

# Hope Education (1765 HK)

## Strong 1HFY20; multiple growth drivers

The Company reported its first interim results after changing year-end to Aug. 1HFY20 adj. NP +55% to RMB356mn (vs +69% YoY in 2HFY19 year-ended Dec), 5% above our expectation. We think MOE's accelerating conversion of independent colleges is a re-rating catalyst of higher education sector. We lifted our TP from HK\$2.31 to HK\$2.80, based on 28.7x FY20E P/E or 1x PEG. Such PEG valuation is not demanding compared to China Education (839 HK) (1.4x PEG) and Yuhua (6169 HK) (1.2x PEG). Hope Education remains our sector top pick. Maintain Buy.

- Strong 1HFY20 results.** Revenue jumped 46% to RMB871mn, led by 21% organic revenue growth and three schools acquired in Sep 2020. GPM widened 1.6ppt to 52.5% led by cost control. We estimate GPM of original businesses +4.6ppt to 55.5% while GPM of the acquired schools was around 38%. Adj. NP margin still expanded 2.4ppt to 40.8% though the Company made income tax provision for Sichuan schools in 1HFY20.
- Organic and M&A growth drivers.** As at end of Feb 2020, the Company had cash of RMB2.3bn and seeks acquisition opportunities of universities. In addition, it has organic growth drivers: (1) self-built schools: it plans to open three vocational colleges in Sep 2021; (2) increase of admission quota: nationwide increase of diploma-to-degree quota and continuing growth of quota. Management said that it had a university being granted 30% growth of degree quota; (3) cost control: the Company will continue to adopt lean management and cost control.
- Opportunities of unpeg of independent colleges.** MOE has speeded up conversion of independent colleges into universities this year (Figure 3). This would provide further growth opportunities for higher education sector in two ways: (1) more M&A opportunities: private sponsors of independent colleges could be forced to sell if they do not have enough resources to meet conversion requirements; (2) enhance profitability: public universities sponsors of independent colleges could accelerate the negotiation with private sponsors about the "termination fees". The Company has four independent colleges paying around RMB150mn management fees to public universities a year. Management hopes to settle the conversion within RMB500mn "termination fees", equivalent to ~4x P/E acquisition.
- Maintain Buy.** We forecast the Company to deliver 28.7% EPS CAGR from FY20-22E after switching to year-ended Aug, stronger than sector's average of 19%. **Catalysts:** (1) M&A; (2) unpeg of independent colleges; (3) 2020/21 total student enrollment beat; (4) removal of policy overhang. **Risk:** surge of teachers' costs.

### Earnings Summary

(YE 31 Dec/Aug)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	1,030	1,331	1,607	2,190	2,735
YoY growth (%)	37	29	na	36	25
Net profit (RMB mn)	168	490	528	707	893
Adj. net profit (RMB mn)	320	474	585	783	969
Adj. EPS (RMB)	0.056	0.071	0.088	0.117	0.145
YoY growth (%)	na	26	na	34	24
Consensus EPS (RMB)	na	na	na	na	na
Adj. P/E (x)	25.2	20.8	22.1	16.5	13.3
Yield (%)	1.1	1.5	1.3	1.7	2.2
Yield (%)	13.3	10.9	13.1	16.0	17.7
Net cash (RMB mn)	907	255	1,147	802	1,136

Source: Bloomberg, Company data, CMBIS estimates, \*FY18/19A with YE 31 Dec

**BUY (Maintain)**

Target Price **HK\$2.80**  
 (Previous TP **HK\$2.31**)  
 Up/Downside **+30%**  
 Current Price **HK\$2.16**

### China Education Sector

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### Stock Data

Mkt Cap (HK\$ mn)	14,411
Avg 3 mths t/o (HK\$ mn)	25.18
52w High/Low (HK\$)	2.23/ 1.00
Total Issued Shares (mn)	6,666.7

Source: Bloomberg

### Shareholding Structure

Hope Education Investment	62.75%
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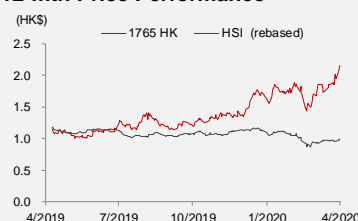
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	26.3%	20.4%
3-mth	33.3%	47.0%
6-mth	80.0%	95.7%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: EY

