +49% with adj. NPM +5.5ppt to 23.6%.
- COVID-19 impact.** The Company has arranged online tuitions to students given that physical classes have been suspended temporarily since 20 Feb. No refund or withdrawal from students were received so far. Admission for new students has been suspended but online consultation continues. Management expects physical classes would gradually resume in Apr. Given the softening economic growth, we think this could increase demand of vocational training.
- FY20E outlook.** The Company plans to add 24 net openings in FY20E (vs 14 in FY19). Also, it will explore opportunities in other industry sectors such as beauty, healthcare and AI. Its first beauty school was opened in Chengdu this year to test market response. Sitting on RMB6.2bn net cash and financial assets, we think the Company would monitor M&A opportunities to accelerate new industry sector development.
- Maintain Buy but lower TP to HK\$15.80.** We cut FY20/21E adj. NP by 10%/4% to factor in lower-than-expected revenue and disrupted admission for new students admission. Our TP is revised from HK\$16.30 to HK\$15.80 based on 26.0x average FY20E and FY21E EPS (vs 27.4x FY20E P/E previously). We forecast the Company to post 20% adj. EPS CAGR in FY19-22E. **Catalyst:** M&A. **Risk:** lower-than-expected student enrollment.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenues (RMB mn)	3,265	3,905	4,372	5,183	5,882
Net profit (RMB mn)	515	848	972	1,283	1,563
Adj. net profit (RMB mn)	547	900	1,052	1,343	1,563
Adj. EPS (RMB)	0.314	0.411	0.480	0.613	0.713
YoY change (%)	na	30.9	16.9	27.6	16.4
Consensus EPS (RMB)	na	na	0.504	0.632	0.763
Adj. P/E (x)	na	25.5	22.2	17.4	14.9
Ex-net cash adj. P/E (x)	na	18.6	15.9	11.9	9.6
P/B (x)	na	3.7	3.5	3.0	2.6
Yield (%)	na	1.8	1.2	1.6	2.0
Adj. ROAE (%)	44.1	25.7	16.3	18.4	18.6
Net cash (RMB mn)	6242	5794	6611	7413	8379

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$15.80
(Previous TP)	HK\$16.30
Up/Downside	+33%
Current Price	HK\$11.88

China Education Sector

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Stock Data

Mkt Cap (HK\$ mn)	26,035
Avg 3 mths t/o (HK\$ mn)	49.92
52w High/Low (HK\$)	17.80/ 9.60
Total Issued Shares (mn)	2,191

Source: Bloomberg

Shareholding Structure

Wu Junbao	34.13%
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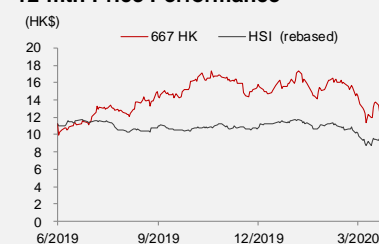
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-20.8%	-12.3%
3-mth	-23.0%	-8.1%
6-mth	-12.2%	-2.9%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte

Figure 1: 1H19 results review

Y/E Dec (RMB mn)	FY19	FY18	change (%)	Remarks
Revenue	3,905	3,265	20%	Average students enrolled +9%; ASP +10% (like-for-like growth and 1ppt increase of short-term student mix)
New East	2,138	1,900	13%	Average students enrolled -1%; ASP +14%
Omick	338	213	59%	Average students enrolled +43%; ASP +11%
Xinhua Internet	774	604	28%	Average students enrolled +29%; ASP -1%
Wisezone	59	70	-16%	Average students enrolled -25%; ASP +13%
Wontoine	531	444	20%	Average students enrolled +9%; ASP +10%
Cuisine Academy	48	21	132%	Average customers registered +76%; ASP +101%
Others	16	12	36%	
Cost of sales	(1,625)	(1,560)	4%	Teachers cost +8%; rental expenses -8% due to HKFRS 16; maintenance fees -8%
Gross profit	2,280	1,705	34%	Ramp up of newly established schools and centers opened in FY17 and FY18
Other income	45	38	19%	
Other gains and losses	131	58	125%	
Selling expenses	(698)	(648)	8%	
Administrative expenses	(576)	(438)	32%	share-based expenses increased by RMB108mn
R&D expenses	(31)	(28)	8%	
Operating profit	1,151	687	68%	
Finance income	72	24	199%	
Finance costs	(132)	0	na	Due to HKFRS 16
Listing expenses	(22)	(24)	na	
Profit before tax	1,070	687	56%	
Tax expense	(222)	(172)	29%	
Net profit	848	515	65%	
Adj. net profit	900	547	64%	excl. share-based exp, listing fees and net foreign exchange gains
Adj. EPS (RMB)	0.41	0.31	31%	
DPS (RMB)	na	na	na	
Margin & Ratio (%)				
Gross margin	58.4	52.2	6.2	Ramp up of loss-making new brands (Omick and Cuisine Academy), ASP growth
Operating margin	29.5	21.0	8.5	
SG&A expenses ratio	32.6	33.3	(0.7)	
Net margin	21.7	15.8	5.9	
Adj. net margin	23.0	16.8	6.3	
Effective tax rate	20.7	25.0	(4.3)	
Payout ratio (%)	na	na	na	
	FY19	FY18	change (%)	
Net cash (RMB mn)	6,242	986	533%	

