

Hope Education (1765 HK)

Acquisition to develop asset light model

The Company announced deals to acquire 29.76% equity interests of Dingli (300050 CH). After the acquisition, the Company will remain focusing on asset heavy, formal higher education while Dingli will focus on asset light, college management output. We think the deal could accelerate the Company's development in vocational education and enhance its curriculum development capability in technology area. Management plans to dispose non-core technology businesses to lower business volatility. The stock trades at 16.1x FY21E P/E, we think valuation is attractive given 31.1% EPS CAGR in FY20-22E. Maintain Buy.

- **Acquisition of controlling stakes of Dingli.** Through the acquisition of shares from Dingli's controlling shareholder and new shares subscription, the Company will spend RMB1.29bn to own 29.76% equity interest of Dingli.
- **Asset light approach to accelerate growth.** Dingli has two business segments: telecom technology & IoT and vocational education. It is a leading player in higher education curricula research and output of college management. Since the establishment of first Dingli College in 2015, it has cooperated with 37 universities and vocational colleges to operate 19 Dingli Colleges and 18 majors cooperation projects. It provides curriculum development, teaching, student admission and employment services and receives certain portion of tuition fees as revenue.
- **Target to set up 100 Dingli colleges in three years.** The Company plans to group both parties' strong majors to output college management. The Company can leverage its strength in nationwide student admission capability (proved again in the three colleges acquired in 2019) to help Dingli enroll more students (current Dingli College's utilization rate ~40-50%). There were 2,688 higher education institutes in 2019 in China. The Company plans to lift number of Dingli Colleges to 100 in three years.
- **Vocational education supported by policies.** School-enterprise cooperation is the future trend. As tuition fee will be determined by market (for-profit schools), colleges which can help graduates to get high-salary jobs can set a higher tuition fee than other colleges. We think the deal could accelerate the Company's development in vocational education and enhance its curriculum development capability in technology.
- **Maintain Buy.** We raise FY21/22E adj. NP by 5% mainly to reflect lower finance cost after refinancing in Aug 2020. We forecast Hope Education to deliver 31.1% adj. EPS CAGR from FY20-22E, stronger than sector's average of 23%. Our TP is fine tuned from HK\$3.17 to HK\$3.05 based on 31.1x FY20E P/E and still at 1x PEG, as we factor in EPS dilution from share placement. **Catalysts:** (1) M&A; (2) policy overhang removes; (3) unpeg of independent colleges. **Risk:** surge of teachers' costs.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	1,030	1,331	1,607	2,253	2,885
YoY growth (%)	37	29	na	40	28
Net profit (RMB mn)	168	490	528	770	1,003
Adj. net profit (RMB mn)	320	474	585	846	1,079
Adj. EPS (RMB)	0.056	0.071	0.087	0.117	0.149
YoY growth (%)	NA	26	NA	35	28
Consensus EPS (RMB)	NA	NA	0.090	0.124	0.144
Adj. P/E (x)	31.9	26.4	21.7	16.1	12.6
Yield (%)	0.8	1.2	1.2	1.8	2.4
AROE (%)	13.3	10.9	11.6	14.0	16.1
Net cash (RMB mn)	907	255	2,334	2,137	2,568

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price HK\$3.05
 (Previous TP) HK\$3.17
Up/Downside +49%
Current Price HK\$2.13

China Education Sector

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Stock Data

Mkt Cap (HK\$ mn)	15,408
Avg 3 mths t/o (HK\$ mn)	92.30
52w High/Low (HK\$)	2.93/ 1.18
Total Issued Shares (mn)	6,666.7

Source: Bloomberg

Shareholding Structure

Credit Suisse Trust	57.86%
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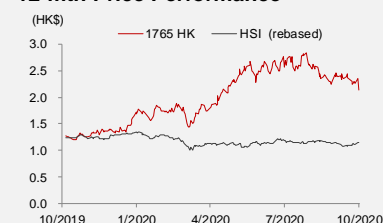
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	2.6%	2.0%
3-mth	-15.2%	-11.3%
6-mth	35.1%	33.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: EY

Related Reports

1. "Hope Education – More optimistic on FY21E student enrollment" – 8 Jun 2020
2. "Strong 1HFY20, multiple growth drivers" – 4 May 2020
3. "Strong FY19 results" – 31 Mar 2020
4. "Acquisition of Malaysia's Inti Education" – 3 Mar 2020
5. "Reverse roadshow takeaways" – 21 Oct 2019

The deal

Share acquisition and entrustment of voting rights of Dingli

On 12 Oct, the Company announced to conditionally purchase 8.75% equity interest of Dingli (300050 CH) at RMB392.5mn from vendor (Mr. Ye, controller of Dingli), representing RMB7.85/share, 2% discount to previous day closing price or 1.8x of book value per share in 1H20. Mr. Ye will entrust his voting rights of the remaining 8% equity interest to the Company. Therefore, the Company can control 16.75% voting rights of the Company.