### Related Reports

- "Strong FY19 results" – 31 Mar 2020
- "Acquisition of Malaysia's Inti Education" – 3 Mar 2020
- "Reverse roadshow takeaways" – 21 Oct 2019
- "Solid 1H19 results; 31% EPS CAGR in FY20-21E" – 2 Sep 2019
- "Undemanding valuation at 25% 3-YR EPS CAGR" – 26 Mar 2019

Figure 1: 1HFY20 results review

Y/E Aug (RMB mn)	1HFY20	1HFY19	change (%)	Remarks	2H19 (Y/E Dec)	2H18 (Y/E Dec)	change (%)
<b>Revenue</b>	<b>871</b>	<b>596</b>	<b>46%</b>	Organic portion +21%	<b>737</b>	<b>502</b>	<b>47%</b>
Cost of sales	(413)	(293)	41%	teachers' costs +38% (organic portion +12%)	(378)	(295)	28%
Gross profit	457	303	51%	Organic portion jumped 33%	359	207	73%
Other income	107	na	na		142	60	135%
Selling expenses	(30)	na	na		(33)	(12)	187%
Administrative expenses	(116)	na	na		(103)	(155)	-33%
Other expenses	(11)	na	na		(13)	(27)	-52%
Operating profit	408	na	na		351	73	379%
Finance income	65	na	na		38	45	-16%
Finance costs	(102)	na	na		(96)	(94)	3%
Non-recurring items			na		0	0	na
Share profit of associates	8	na	na		5	0	na
Profit before tax	378	na	na		297	25	1112%
Tax expense	(44)	na	na	Colleges in Sichuan made 15% income tax provision	(51)	10	-615%
Profit after tax	334	151	122%		247	34	616%
Non-controlling interests	0	na	na		(0)	0	-141%
<b>Net profit</b>	<b>334</b>	<b>151</b>	<b>122%</b>		<b>247</b>	<b>34</b>	<b>617%</b>
<b>Adj. net profit</b>	<b>356</b>	<b>229</b>	<b>55%</b>		<b>217</b>	<b>128</b>	<b>69%</b>
<b>Margin &amp; Ratio (%)</b>							
Gross margin	52.5	50.9	1.6	Organic portion +4.6ppt	48.7	41.3	7.4
Adj. net margin	40.8	38.4	2.4		29.5	25.6	3.9
Effective tax rate	11.7	na	na		17.1	(40.3)	57.5

