

# China Maple Leaf Education Systems Limited (1317.HK)

Driven by light asset model with a promising outlook of international schools in China

5 July 2018

Hong Kong | Education | Company Report

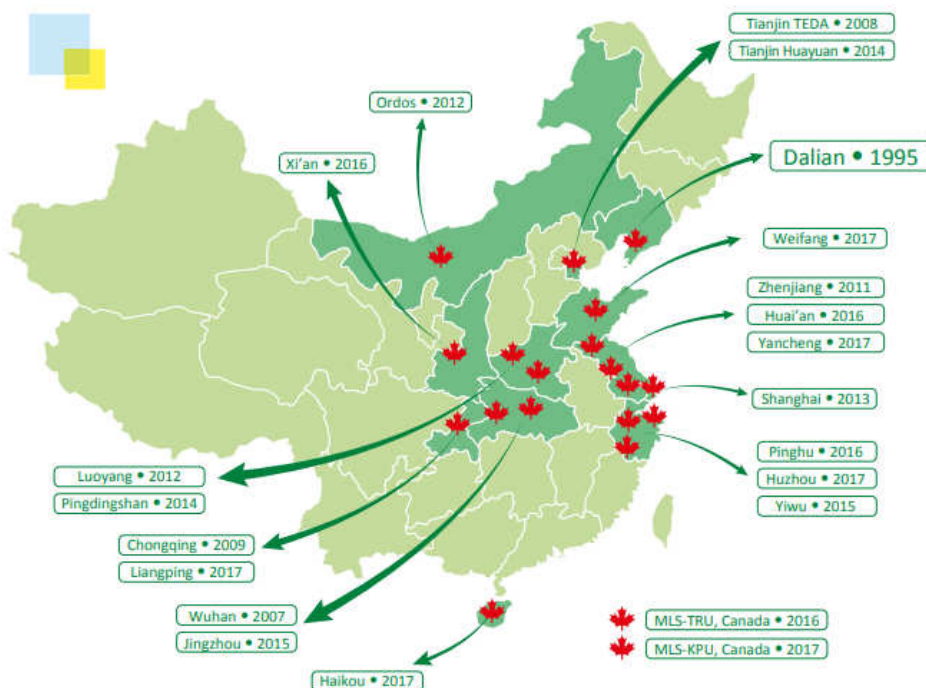
## Investment Summary

China Maple Leaf Education Systems Limited is a leading international school operator, from preschool to grade 12 education (K-12) in China. Thanks to the rise of middle class in China, its light asset development model and unique dual-diploma curriculum, we believe Maple Leaf will be one of the most promising players in the China education sector. We initiate an “accumulate” rating on Maple Leaf, and a target price of HK\$15.48 based on earnings in 19F assuming 1x PEG (30% CAGR on earnings for FY18E-20E), with 12.2% potential upside. (Closing price at 3 July 2018)

## Corporate Background

Founded in 1995, it is operating 82 schools (where five are new acquisitions, and yet consolidated) in Dalian, Wuhan, Tianjin, Chongqing, Zhenjiang, Luoyang, Shanghai, Shenzhen, etc. The group has accelerated its school expansion in recent years, with 17 net increases in March of 2018, excluding five new acquisitions. Currently, the group comprised of 13 high schools (for students in grade 10 to 12), 21 middle schools (for students in grade 7 to 9), 21 elementary schools (for students in grade 1 to 6), 19 preschools and 3 foreign national schools.

Figure: Schools location (End of 2017)



Source: Company report, Phillip Securities (HK) Ltd.

## Accumulate (Initially)

CMP HKD 14.30

(Closing price at 3 July 2018)

TARGET HKD 15.68 (+9.7%)

### COMPANY DATA

O/S SHARES (MN) :	1,490
MARKET CAP (HKDMN) :	21,301
52 - WK HI/LO (HKD):	15.26 / 6.04

### SHARE HOLDING PATTERN • %

Shu Liang Sherman Jen	49.99
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### PRICE PERFORMANCE • %

	1M	3M	1Y
CNHEG	-2.46	35.93	119.33
HSI	-7.91	-5.42	10.71

### RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

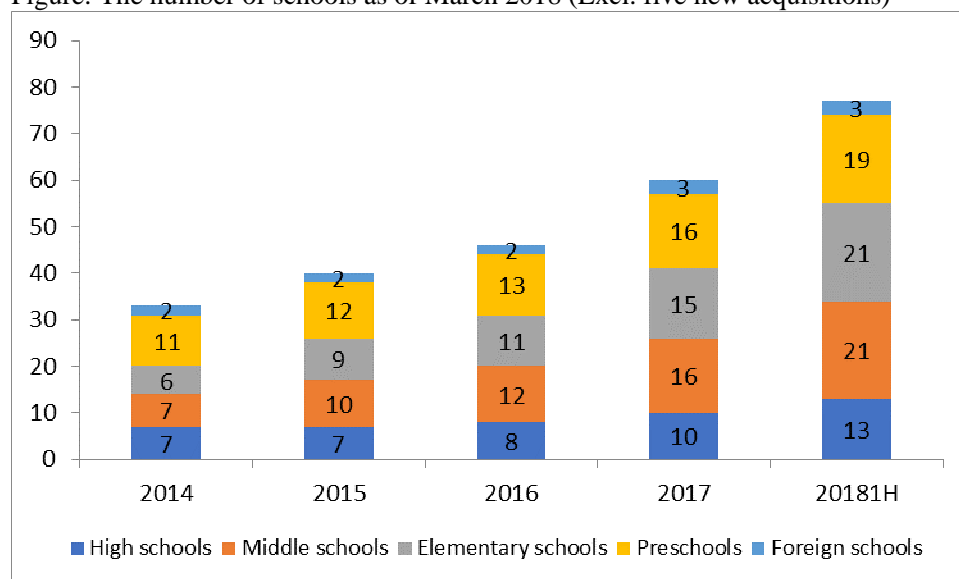
### KEY FINANCIALS

RMB mn	FY16	FY17	FY18E	FY19E
Revenue	830	1083	1454	1868
Net Profit	308	414	513	674
EPS, RMB	0.226	0.298	0.341	0.448
PER, x	54.11	41.10	35.85	27.32
BVPS, RMB	1.49	1.76	2.36	2.61
P/BV, x	8.23	6.95	5.17	4.68
ROE, %	16.0	18.4	17.1	18.0

Source: Company reports, Phillip Securities Est.