Proposed subscription of new shares of Dingli

After completion of share entrustment from Mr. Ye, the Company will subscribe 171mn new shares of Dingli at RMB5.27/share (RMB901mn consideration). Therefore, the Company can own 29.76% of the enlarged issued shares of Dingli and its results can be consolidated into the Company by equity method. Capex per Dingli College is around RMB7-15mn per 1,000-1,500 student capacity. The proceeds would be sufficient for opening 60-100 new Dingli Colleges.

Approvals required

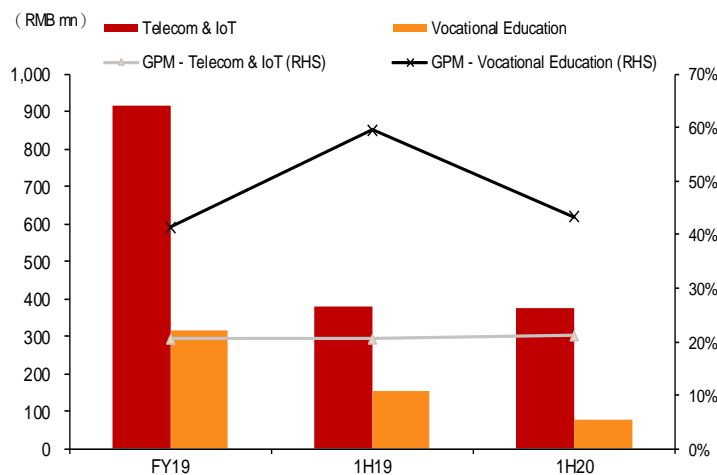
The deal is subject to the approvals of the Company’s shareholders, HKEX, Shenzhen Stock Exchange and CSRC. It could take near a year’s time to complete the deal.

Background of Dingli

Company background

Founded in 2001, Dingli (300050 CH) has two major businesses: telecom technology & IoT and vocational education. In 1H20, telecom technology & IoT and vocational education contributed 83% and 17% revenue. In 1HFY20, Dingli reported net profit of RMB14.9mn, down 26% YoY.

Figure 1: Revenue and GPM by segment



Source: Company, CMBIS

Figure 2: Cooperating parties of Dingli Colleges



Source: Company

Telecom technology & Internet of Things segment

Telecommunication technology: Dingli provides professional network testing, optimization, construction, operation and maintenance products, services and comprehensive solutions for communication operators, system equipment vendors, and terminal manufacturers. It is a leading comprehensive supplier of mobile communication network optimization solutions in China. In terms of big data technology services, it has core capabilities such as ultra-large-scale big data storage, distributed computing, real-time big data streaming, rapid modeling and data mining, and has accumulated rich experience in business data management analysis.

IoT: Its products and services include industrial automation equipment, RFID products, and IoT industry solutions.

Vocational education

Dingli is a leading player in higher education curricula research and output of college management. It provides higher education formal education service and sales of education equipment products and provide international academic courses education services and high-end financial training services.

Dingli acquired Shanghai Zhixiang in Dec 2014 and then launched its first “Dingli College” in 2015. In FY19, the Company has cooperated with 37 domestic public and private universities and colleges to operate 19 Dingli Colleges and 18 majors cooperation projects. In finance management, the Company operates five Metro International Finance Colleges and one International Art College. Total student enrollment was near 20,000. The Company charges 80-100%/50-70% of tuition fees from public/private colleges. Net profit per student in private university is around RMB4,000 per student.

Dingli College cooperates with various colleges in China. For example, Dingli College cooperates with Minsheng’s Dianchi College to operate three majors, namely telecom engineering, AI and IoT engineering, in 2020-21 school year. The tuition fee is RMB18,000/year.

