

China East Education (667 HK)

YTD number of new students enrolled exceed pre-pandemic level

Adj. NP fell 44% to RMB500mn, 27%/13% below consensus/our estimates due to lower GPM and higher eff. tax rate. However, we think the strong recovery of new students enrolled (15% growth compared to corresponding period in 2019) should be more vital than missed earnings. Our TP was lifted from HK\$19.30 to HK\$20.80. We forecast the Company to post record high revenue and adj. NP in FY21E. Share price was 18% below record high on 23 Jul 2020. The stock trades at 26.8x FY21E P/E, near the trough of P/E band. Valuation is attractive. Maintain Buy.

- **Results highlights.** Revenue fell 7% to RMB3,649mn, 2% above our est./4% below consensus. Number of new students enrolled dropped 5% (vs 20% drop in 1H20) as pandemic outbreak affected admission. GPM fell 4.4ppt to 54.0% on operating deleverage, 1ppt below our estimates. Selling exp. ratio up 4.8ppt to 22.7% because the Company further spent in ad in 2Q20 and increased ad for new schools (26 new schools in FY20 vs 14 in FY19). Eff. tax rate jumped from 20.7% in FY19 to 41.9% in FY20 because certain schools made loss. The Company paid a special dividend of HK\$0.135/sh making payout ratio to 105%.
- **New students enrolled grows from pre-pandemic level.** As at 20 Mar 2020, number of new students enrolled increased 15% compared to corresponding period in 2019, driven by 50%+ growth of Omick, 40%+ growth of Wontone. 3-year secondary vocation students saw 100% growth. The Company plans to add more schools to operate secondary vocational education business this year.
- **M&A strategy.** The Company had RMB6.1bn net cash at end of FY20. It plans to acquire (1) vocational education companies which focus on industries different from its own (culinary arts, computer & internet, auto) such as beauty, etc., and (2) secondary vocational schools, which could benefit from the government's policy to increase mix of secondary vocational students to 50% from 40%.
- **Network expansion on track.** The Company had 206 schools in end of FY20. It plans to open around 20 new schools per year. Annual capex is around RMB800-900mn, which could be totally financed by its operating cash flow (>RMB1bn per year).
- **Maintain Buy but lifted TP to HK\$20.80.** We lowered FY21/22E adj. NP by 5%/7% mainly to factor in lower GPM, higher selling expenses and eff. tax rate. Our TP was lifted from HK\$19.30 to HK\$20.80, at 31.7x average FY21E and FY22E adj. EPS, as we rolled forward our valuation basis. **Catalysts:** M&A, student enrollment beats. **Risk:** lower-than-expected student enrollment.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenues (RMB mn)	3,905	3,649	4,897	5,578	6,297
Net profit (RMB mn)	848	258	1,057	1,303	1,523
Adj. net profit (RMB)	900	500	1,117	1,303	1,523
Adj. EPS (RMB)	0.411	0.228	0.509	0.594	0.694
YoY change (%)	31	(45)	123	17	17
Consensus EPS (RMB)	NA	NA	0.494	0.594	0.647
Adj. P/E (x)	34.9	63.5	26.8	23.0	19.7
Ex-net cash adj. P/E (x)	28.0	51.3	21.1	17.8	14.9
P/B (x)	5.1	5.3	4.5	4.0	3.6
Yield (%)	1.3	1.7	1.7	2.0	2.3
Adj. ROAE (%)	25.7	8.2	17.6	18.5	19.3
Net cash (RMB mn)	6,242	6,070	6,308	6,690	7,254

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$20.80
(Previous TP)	HK\$19.30)
Up/Downside	+28%
Current Price	HK\$16.26

China Education Sector

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Stock Data

Mkt Cap (HK\$ mn)	35,723
Avg 3 mths t/o (HK\$ mn)	91.39
52w High/Low (HK\$)	20.85/ 10.62
Total Issued Shares (mn)	2,190.9

Source: Bloomberg

Shareholding Structure

Wu Junbao	34.13%
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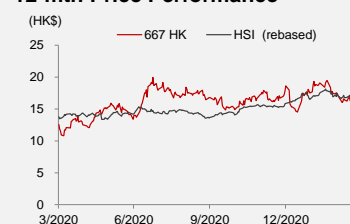
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-12.1%	-5.3%
3-mth	-6.6%	-11.6%
6-mth	-5.1%	-21.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte