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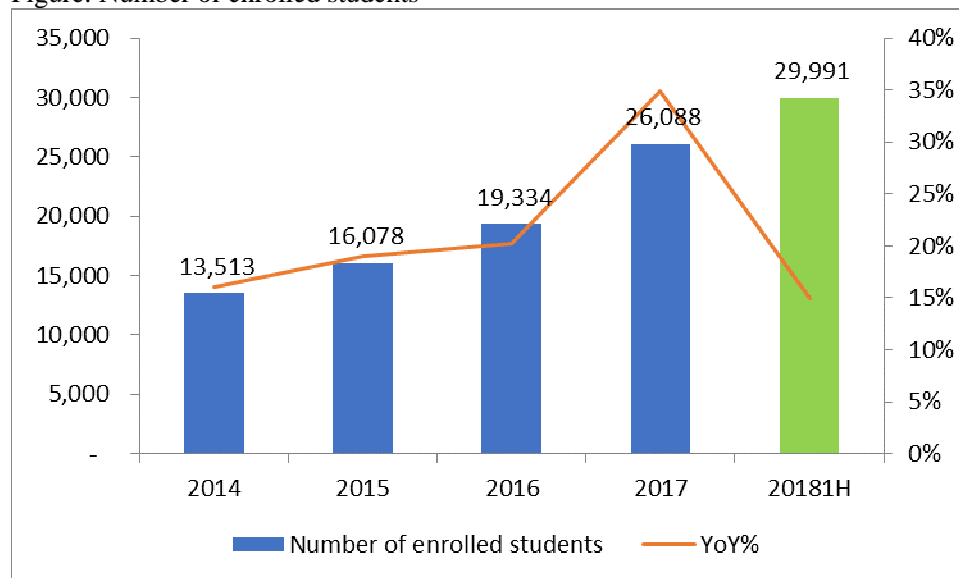
Figure: The number of schools as of March 2018 (Excl. five new acquisitions)



Source: Company reports, Phillip Securities (HK) Research

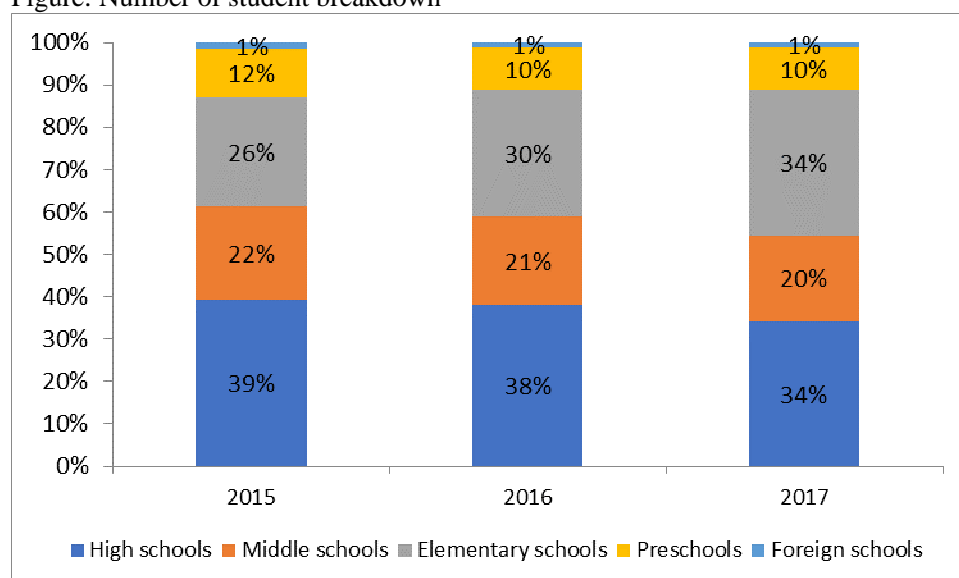
With a total of 29,991 as of March 2018, the number of enrolled students grew at a CAGR of 26% in the past three and half years. As the group aims to establish a pyramid structure of student enrolment from elementary to high schools, the proportion of elementary student students rose from 26% in 2015 to 34% in 2017; whereas that of high school students dropped from 39% in 2015 to 34% in 2017, indicating it is determined to expand its business in compulsory education.

Figure: Number of enrolled students



Source: Company reports, Phillip Securities (HK) Research

Figure: Number of student breakdown



Source: Company reports, Phillip Securities (HK) Research

The average tuition and boarding fees for preschools/elementary schools/middle schools/high schools were RMB 29,000/44,850/47,588/86,833 respectively. The average tuition fee per student in 2017 was RMB 38,642 with 2% drop YoY, due mainly to the increase in proportion of elementary school students that charges lower tuition fees than high schools.

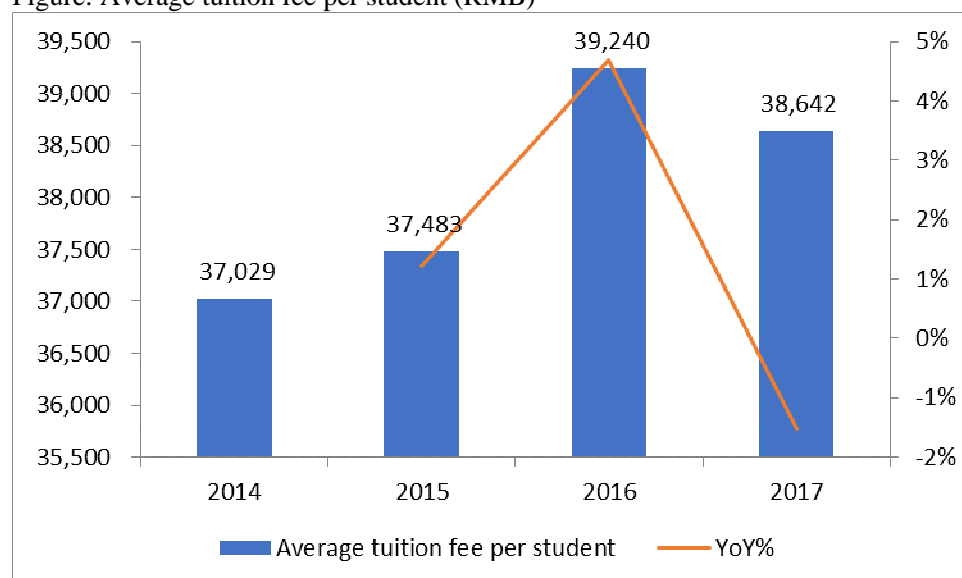
Figure: Tuition and boarding fee (RMB) for Chinese students