(See the link:

https://ynudcczs.bysjy.com.cn/recruit/detail/news?article_id=6690&menu_id=&panel_id=&sidebar_index=-1¬ice_name=%E6%8B%9B%E7%94%9F%E4%B8%93%E4%B8%9A&enter_url=%2Frecruit%2Fmodule%2Fnews%3Fnotice_id%3D344)

Another example is the cooperation with City College of Southwest University of Science and Technology. Its Dingli College has established practical labs regarding Ali-Cloud, Android apps development, telecom project, smart manufacturing etc. Cooperating partners include Microsoft, IBM, Huawei, AHK, China Mobile, China Telecom, Shanghai Electric, Changan Auto, Datang Mobile Telecom, Inspur, China State Shipbuilding Corp, Hawtai New Energy etc.

(See the link: <https://dlxy.ccswust.edu.cn/about/about/>)

Figure 3: Changes of our estimates

RMB mn	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	1,607	2,253	2,885	1,607	2,235	2,847	0%	1%	1%
Gross Profit	808	1,188	1,553	808	1,176	1,527	0%	1%	2%
Operating Profit	675	913	1,165	675	905	1,148	0%	1%	1%
Net profit	585	846	1,079	585	807	1,027	0%	5%	5%
Gross Margin	50.3%	52.7%	53.8%	50.3%	52.6%	53.7%	flat	+0.1ppt	+0.1ppt
Operating Margin	42.0%	40.5%	40.4%	42.0%	40.5%	40.3%	flat	flat	+0.1ppt
Net Margin	36.4%	37.5%	37.4%	36.4%	36.1%	36.1%	flat	+1.4ppt	+1.3ppt

Source: Company data, CMBIS estimates

Figure 4: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY19E	FY20E	FY21E
Revenue	1,607	2,253	2,885	1,690	2,315	2,867	-5%	-3%	1%
Gross Profit	808	1,188	1,553	867	1,193	1,502	-7%	0%	3%
Operating Profit	675	913	1,165	759	974	1,233	-11%	-6%	-6%
Net profit	585	846	1,079	610	823	994	-4%	3%	9%
Gross Margin	50.3%	52.7%	53.8%	51.3%	51.5%	52.4%	-1.0ppt	+1.2ppt	+1.4ppt
Operating Margin	42.0%	40.5%	40.4%	44.9%	42.1%	43.0%	-2.9ppt	-1.6ppt	-2.6ppt
Net Margin	36.4%	37.5%	37.4%	36.1%	35.6%	34.7%	+0.3ppt	+1.9ppt	+2.7ppt