Related Reports

1. "China East Education – Profit warning due to COVID-19; expect strong rebound in FY21E" – 8 Dec 2020
2. "China East Education – COVID-19" does not change long-term growth outlook – 21 Aug 2020
3. "China East Education – Fundamentals remain intact despite 1H20E profit affected by COVID-19" – 3 Aug 2020
4. "China East Education – Earnings cut could be priced in" – 2 Apr 2020

Figure 1: FY20 results review

Y/E Dec (RMB mn)	FY20	FY19	change (%)	Remarks
Revenue	3,649	3,905	-7%	5% decrease in number of new students enrollments
New East	1,954	2,138	-9%	new students enrolled -12%
Omick	325	338	-4%	new students enrolled +22%, led by short-term course
Xinhua Internet	748	774	-3%	new students enrolled rose 9%
Wisezone	46	59	-23%	new students enrolled -15%
Wontoine	483	531	-9%	new students enrolled +11%
Cuisine Academy	56	48	16%	new students enrolled -6%
Others	37	16	126%	
Cost of sales	(1,680)	(1,625)	3%	Teachers cost +4%
Gross profit	1,969	2,280	-14%	
Other income	78	45	73%	government grant increased and received rent concession
Other gains and losses	(127)	131	-197%	recorded RMB167mn exchange loss in FY20
Selling expenses	(829)	(698)	19%	placed more advertising costs and expenses from new schools
Administrative expenses	(570)	(576)	-1%	Share-based payments declined 35% to RMB76mn
R&D expenses	(44)	(31)	43%	
Operating profit	477	1,151	-59%	
Finance income	112	72	57%	
Finance costs	(146)	(132)	na	
Listing expenses	0	(22)	na	
Profit before tax	444	1,070	-59%	
Tax expense	(186)	(222)	-16%	
Net profit	258	848	-70%	
Adj. net profit	500	900	-44%	excl. share-based exp, listing fees and net foreign exchange gains
Adj. EPS (RMB)	0.23	0.41	-45%	
DPS (HKD)	0.27	0.21	29%	including HK\$0.135/sh special dividend in FY20
Margin & Ratio (%)				
Gross margin	54.0	58.4	(4.4)	decreases of revenue as a result of COVID-19
Operating margin	13.1	29.5	(16.4)	
SG&A expenses ratio	38.3	32.6	5.7	
Net margin	7.1	21.7	(14.6)	
Adj. net margin	13.7	23.0	(9.3)	
Effective tax rate	41.9	20.7	21.2	some old schools turned into loss in FY20
Payout ratio (%)	105.4	45.1	60.4	
	FY20	FY19	change (%)	
Net cash (RMB mn)	6,070	6,242	-3%	

Source: Company data

Figure 2: Changes of our estimates

US\$ mn	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	4,897	5,578	6,297	4,797	5,516	na	2%	1%	na
Gross Profit	2,860	3,310	3,767	2,857	3,331	na	0%	-1%	na
EBIT Profit	1,404	1,722	1,991	1,452	1,798	na	-3%	-4%	na
Net profit	1,117	1,303	1,523	1,176	1,404	na	-5%	-7%	na
Gross Margin	58.4%	59.3%	59.8%	59.6%	60.4%	na	-1.2ppt	-1.1ppt	na
EBIT Margin	28.7%	30.9%	31.6%	30.3%	32.6%	na	-1.6ppt	-1.7ppt	na
Net Margin	22.8%	23.4%	24.2%	24.5%	25.4%	na	-1.7ppt	-2.0ppt	na