City	Preschools	Elementary schools	Middle schools	High schools
Dalian		34,000	34,000	74,000
Wuhan		35,000	39,000	74,000
Tianjin Teda	40,000	43,000	48,000	93,000
Tianjin Huayuan		48,000	50,000	
Chongqing		28,000	34,000	65,000
Luoyang		23,000	25,000	59,000
Pingdingshan	18,000	18,000	21,000	
Zhenjiang		26,000	34,000	74,000
Shanghai			43,000	100,000
Ordos		22,000	29,000	
Yiwu		39,000	42,000	74,000
Jingzhou		22,000	25,000	
Xi'an	20,000	29,000	34,000	59,000
Pinghu	27,668	36,000	40,000	
Huai'an		22,000	29,000	
Huzhou	32,000	36,000	40,000	
Liang Ping	23,000	22,000	29,000	
Weifang	25,000	28,000	33,000	
Yancheng		22,000	34,000	74,000
Hainan		Meihua: 9,850 Meishe: 14,700 Meiwen: 14,700	Meishe: 16,700	Domestic curriculum: 21,000 BC curriculum: 60,000

Shenzhen	137,000	177,000	207,000
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Source: Company website, Phillip Securities (HK) Research

Figure: Average tuition fee per student (RMB)



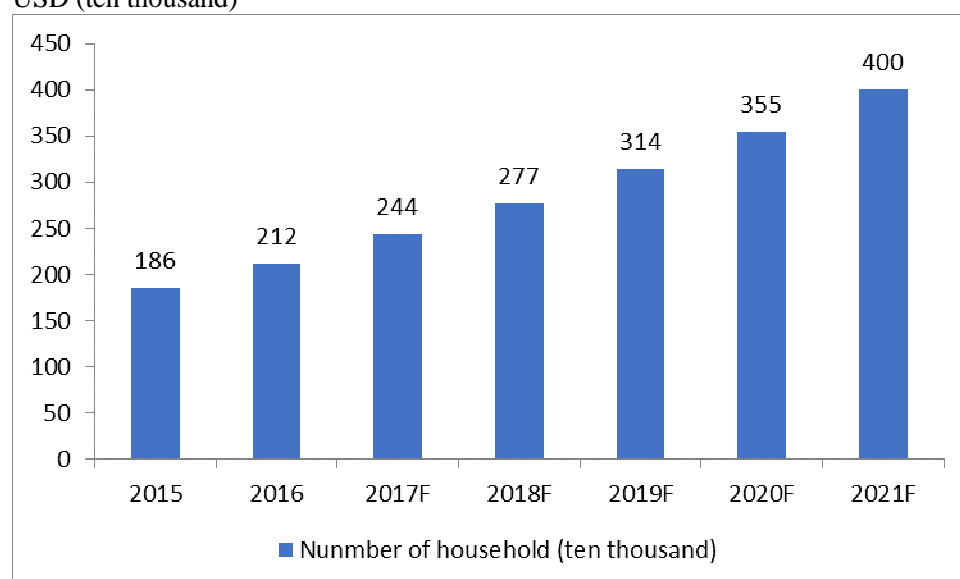
Source: Company reports, Phillip Securities (HK) Research

## Industry overview

### The proliferation of middle class in China

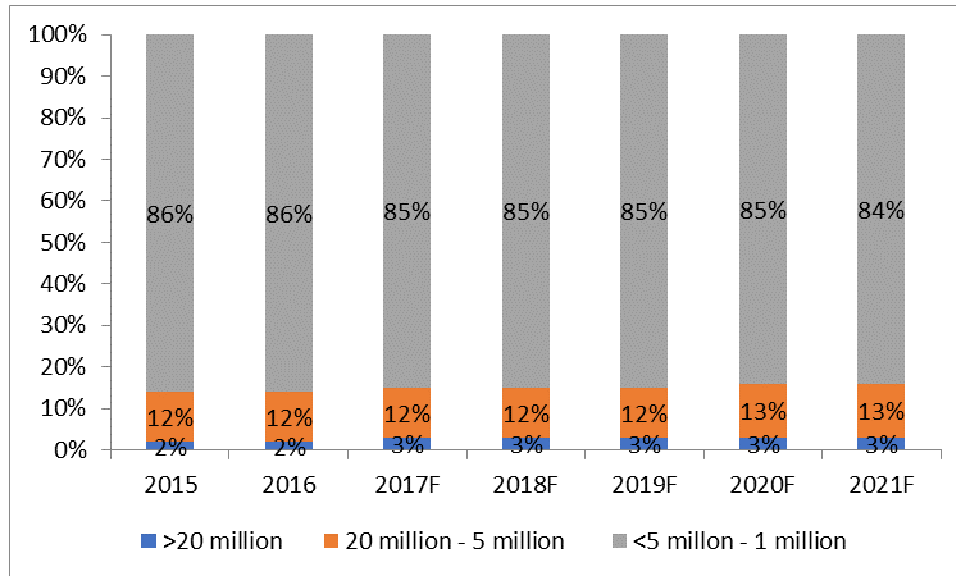
After Chinese economic reform, China has become the world's second largest economy, just behind US. The number of middle class has soared along with the economic development. According to The Boston Consulting Group, the number of households in China with investable assets more than 1 million USD will reach 4 million in 2021, growing in a CAGR of 13.6%. The proportion of households that own more than 5 million USD investable assets also expected to rise from 14% in 2015 to 16% in 2021. The rise in middle class will create a significant demand for international school, as parents are more affordable to the tuition fees.