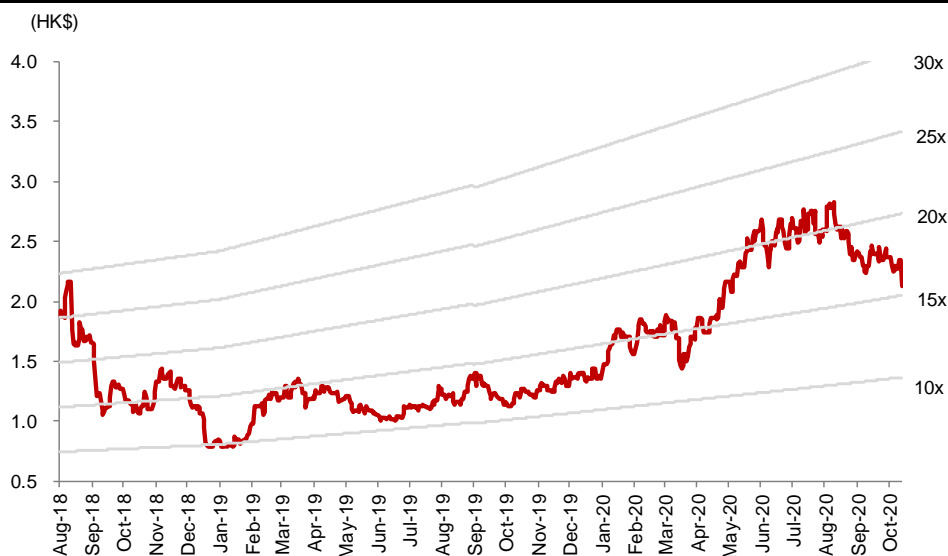
Source: Company data, CMBIS estimates

Figure 5: 33% CAGR of student enrolment from 2018/19 to 2021/22 school year

Student enrolment (school year)	2017/2018	2018/2019	2019/2020E	2020/2021E	2021/2022E	3-yr CAGR
Universities						
Southwest Jiaotong University Hope College	15,123	17,268	20,454	23,481	25,344	14%
<i>Bachelor's degree program</i>	10,855	12,049	13,391	14,864	15,607	9%
<i>Junior college diploma program</i>	4,268	5,219	7,063	8,617	9,737	23%
Business College of Guizhou University of Finance and Economi	14,356	15,548	18,128	20,847	22,202	13%
Jinci College of Shanxi Medical University	4,801	5,953	7,149	8,221	8,715	14%
College of Science and Technology of Guizhou University *			9,959	10,606	11,031	na
Yinchuan schools			15,569	17,969	20,369	na
Inti Education				16,557	17,716	na
Junior colleges						
Sichuan Tianyi University	11,765	10,971	11,521	14,401	16,561	15%
Sichuan Hope Automotive Vocational College	4,559	4,373	6,563	8,860	10,455	34%
Sichuan Vocational College of Culture&Communication	7,371	8,920	10,349	11,384	12,295	11%
Guizhou Vocational Institute of Technology	2,989	5,903	8,021	9,465	10,222	20%
Sichuan TOP IT Vocational Institute	12,548	12,869	13,731	14,418	15,138	6%
Hebi Automotive College			5,434	6,834	8,234	na
Suzhou Top Institute			5,012	7,012	9,012	na
Jiangxi Zhangshu					1,500	na
Chongqing Zhongxian					1,500	na
Gansu Baiyin					1,500	na
Technician education services						
Sichuan Hope Automotive Technician College	2,127	4,193	8,235	10,706	12,311	43%
Total students	75,639	86,033	140,125	180,761	204,105	33%
Total students - degree	30,012	33,550	64,196	89,065	95,640	42%
Total students - others	45,627	52,448	75,929	91,696	108,465	27%

Source: Company data, CMBIS estimates

*Assume the investment of the school is financially consolidated by equity method.

Figure 6: P/E band chart

Source: Company data, Bloomberg, CMBIS estimates

Figure 7: Peers valuation table

	Ticker	Rating	Mkt Cap (US\$ m)	Price	Year end	P/E (x)			Adj. net profit growth (%)			Adj. EPS growth (%)			PEG (x)			Revenue growth (%)		
						FY1	FY2	FY3	FY1	FY2	FY3	FY1	FY2	FY3	FY1	FY2	FY3	FY1	FY2	FY3
Higher Education services providers																				
China Education	839 HK	NR	3,862	13.92	Aug-19	27.2	20.4	16.5	26	37	24	20	33	23	0.97	36	35	18		
Yuhua Education	6169 HK	NR	2,956	6.86	Aug-19	21.8	16.1	13.7	28	27	16	12	36	17	0.84	43	14	10		
Hope Education	1765 HK	Buy	1,988	2.13	Aug-19	21.7	16.1	12.6	na	45	28	na	35	28	0.70	na	40	28		
Kepei Education	1890 HK	NR	1,534	5.90	Dec-19	16.7	13.6	11.5	34	24	17	34	23	18	0.82	30	30	14		
New Higher Education	2001 HK	NR	962	4.70	Dec-19	11.7	9.7	8.1	38	22	20	36	21	19	0.58	28	18	15		
Cahtay Media	1981 HK	NR	1,015	4.74	Dec-19	23.9	16.0	12.4	7	39	32	(13)	49	29	0.62	9	34	21		
Edvantage	382 HK	NR	774	5.89	Aug-19	17.3	13.5	10.9	27	28	24	(2)	28	24	0.66	16	18	21		
Minsheng Education	1569 HK	NR	610	1.12	Dec-19	9.0	7.6	6.8	11	17	12	10	18	13	0.60	17	14	11		
Xinhua Education	2779 HK	Buy	490	2.36	Dec-19	10.5	9.4	8.6	8	11	9	8	11	9	1.04	14	11	9		
Huali University	1756 HK		449	2.90	Aug-19	9.9	7.9	6.3	20	30	25	21	25	25	0.39	18	18	18		
Average						16.9	13.0	10.8	22	28	21	14	28	20	0.72	23	23	17		