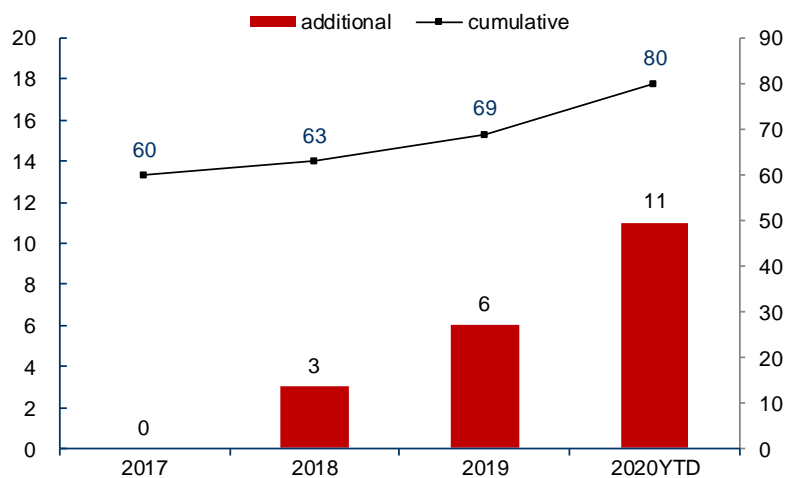
Source: Company data, CMBIS estimates

Figure 2: Peers valuation table

	Ticker	Rating	Mkt Cap		TP	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	FY1	FY2	FY3
<b>Higher Education services providers</b>																					
China Education	839 HK	NR	3,403	13.06		Aug-19	25.9	22.0	18.5	29	20	17	24	18	18	1.42	36	15	12		
Yuhua Education	6169 HK	NR	3,360	7.80		Aug-19	24.7	19.3	17.2	49	16	13	18	28	12	1.24	45	9	8		
Hope Education	1765 HK	Buy	1,859	2.16	2.80	Aug-19	22.1	16.5	13.3	na	34	24	na	34	24	0.77	na	36	25		
Kepei Education	1890 HK	NR	1,275	4.94		Dec-19	15.0	12.4	10.9	33	20	17	31	21	14	0.86	27	22	14		
New Higher Education	2001 HK	NR	809	4.07		Dec-19	10.8	9.4	8.1	34	19	17	34	15	16	0.70	27	15	14		
Edvantage	382 HK	NR	690	5.25		Aug-19	15.7	12.8	10.5	42	22	21	1	23	21	0.71	18	19	17		
Minsheng Education	1569 HK	NR	669	1.29		Dec-19	10.5	9.1	8.4	14	15	8	14	15	9	0.89	21	14	7		
Xinhua Education	2779 HK	Buy	515	2.48	2.85	Dec-19	11.2	10.0	9.2	8	11	9	8	11	9	1.11	14	11	9		
Huali University	1756 HK		503	3.25		Aug-19	11.4	9.0	7.2	17	35	23	23	27	24	0.45	18	18	17		
<b>Average</b>							<b>16.4</b>	<b>13.4</b>	<b>11.5</b>	<b>28</b>	<b>21</b>	<b>17</b>	<b>19</b>	<b>21</b>	<b>16</b>	<b>0.91</b>	<b>26</b>	<b>18</b>	<b>14</b>		

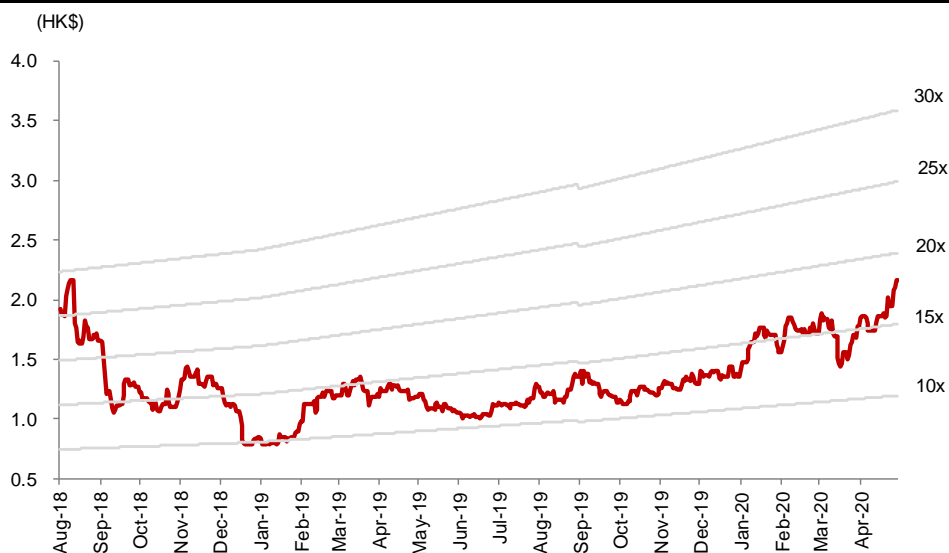
Source: Bloomberg estimates, CMBIS estimates

**Figure 3: Number of independent colleges approved to convert into universities**



Source: MOE

**Figure 4: P/E band chart**



Source: Company data, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec/Aug (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>1,030</b>	<b>1,331</b>	<b>1,607</b>	<b>2,190</b>	<b>2,735</b>
Tuition fees	854	1,093	1,358	1,812	2,309
Boarding fees	85	103	97	148	171
Others	90	136	151	229	254
Cost of sales	(562)	(657)	(798)	(1,041)	(1,274)
Gross profit	467	675	808	1,148	1,461
Other income	101	130	156	166	199
Selling expenses	(21)	(45)	(59)	(101)	(137)
Administrative expenses	(111)	(152)	(220)	(324)	(424)
Other expenses	(5)	(16)	(10)	(10)	(12)
EBIT	431	591	675	880	1,087
Finance income	79	94	98	88	88
Finance costs	(201)	(171)	(200)	(193)	(193)
Share of JV	(2)	5	13	17	20
Non-operating items	(148)	36	13	10	10
Pre-tax profit	159	556	599	802	1,013
Income tax	8	(66)	(71)	(95)	(120)
Less: Minority interests	(1)	0	0	0	0
<b>Net profit</b>	<b>168</b>	<b>490</b>	<b>528</b>	<b>707</b>	<b>893</b>
<b>Adjusted net profit</b>	<b>320</b>	<b>474</b>	<b>585</b>	<b>783</b>	<b>969</b>