Figure: Number of households in China with investable assets more than 1 million USD (ten thousand)



Source: BCG, Phillip Securities (HK) Research

Figure: Breakdown of households in China with investable assets more than 1 million USD

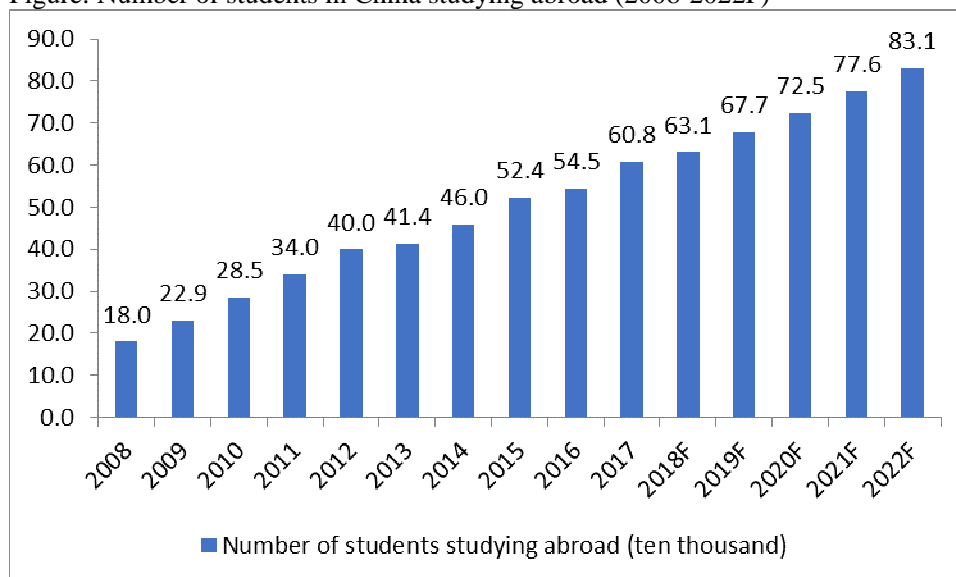


Source: BCG, Phillip Securities (HK) Research

#### Steady rise in students studying abroad

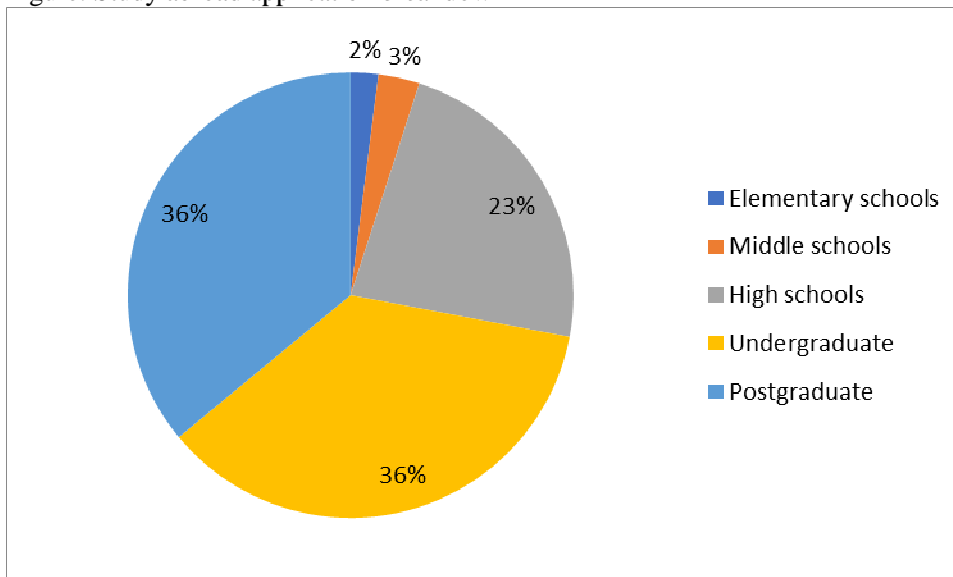
As parents strived to provide better education to their children, studying abroad is gaining popularity in China. According to the Ministry of Education of PRC, the number of students studying abroad increased from 179,800 in 2008 to 608,400 in 2017, growing in a CAGR of 14.5%. Frost & Sullivan predicted the number could reach 830,500 in 2022, with a CAGR of 7.1% during 2018 – 2022. Most of the applications for studying abroad are for undergraduate and postgraduate, which both accounted for 36%. It indicates parents tended to let their children finish K-12 education in China before studying abroad, which will benefit the K-12 international schools that aims to help students prepare for studying abroad, such as Maple Leaf Education.

Figure: Number of students in China studying abroad (2008-2022F)



Source: Ministry of Education of the People's Republic of China, Frost & Sullivan, Phillip Securities (HK) Research

Figure: Study abroad application breakdown



Source: JIL Oversea Education, Phillip Securities (HK) Research

Limitation on international classes in public school offers opportunities for private international schools

In 2013, Chinese government implemented 《高中階段國際項目暫行管理辦法》，in order to limit the supply of international classes in public schools. Municipal government stopped verifying new international classes. The number of international classes dropped by 1 to 224 in 2016; whereas that of private international schools increased by 136 to 392 in 2016. As international classes used to be a substitution for private international schools, the limited supply in international classes will abate intensity of competition in the sector.

Figure: Number of Foreign national schools/International classes in public schools/Private international schools



Source: 中國教育在線, Phillip Securities (HK) Research

## Long-term drivers in the future

Light asset development model

Since 2012, the group started its light asset development model. A light asset development model means the group cooperates with third parties, mainly local government [if the third party is government, then it refers to a Public-private partnership (PPP)], where third parties provides land or school facilities, while the group is responsible for operation, i.e. teacher, teaching material, or facility renovation. The cooperation could be either rental or profit sharing. In rental model, fees are usually determined by number of students or trigger of a certain event. In profit sharing model, the profit is usually shared by half with the third parties.

The advantages of light asset development model are 1) shorter payback period and 2) accelerating the expansion.

First, cooperating with third parties, the group could save substantial initial capital expenditure on land and school facilities, which will shorten the payback period from more than two years (self-owned school) to around a year. This model could leverage the group's enriched experience in operations.

Second, with less initial capital expenditure and the help from local government, the group could accelerate its expansion and enlarge its business scale. The larger businesses scale could improve the operating efficiency by sharing the resource across their schools and enhance its reputation, which in turn lead to more PPP projects from local governments.