Source: Company data

Figure 2: Changes of our estimates

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	4,372	5,183	5,882	4,906	5,770	na	-10.9%	-10.2%	na
Gross Profit	2,603	3,166	3,635	2,724	3,255	na	-4.5%	-2.8%	na
EBIT Profit	1,223	1,601	1,932	1,267	1,575	na	-3.4%	1.7%	na
Net profit	1,052	1,343	1,563	1,165	1,399	na	-9.6%	-4.0%	na
Gross Margin	59.5%	61.1%	61.8%	55.5%	56.4%	na	+4.0ppt	+4.7ppts	na
EBIT Margin	28.0%	30.9%	32.9%	25.8%	27.3%	na	+3.2ppts	+3.6ppts	na
Net Margin	24.1%	25.9%	26.6%	23.7%	24.2%	na	+0.4ppts	+1.7ppts	na

Source: Company data, CMBIS estimates

Figure 3: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	4,372	5,183	5,882	4,900	5,958	6,618	-11%	-13%	-11%
Gross Profit	2,603	3,166	3,635	2,827	3,524	4,110	-8%	-10%	-12%
EBIT Profit	1,223	1,601	1,932	1,405	1,722	2,149	-13%	-7%	-10%
Net profit	1,052	1,343	1,563	1,105	1,381	1,671	-5%	-3%	-6%
Gross Margin	59.5%	61.1%	61.8%	57.7%	59.1%	62.1%	+1.8ppt	+2.0ppts	-0.3ppts
EBIT Margin	28.0%	30.9%	32.9%	28.7%	28.9%	32.5%	-0.7ppts	+2.0ppts	+0.4ppts
Net Margin	24.1%	25.9%	26.6%	22.6%	23.2%	25.2%	+1.5ppts	+2.7ppts	+1.4ppts

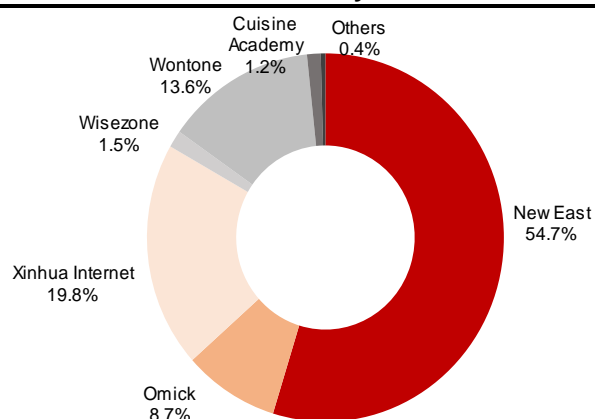
Source: Company data, CMBIS estimates

Figure 4: P/E band chart



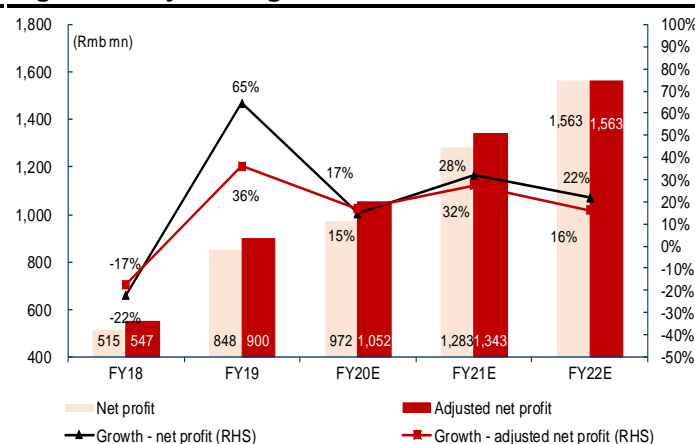
Source: Company data, Bloomberg, CMBIS estimates