### Cash flow summary

YE 31 Dec/Aug (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Profit before tax</b>	159	556	528	707	893
Depreciation and amortization	161	218	294	357	413
Change in working capital	249	(47)	42	319	317
Others	233	(29)	12	104	71
<b>Net cash from operating</b>	<b>802</b>	<b>697</b>	<b>876</b>	<b>1,486</b>	<b>1,695</b>
Capex & investments	(624)	(279)	(500)	(500)	(500)
Acquisitions	(15)	(447)	(56)	(936)	(401)
Others	(130)	(1,139)	1,055	(18)	(26)
<b>Net cash from investing</b>	<b>(769)</b>	<b>(1,865)</b>	<b>499</b>	<b>(1,454)</b>	<b>(927)</b>
Equity raised	2,705	-	5	-	-
Change of borrowings	259	313	299	-	-
Dividend paid	-	(105)	(150)	(169)	(226)
Others	(595)	(272)	124	(208)	(208)
<b>Net cash from financing</b>	<b>2,369</b>	<b>(65)</b>	<b>278</b>	<b>(377)</b>	<b>(434)</b>
<b>Net change in cash</b>	<b>2,402</b>	<b>(1,232)</b>	<b>1,652</b>	<b>(345)</b>	<b>334</b>
Cash at the beginning of the year	181	3,039	829	2,482	2,136
Exchange difference	2,584	1,806	2,482	2,136	2,470
<b>Cash at the end of the year</b>	<b>3,039</b>	<b>1,690</b>	<b>2,482</b>	<b>2,136</b>	<b>2,470</b>

### Balance sheet

YE 31 Dec/Aug (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>5,119</b>	<b>7,348</b>	<b>7,775</b>	<b>8,815</b>	<b>8,922</b>
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	247
Others	1,081	1,425	1,540	1,869	1,853
<b>Current assets</b>	<b>3,172</b>	<b>3,508</b>	<b>3,889</b>	<b>3,575</b>	<b>3,943</b>
Cash	3,039	1,690	2,482	2,136	2,470
Prepayments	129	252	310	341	376
Others	4	1,565	1,097	1,097	1,097
<b>Current liabilities</b>	<b>1,851</b>	<b>3,143</b>	<b>4,013</b>	<b>4,274</b>	<b>4,164</b>
Contract liabilities	591	806	1,758	2,046	2,306
Other payables	637	1,176	1,148	1,121	751
Borrowings	527	1,003	981	981	981
Current income tax	34	65	65	65	65
Others	62	91	60	60	60
<b>Non-current liabilities</b>	<b>2,280</b>	<b>3,149</b>	<b>3,031</b>	<b>2,957</b>	<b>2,876</b>
Deferred income	658	1,073	1,051	1,005	951
Borrowings	1,605	1,594	1,515	1,515	1,515
Others	17	482	466	438	410
<b>Total net assets</b>	<b>4,160</b>	<b>4,565</b>	<b>4,620</b>	<b>5,158</b>	<b>5,825</b>
<b>Shareholders' equity</b>	<b>4,157</b>	<b>4,562</b>	<b>4,616</b>	<b>5,154</b>	<b>5,821</b>
<b>Minority Interest</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>4</b>	<b>4</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Tuition & boarding fees	83.0	82.1	84.5	82.8	84.4
Ancillary services	8.3	7.7	6.1	6.8	6.3
Others	8.7	10.2	9.4	10.4	9.3
<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	45.4	50.7	50.3	52.4	53.4
EBIT margin	41.9	44.4	42.0	40.2	39.8
Effective tax rate	31.1	35.6	11.8	11.8	11.8
Adj. net profit margin	(4.9)	11.8	36.4	35.8	35.4
Payout ratio	31.3	31.7	32.0	32.0	32.0
<b>Balance sheet ratios</b>					
Current ratio (x)	1.7	1.1	1.0	0.8	0.9
Asset turnover (x)	0.1	0.1	0.1	0.2	0.2
Net cash (RMB mn)	907	255	1,147	802	1,136
<b>Returns (%)</b>					
Adj. ROAE	13.3	10.9	13.1	16.0	17.7
Adj. ROAA	4.6	4.9	5.3	6.5	7.7
<b>Per share data</b>					
Adj. EPS (RMB)	0.056	0.071	0.088	0.117	0.145
DPS (RMB)	0.015	0.023	0.025	0.034	0.043
BVPS (RMB)	0.624	0.684	0.692	0.773	0.873

Source: Company data, CMBIS estimates

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