As of Sep 2017, 54% of its schools are either leased or profit shared. We expect this strategy will continue and the proportion of rental and profit sharing school will be driven up in next few years.

Figure: Schools operation model breakdown as of Sep 2017

CHINA SCHOOLS	Leased	Profit Shared	Owned
China Pre-Schools	14		
Chongqing	3		3
Dalian	2		4
Haikou			4
Huai'an, Jiangsu	2		
Huzhou		3	
Jingzhou, Hubei			2
Luoyang, Henan		3	
Ordos, Inner Mongolia	2		
Pingdingshan, Henan			3
Pinghu, Zhejiang			2
Shanghai			2
Tianjin	2		3
Weifang, Shandong		3	
Wuhan, Hubei			4
Xi'an, Shannxi		3	
Yancheng, Jiangsu		2	
Yiwu, Zhejiang			4
Zhenjiang, Jiangsu			3
<b>INTERNATIONAL SCHOOLS</b>			
Kamloops (B.C. Canada)	1		

Richmond (B.C. Canada)	1		
Singapore			1
Total	27	14	35
Percentage (%)	36%	18%	46%

Source: Company website, Phillip Securities (HK) Research

#### Expansion to top first tier cities

The group first focused on first, second, third and fourth tier cities before expanding to top first tier cities. In the beginning, the group was not as competitive as those renowned schools located in top first cities such as YK Pao School, International school of Beijing, Dulwich College Beijing, etc. However, with more operation experience and reputation accumulated in mid-tier cities, it paves the way for the group to top first tier cities. In 2013, the group set up its first international schools in the top first tier city – Shanghai, and later acquired 55% equity interest in Shenzhen Yisidun Longgang School in 2017, becoming the second schools in the top first city for the group. We expect the group will gradually expand its network in those top first cities by either M&A or self-establishment.

Figure: Cities of schools

City	Year of entry	Tier
Shanghai	2013	Top first
Shenzhen	2017	Top first
Wuhan	2007	First
Tianjin Teda	2008	First
Chongqing	2009	First
Tianjin Huayuan	2014	First
Xi'an	2016	First
Dalian	1995	Second
Weifang	2017	Second
Zhenjiang	2011	Third
Luoyang	2012	Third
Yiwu	2015	Third
Jingzhou	2015	Third
Huai'an	2016	Third
Yancheng	2017	Third
Huzhou	2017	Third
Haikou	2017	Third
Ordos	2012	Fourth
Pingdingshan	2014	Fourth
Pinghu	2016	Fourth
Liangping	2017	Fourth

Source: 新一線城市研究, Company website, Phillip Securities (HK) Research

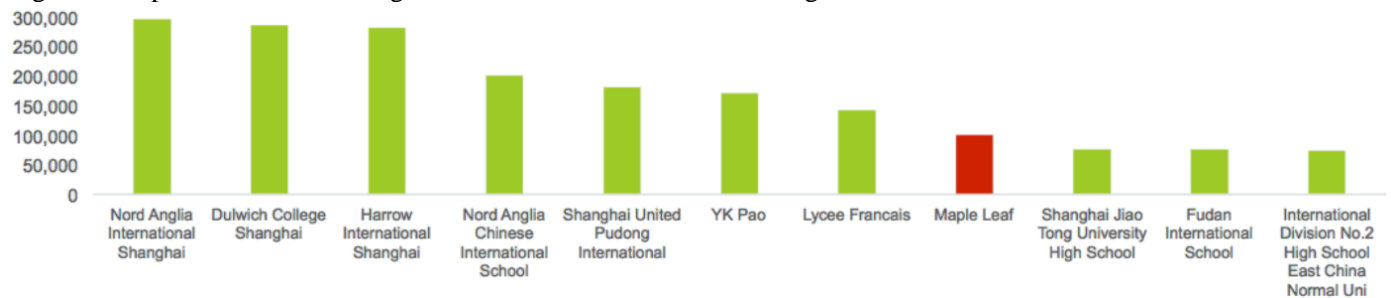
#### Tuition fee hikes plus increasing source of revenue from additional services

The group confirmed to raise the tuition fees by 25% in Sep 2018 in Dalian, Chongqing, Wuhan, Zhenjiang, Tianjin, and Luoyang. Mgt claimed it is also



possible for other schools to raise its tuition fees in Sep, but it is due to confirm. Since the new tuition fees are only subject to new students, we believe the effect in revenue and GPM will take a few years to be reflected. Despite the 25% hike in tuition fees, we believe the group's tuition fees are still competitive compared to other international schools, as the group's tuition fees are much lower than its competitors in the past.

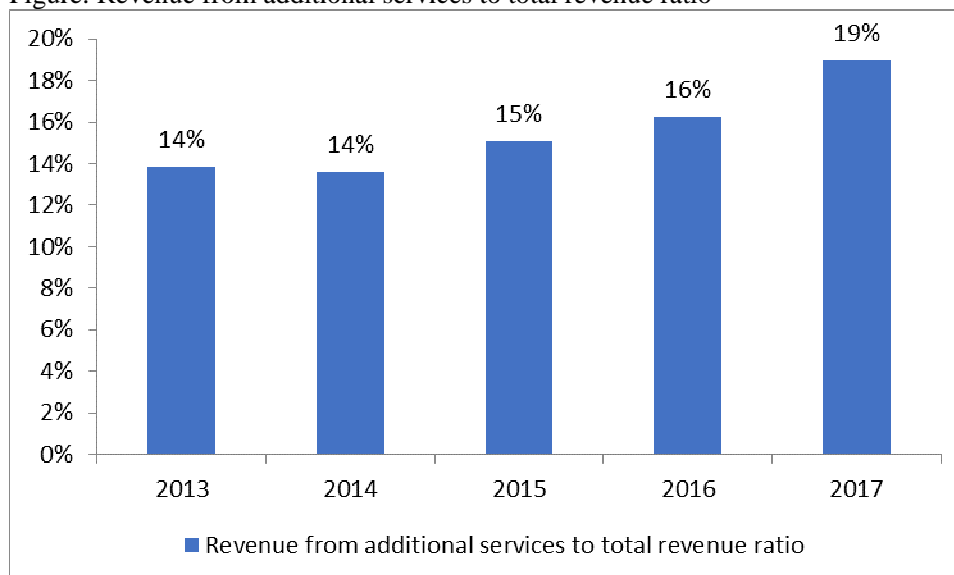
Figure: Comparison of selected high school annual tuition fees in Shanghai



Source: Company website, Phillip Securities (HK) Research

Besides, the group is eager to exploit more sources of revenue by providing additional services, such as overseas studies consulting services, study tour, educational vacation activities, and educational books rental. The revenue from additional services to total revenue ratio increased from 14% in 2013 to 19% in 2017. With more valued-added services provided to students, not only do the students enjoy, the group can also benefit from an extra source of revenue.