Figure 5: Revenue breakdown by brand in FY19



Source: Company data

Figure 6: Adj. NP to grow at 20% CAGR in FY19-22E



Source: Company data, CMBIS estimates

Figure 7: Peers valuation table

Ticker	Rating	Mkt Cap		Year end	P/E (x)			Adj. net profit growth (%)			Adj. EPS growth (%)			PEG (x)	Revenue growth (%)			
		(US\$ m)	Price		FY1	FY2	FY3	FY1	FY2	FY3	FY1	FY2	FY3		FY1	FY2	FY3	
K12 tutoring services providers																		
New Oriental Education	EDU US	NR	17,148	108.24	May-19	31.1	22.5	17.2	34	40	30	35	38	31	0.91	23	32	25
TAL Education	TAL US	NR	31,516	53.26	Feb-19	131.8	51.3	34.1	(59)	256	47	(45)	157	51	1.36	35	40	35
Onesmart Education	ONE US	NR	825	5.10	Aug-18	392.3	18.9	13.2	(0)	26	45	na	1,977	43	0.88	40	18	24
Scholar Education	1769 HK	NR	725	10.12	Dec-18	41.6	1.4	1.4	83	22	36	na	2,798	1	0.09	43	28	38
Beststudy Education	3978 HK	Buy	390	3.56	Dec-18	17.9	12.9	10.1	48	39	25	na	39	25	0.56	23	24	22
Average						122.9	21.4	15.2	21	77	37	-5	1,002	30	0.76	33	28	29
Non-formal vocational education services provider																		
China East Education	667 HK	Buy	3,359	11.88	Dec-18	26.0	22.2	17.1	64	17	28	na	17	28	1.17	20	12	19
K12 education services providers																		
Wisdom Education	6068 HK	Buy	658	2.49	Aug-18	13.0	10.1	7.7	16	28	30	13	29	28	0.46	35	19	23
Tianli Education	1773 HK	NR	924	3.45	Dec-18	22.6	16.8	13.6	28	47	31	na	34	24	0.78	38	39	30
Maple Leaf	1317 HK	NR	912	2.36	Aug-18	9.5	8.4	7.3	21	15	16	16	16	16	0.60	17	19	16
Bright Scholar	BEDU US	NR	811	6.73	Aug-18	18.3	14.4	12.4	(2)	55	16	28	28	16	0.82	49	57	11
Virscend Education	1565 HK	NR	614	1.54	Dec-18	10.1	6.7	5.0	20	52	32	17	50	33	0.24	28	27	25
Average						14.7	11.3	9.2	16	39	25	18	31	23	0.58	33	32	21
Higher Education services providers																		
China Education	839 HK	NR	2,716	10.42	Aug-18	25.3	20.8	18.1	17	25	17	9	24	15	1.30	na	35	13
Yuhua Education	6169 HK	NR	2,447	5.68	Aug-18	23.7	17.3	14.9	18	43	16	13	40	16	0.87	40	43	8
Hope Education	1765 HK	Buy	1,532	1.78	Dec-18	22.5	16.4	12.2	50	37	32	28	37	32	0.65	29	31	42
Minsheng Education	1569 HK	NR	555	1.07	Dec-18	9.3	8.4	7.4	21	16	16	25	10	15	0.74	58	23	15
Kepei Education	1890 HK	NR	1,058	4.10	Dec-18	17.2	12.8	10.8	25	35	19	(5)	35	19	0.65	24	29	21
Xinhua Education	2779 HK	Buy	415	2.00	Dec-18	9.8	9.0	7.9	14	8	11	7	8	11	1.00	13	14	11
New Higher Education	2001 HK	NR	585	2.94	Dec-18	10.6	8.0	6.9	31	36	19	27	33	15	0.44	88	30	15
Edvantage	382 HK	NR	543	4.13	Aug-18	12.3	12.1	9.9	34	42	22	na	3	22	0.99	11	18	19
Chunlai Education	1969 HK	NR	238	1.54	Aug-18	11.8	7.8	6.4	(4)	54	24	(14)	50	22	0.33	15	33	13
Average						15.8	12.5	10.5	23	33	20	11	27	19	0.78	35	29	18
Education sector average						42.8	14.9	11.7	23	45	26	11	271	23	0.74	33	29	21

Source: Bloomberg estimates, CMBIS estimates

Price is closing price as of 29 Aug 2019.