Source: Bloomberg estimates, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec/Aug (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	1,030	1,331	1,607	2,253	2,885
Tuition fees	854	1,093	1,358	1,868	2,446
Boarding fees	85	103	97	155	182
Others	90	136	151	231	257
Cost of sales	(562)	(657)	(798)	(1,065)	(1,332)
Gross profit	467	675	808	1,188	1,553
Other income	101	130	156	171	210
Selling expenses	(21)	(45)	(59)	(104)	(147)
Administrative expenses	(111)	(152)	(220)	(331)	(438)
Other expenses	(5)	(16)	(10)	(10)	(12)
EBIT	431	591	675	913	1,165
Finance income	79	94	100	109	105
Finance costs	(201)	(171)	(203)	(176)	(163)
Share of JV	(2)	5	13	17	21
Non-operating items	(148)	36	13	10	10
Pre-tax profit	159	556	599	873	1,138
Income tax	8	(66)	(71)	(103)	(134)
Less: Minority interests	(1)	0	0	0	0
Net profit	168	490	528	770	1,003
Adjusted net profit	320	474	585	846	1,079

Cash flow summary

YE 31 Dec/Aug (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before tax	159	556	528	770	1,003
Depreciation and amortization	161	218	294	357	413
Change in working capital	249	(47)	106	405	328
Others	233	(29)	14	87	41
Net cash from operating	802	697	941	1,619	1,785
Capex & investments	(624)	(279)	(500)	(500)	(500)
Acquisitions	(15)	(447)	(56)	(936)	(401)
Others	(130)	(1,139)	1,055	(19)	(29)
Net cash from investing	(769)	(1,865)	499	(1,455)	(930)
Equity raised	2,705	-	1,128	-	-
Change of borrowings	259	313	1,033	(730)	-
Dividend paid	-	(105)	(150)	(169)	(246)
Others	(595)	(272)	122	(192)	(178)
Net cash from financing	2,369	(65)	2,133	(1,091)	(425)
Net change in cash	2,402	(1,232)	3,573	(927)	430
Cash at the beginning of the year	181	3,039	829	4,402	3,476
Exchange difference	2,584	1,806	4,402	3,476	3,906
Cash at the end of the year	3,039	1,690	4,402	3,476	3,906

Balance sheet

YE 31 Dec/Aug (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	5,119	7,348	7,775	8,815	8,923
PPE	3,448	4,564	4,903	5,664	5,838
Prepaid lease payments	590	1,163	1,122	1,055	984
JV	-	196	210	227	248
Others	1,081	1,425	1,540	1,869	1,853
Current assets	3,172	3,508	5,810	4,914	5,379
Cash	3,039	1,690	4,402	3,476	3,906
Prepayments	129	252	310	341	376
Others	4	1,565	1,097	1,097	1,097
Current liabilities	1,851	3,143	4,810	4,428	4,328
Contract liabilities	591	806	1,821	2,196	2,467
Other payables	637	1,176	1,148	1,121	751
Borrowings	527	1,003	1,715	985	985
Current income tax	34	65	65	65	65
Others	62	91	60	60	60
Non-current liabilities	2,280	3,149	3,031	2,957	2,872
Deferred income	658	1,073	1,051	1,004	948
Borrowings	1,605	1,594	1,515	1,515	1,515
Others	17	482	466	438	410
Total net assets	4,160	4,565	5,743	6,344	7,101
Shareholders' equity	4,157	4,562	5,740	6,340	7,097
Minority Interest	3	3	3	4	4

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Tuition & boarding fees	83.0	82.1	84.5	82.9	84.8
Ancillary services	8.3	7.7	6.1	6.9	6.3
Others	8.7	10.2	9.4	10.2	8.9
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross profit margin	45.4	50.7	50.3	52.7	53.8
EBIT margin	41.9	44.4	42.0	40.5	40.4
Effective tax rate	31.1	35.6	11.8	11.8	11.8
Adj. net profit margin	(4.9)	11.8	36.4	37.5	37.4
Payout ratio	31.3	31.7	32.0	32.0	32.0
Balance sheet ratios					
Current ratio (x)	1.7	1.1	1.2	1.1	1.2
Asset turnover (x)	0.1	0.1	0.1	0.2	0.2
Net cash (RMB mn)	907	255	2,334	2,137	2,568
Returns (%)					
Adj. ROAE	13.3	10.9	11.6	14.0	16.1
Adj. ROAA	4.6	4.9	4.8	6.2	7.7
Per share data					
Adj. EPS (RMB)	0.056	0.071	0.087	0.117	0.149
DPS (RMB)	0.015	0.023	0.023	0.034	0.044
BVPS (RMB)	0.624	0.684	0.794	0.876	0.981

Source: Company data, CMBIS estimates

Year-end is changed to Aug from FY20E onwards

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