Figure: Revenue from additional services to total revenue ratio



Source: Company report, Phillip Securities (HK) Research

#### Dual-diploma curriculum – PRC and BC high school diploma

The group's high schools are certified by the Ministry of Education of BC, Canada and the Chinese government, where the graduates will be entitled to both a PRC and a BC high school diploma, offering greater flexibility for graduates in the choices.

It takes six steps to be a B.C. certified offshore school, 1) Expression of Interest, 2) Interview, 3) Application, 4) Application Inspection, 5) Pre-Certification, and 6) Certification. First, the applicant contacts ministry staff to request its interest, then the Ministry of Education will review the submission. Second, Ministry of

Education representatives will conduct an in-person interview to assess their motivation, capacity to operate an offshore school, and goals and plans for the school. Third, the applicant needs to submit documents, including: Business plan for the offshore school, Audited financial statements, budget forecasts and Local government approvals. Fourth, A Ministry of Education will appoint inspection team performs an on-site inspection of their school. Fifth, if the applicant passes the inspection, they will sign one-year Pre-Certification Agreement with the Ministry of Education. The ministry will decide whether to certify the school based on the recommendations of the inspection team and whether the school meets the requirements set out in the Pre-Certification Agreement. Finally, passing the pre-certification, the applicants then sign one-year Certification Agreement with the Ministry of Education. And, to renew certification, the applicant needs to pass an annual on-site inspection.

We believe the stringent process in B.C. certification will create a barrier to the potential applicants, protecting the advantages of the existing offshore school operators – Maple Leaf Education.

According to BCMOE, 13 out of 38 offshore schools in China are under Maple Leaf Education, accounted for one-third of the total schools.

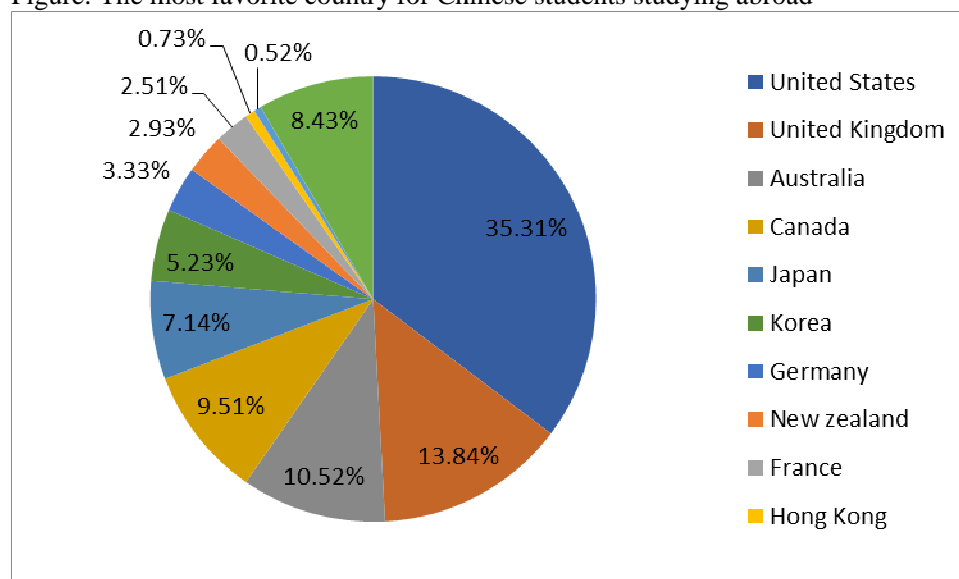
Figure: Number of B.C. certified offshore schools in China

School operators in China	Number
<b>China Maple Leaf Educational Systems Ltd.</b>	<b>13</b>
Beijing Kezhi Times International Consulting Co. Ltd.	6
Canadian-Sino Education Exchange Centre	4
CINEC Education Group Ltd.	4
Beijing Sino Bright Education Co. Ltd.	2
Nanning Gaojie Education Consultant Co. Ltd.	1
Grand Canadian Academy (Asia) Ltd.	1
Heilongjiang Zhongshi Group Ltd.	1
Canada Horizon International Education Inc.	1
MeiLun International Centre	1
Nanjing Foreign Language School	1
Xiehe Education Group	1
Feng Hua Investment Group Inc.	1
Ge Cui Bing Suzhou Industrial Park Oriental Education Investment Co. Ltd	1
<b>Total</b>	<b>38</b>

Source: BCMOE, Phillip Securities (HK) Research

With BC high school diploma, the graduates could pave their way to top-tier universities, particularly universities in Canada. As BC high school diploma is a diploma certified by Canada, the graduates are easier to admit to universities in Canada than other certifications, such as IB, AP, or A-level. According to the research from JIL Oversea Education, Canada ranked 4<sup>th</sup> in the most favorite country for Chinese students studying abroad, accounted for 9.51%, just behind United States, United Kingdom, and Australia. We believe the B.C. certified offshore schools of the group will be attractive choices for students targeting to study abroad in Canada.