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	3,265	3,905	4,372	5,183	5,882
Cost of sales	(1,560)	(1,625)	(1,769)	(2,017)	(2,247)
Gross profit	1,705	2,280	2,603	3,166	3,635
Other income	38	45	47	51	54
Other gains and losses	58	131	45	45	45
Selling expenses	(648)	(698)	(857)	(1,005)	(1,147)
Administrative expenses	(438)	(576)	(579)	(614)	(608)
R&D expenses	(28)	(31)	(35)	(41)	(47)
EBIT	687	1,151	1,223	1,601	1,932
Net finance income	24	(60)	3	17	38
Listing expenses	(24)	(22)	0	0	0
Profit before tax	687	1,070	1,226	1,618	1,970
Income tax expenses	(172)	(222)	(254)	(335)	(408)
Net profit	515	848	972	1,283	1,563
Net profit	515	848	972	1,283	1,563
Net forex loss	0	(85)	0	0	0
Listing expenses	24	22	0	0	0
Share-based expenses	8	116	80	60	0
Adjusted net profit	547	900	1,052	1,343	1,563

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19E	FY20E	FY21E	FY22E
Profit before tax	682	1,005	1,226	1,618	1,970
D&A	360	449	525	543	565
Change in working capital	182	147	194	195	209
Others	(245)	(243)	(388)	(499)	(653)
Net cash from operating	980	1,357	1,558	1,856	2,092
Capex	(666)	(892)	(750)	(750)	(750)
Others	93	124	190	204	225
Net cash from investing	(573)	(768)	(560)	(546)	(525)
Equity raised	1	4,252	0	0	0
Dividend paid	(874)	(34)	(413)	(292)	(385)
Change of borrowings	0	0	0	0	0
Others	(582)	0	(216)	(216)	(216)
Net cash from financing	(1,456)	4,218	(629)	(508)	(601)
Net change in cash	296	4,807	369	802	966
Cash at the beginning of the year	1,739	986	3,883	4,252	5,054
Exchange difference	0	0	0	0	0
Cash at the end of the year	2,035	5,794	4,252	5,054	6,020

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	3,066	3,180	3,899	4,518	5,115
PPE	1,361	1,406	1,896	2,399	2,897
Right-of-use assets	1,675	1,712	1,936	2,048	2,143
Prepayments for rental	0	24	27	30	33
Others	30	38	39	41	42
Current assets	1,165	6,498	6,887	7,738	8,747
Cash	986	3,883	4,252	5,054	6,020
Time deposits	0	1,892	1,892	1,892	1,892
Receivables	140	203	228	270	306
Others	39	520	516	523	529
Current liabilities	2,031	2,272	2,518	2,820	3,121
Contract liabilities	1,233	1,383	1,549	1,766	1,978
Payables	478	443	473	523	577
Tax payables	108	138	138	138	138
Lease liabilities	178	307	358	393	428
Others	34	0	0	0	0
Non-current liabilities	1,327	1,285	1,507	1,624	1,752
Lease liabilities	1,267	1,207	1,405	1,542	1,679
Others	60	79	102	82	73
Total net assets	873	6,120	6,760	7,811	8,989
Shareholders' equity	873	6,120	6,760	7,811	8,989

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
New East	58.2	54.7	52.7	50.4	48.9
Omick	6.5	8.7	9.7	11.2	12.5
Xinhua Internet	18.5	19.8	20.5	20.8	21.0
Wisezone	2.2	3.2	1.4	1.3	1.2
Wontone	13.6	13.6	13.8	14.2	14.2
Cuisine Academy	0.6	1.2	1.4	1.5	1.6
Others	0.4	0.4	0.5	0.5	0.6
P&L ratios (%)					
Gross profit margin	52.2	58.4	59.5	61.1	61.8
EBIT margin	21.0	29.5	28.0	30.9	32.9
Effective tax rate	25.0	20.7	20.7	20.7	20.7
Net profit margin	15.8	21.7	22.2	24.8	26.6
Adj. net profit margin	16.8	23.0	24.1	25.9	26.6
Payout ratio	na	48.7	30.0	30.0	30.0
Balance sheet ratios					
Current ratio (x)	0.7	0.5	2.7	2.7	2.8
Average inv. turnover days	7.8	10.0	10.2	9.2	9.3
Asset turnover (x)	1.2	0.9	0.4	0.4	0.4
Total asset/total equity (x)	3.2	0.7	1.6	1.6	1.5
Net cash (RMB mn)	986	6,242	6,611	7,413	8,379
Returns (%)					
Adjusted ROAE	44.1	25.7	16.3	18.4	18.6
Adjusted ROAA	17.3	25.5	14.0	11.7	12.0

Source: Company data, CMBIS estimates

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