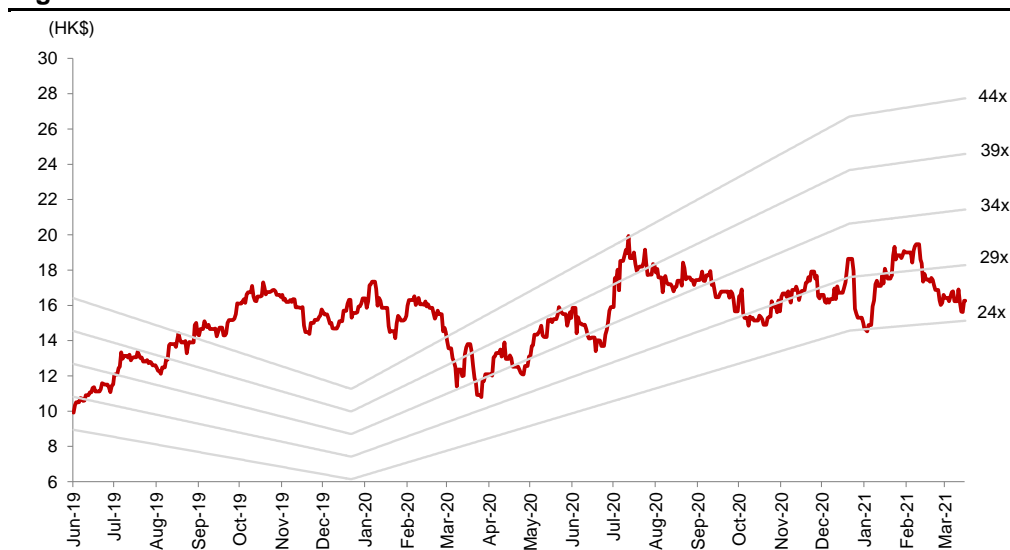
Source: Company data, CMBIS estimates

Figure 3: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	4,897	5,578	6,297	4,920	5,658	6,149	0%	-1%	2%
Gross Profit	2,860	3,310	3,767	2,878	3,363	3,568	-1%	-2%	6%
EBIT Profit	1,404	1,722	1,991	1,322	1,556	1,666	6%	11%	20%
Net profit	1,117	1,303	1,523	1,136	1,379	1,429	-2%	-6%	7%
Gross Margin	58.4%	59.3%	59.8%	58.5%	59.4%	58.0%	-0.1ppt	-0.1ppt	+1.8ppt
EBIT Margin	28.7%	30.9%	31.6%	26.9%	27.5%	27.1%	+1.8ppt	+3.4ppt	+4.5ppt
Net Margin	22.8%	23.4%	24.2%	23.1%	24.4%	23.2%	-0.3ppt	-1.0ppt	+1.0ppt

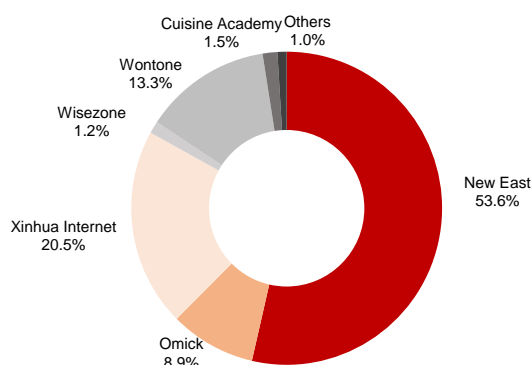
Source: Company data, CMBIS estimates

Figure 4: P/E band chart



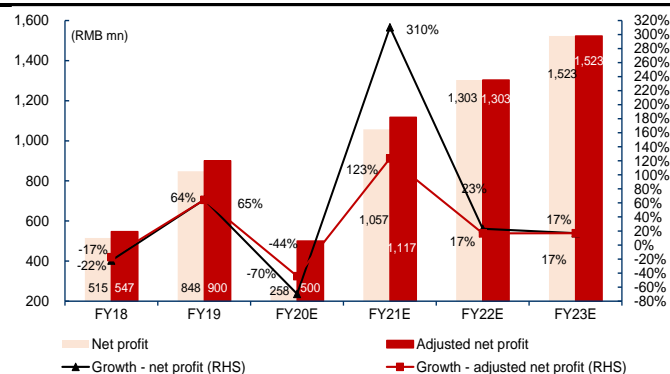
Source: Company data, Bloomberg, CMBIS estimates

Figure 5: Revenue breakdown by brand in FY19



Source: Company data

Figure 6: Adj. NP to grow at 45% CAGR in FY20-23E



Source: Company data, CMBIS estimates

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	3,905	3,649	4,897	5,578	6,297
Cost of sales	(1,625)	(1,680)	(2,037)	(2,268)	(2,530)
Gross profit	2,280	1,969	2,860	3,310	3,767
Other income	45	78	51	56	61
Other gains and losses	131	(127)	40	40	40
Selling expenses	(698)	(829)	(906)	(1,054)	(1,196)
Administrative expenses	(576)	(570)	(593)	(575)	(618)
R&D expenses	(31)	(44)	(49)	(56)	(63)
EBIT	1,151	477	1,404	1,722	1,991
Net finance income	(60)	(34)	(57)	(83)	(75)
Listing expenses	(22)	0	0	0	0
Profit before tax	1,070	444	1,347	1,639	1,916
Income tax expenses	(222)	(186)	(290)	(336)	(393)
Net profit	848	258	1,057	1,303	1,523
Net profit	848	258	1,057	1,303	1,523
Net forex loss	(85)	167	0	0	0
Listing expenses	22	0	0	0	0
Share-based expenses	116	76	60	0	0
Adjusted net profit	900	500	1,117	1,303	1,523