Figure: The most favorite country for Chinese students studying abroad



Source: JIL Oversea Education, Phillip Securities (HK) Research

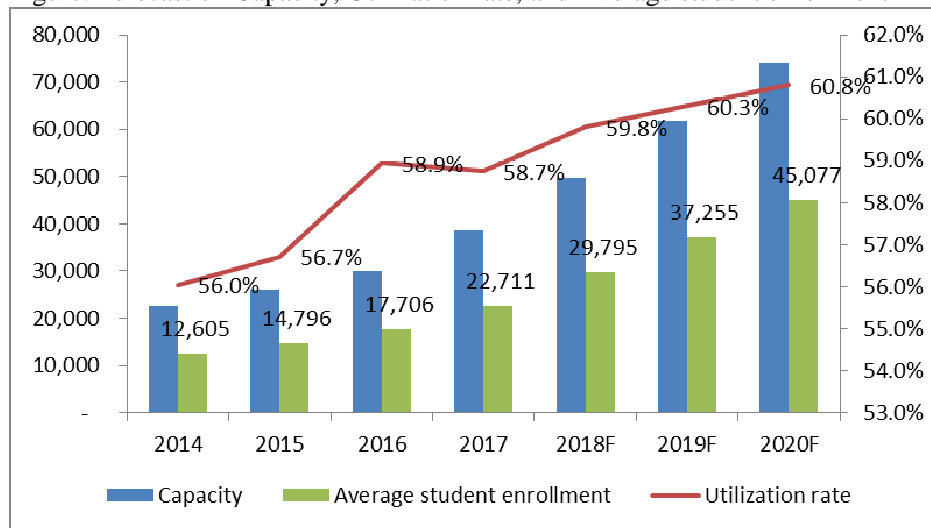
### Excellent record in graduates

Based on Maple Leaf Global Top 100 University Guide compiled by the group (comprises of Top 30 National Universities by US News, Top 10 Liberal Arts Colleges by US News, Top 20 UK Universities by Times Higher Education, Top 10 Medical/Doctoral Universities by Maclean's, Top 10 Comprehensive Universities by Maclean's, Top 10 Australian Universities by QS, and Top 10 SHIN Universities by QS), 56% out of 1,807 graduates received offers from one of the Maple Leaf Global Top 100 universities, and 46 of whom even received offers from top 10 universities in the world, including Imperial College of London and University College of London for the year ended 31 August 2017. The excellent record in graduates reflected the education quality of the group, which will serve as a strong competitive advantage.

### Earnings forecast

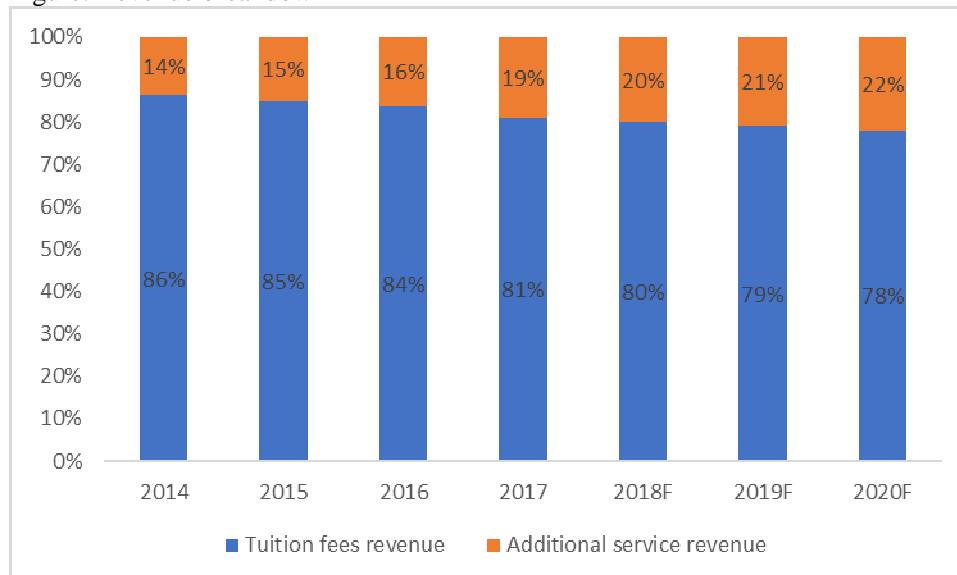
We expect the growth in capacity will remain strong, yet decline in the next three years, with 28.9%/24%/20% for FY18-20E by PPP, M&A, or Self-establishment. Meanwhile, the utilization rate is expected to climb from 58.7 in 2017 to 60.8% in 2020E. We do not have an aggressive estimation on it because of the robust growth in capacity. The average number of students will climb from 22,711 in 2017 to 45,077 in 2020F. Besides, as the group will continue exploring additional services to student, we expect the proportion revenue from additional services will rise from 19% in 2017 to 22% in 2020F. The average tuition fee per students is also expected to hike by 1%/1.5%/2.5% in 2018F-20F in order to reflect the increase in tuition fee starting in Sep 2018. Therefore, we project the growth in revenue will be 34.2%/28.5%/25.6% in 2018F-20F respectively.

Figure: Forecast on Capacity, Utilization rate, and Average student enrollment



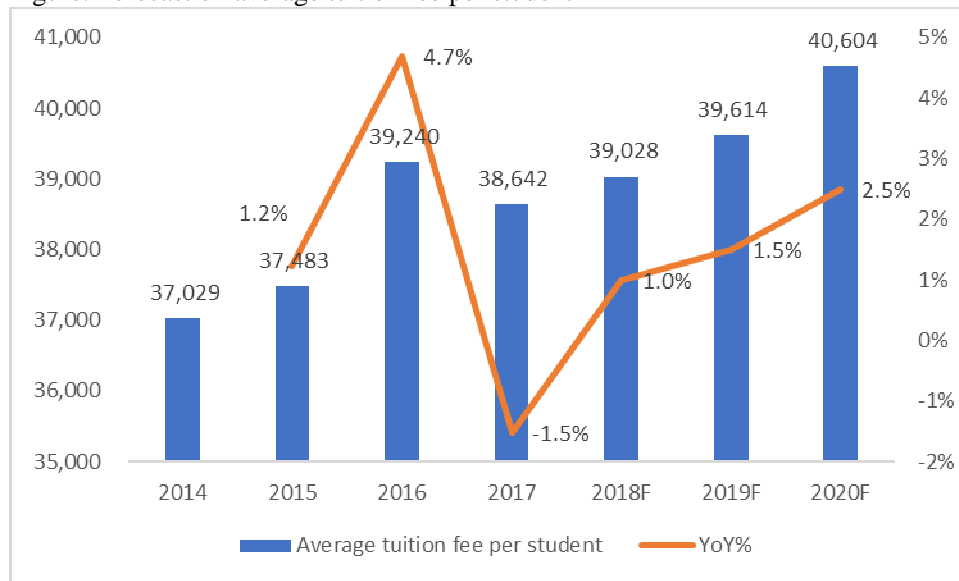
Source: Phillip Securities (HK) Research