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20E	FY21E	FY22E	FY23E
Profit before tax	1,070	487	1,347	1,639	1,916
D&A	543	557	660	694	731
Change in working capital	108	238	285	214	239
Others	(124)	(263)	(398)	(489)	(553)
Net cash from operating	1,596	1,019	1,894	2,057	2,333
Capex	(371)	(750)	(850)	(850)	(850)
Others	(2,265)	172	538	133	140
Net cash from investing	(2,637)	(578)	(312)	(717)	(710)
Equity raised	4,289	0	0	0	0
Dividend paid	(34)	(407)	(527)	(503)	(586)
Change of borrowings	0	0	0	0	0
Others	(347)	(224)	(426)	(455)	(473)
Net cash from financing	3,908	(631)	(954)	(957)	(1,060)
Net change in cash	2,868	(190)	628	383	563
Cash at the beginning of the year	986	3,883	2,972	3,600	3,983
Exchange difference	29	0	0	0	0
Cash at the end of the year	3,883	3,693	3,600	3,983	4,546

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	3,180	3,514	4,115	4,683	5,213
PPE	1,406	1,416	1,912	2,395	2,862
Right-of-use assets	1,712	1,927	2,028	2,110	2,170
Prepayments for rental	24	25	28	30	33
Others	38	147	147	148	149
Current assets	6,498	6,307	6,619	7,045	7,655
Cash	3,883	2,972	3,601	3,985	4,551
Time deposits	1,892	2,198	2,198	2,198	2,198
Receivables	203	180	242	275	311
Others	520	957	578	586	595
Current liabilities	2,272	2,427	2,757	2,993	3,253
Contract liabilities	1,383	1,385	1,662	1,844	2,047
Payables	443	578	649	716	790
Tax payables	138	126	126	126	126
Lease liabilities	307	339	321	307	290
Others	0	0	0	0	0
Non-current liabilities	1,285	1,354	1,347	1,302	1,243
Lease liabilities	1,207	1,279	1,258	1,205	1,137
Others	79	75	88	97	106
Total net assets	6,120	6,040	6,631	7,433	8,372
Shareholders' equity	6,120	6,040	6,630	7,430	8,367

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
New East	54.7	53.6	51.8	49.6	48.0
Omick	8.7	8.9	10.4	11.1	12.1
Xinhua Internet	19.8	20.5	19.1	19.2	19.3
Wisezone	3.2	4.2	1.4	1.3	1.2
Wontone	13.6	13.3	15.0	16.2	16.6
Cuisine Academy	1.2	1.5	1.4	1.5	1.6
Others	0.4	1.0	0.9	1.1	1.3
P&L ratios (%)					
Gross profit margin	58.4	54.0	58.4	59.3	59.8
EBIT margin	29.5	13.1	28.7	30.9	31.6
Effective tax rate	20.7	41.9	21.5	20.5	20.5
Net profit margin	21.7	7.1	21.6	23.4	24.2
Adj. net profit margin	23.0	13.7	22.8	23.4	24.2
Payout ratio	45.1	105.4	45.0	45.0	45.0
Balance sheet ratios					
Current ratio (x)	2.9	2.6	2.4	2.4	2.4
Average inv. turnover days	10.0	11.7	11.1	11.6	11.6
Asset turnover (x)	0.4	0.4	0.5	0.5	0.5
Total asset/total equity (x)	1.6	1.6	1.6	1.6	1.5
Net cash (RMB mn)	6,242	6,070	6,308	6,692	7,258
Returns (%)					
Adjusted ROAE	25.7	8.2	17.6	18.5	19.3
Adjusted ROAA	12.9	5.1	10.9	11.6	12.4

Source: Company data, CMBIS estimates

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