Figure: Revenue breakdown



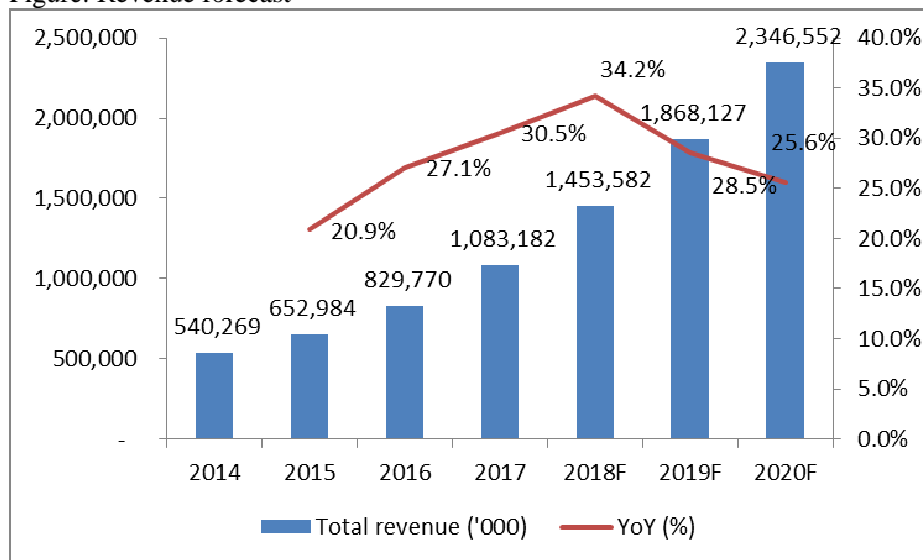
Source: Phillip Securities (HK) Research

Figure: Forecast on average tuition fee per student



Source: Phillip Securities (HK) Research

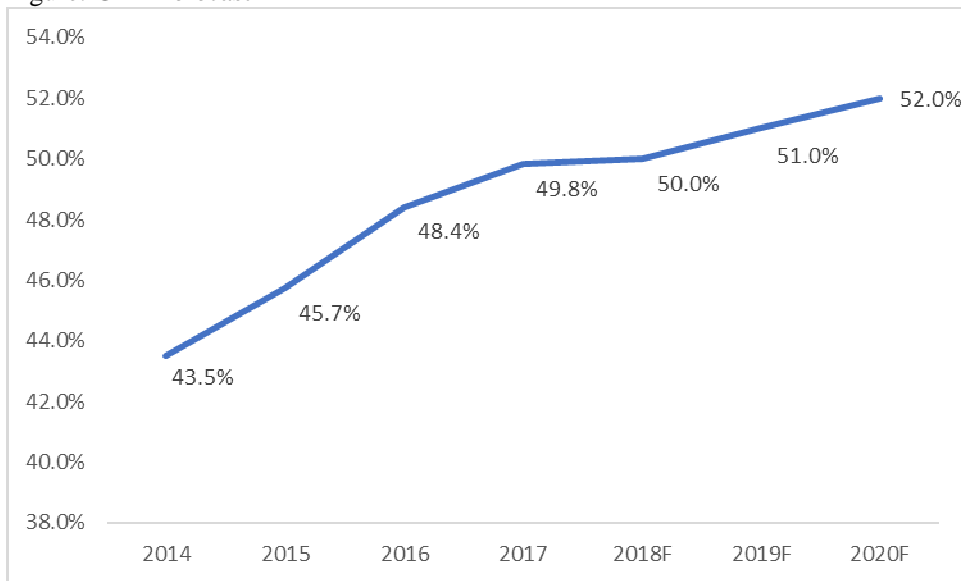
Figure: Revenue forecast



Source: Phillip Securities (HK) Research

As the tuition fee hikes, we expect the GPM will increase from 49.8% in 2017 to 52% in 2020F.

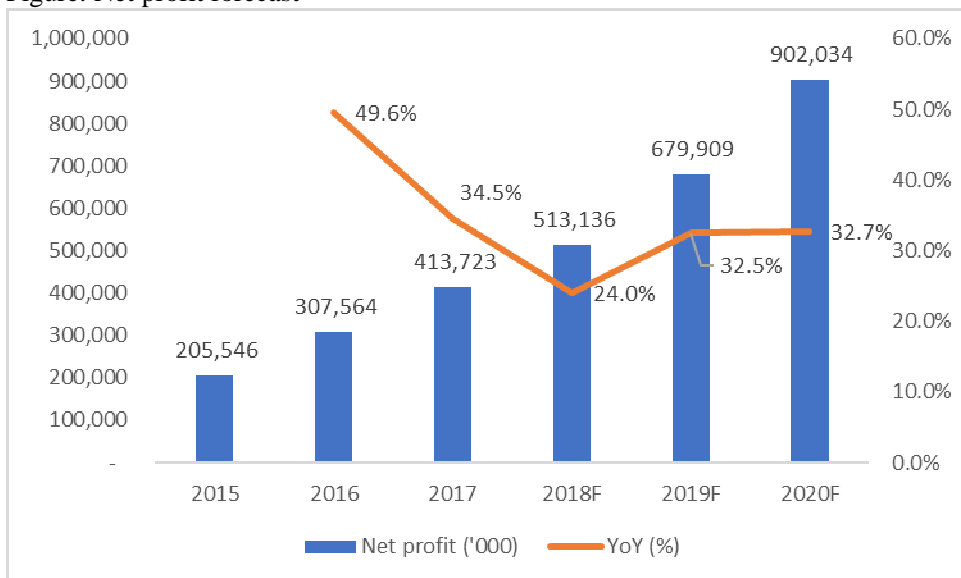
Figure: GPM forecast



Source: Phillip Securities (HK) Research

We predict the growth to be 24%/31.1%/28.7% in 2018F-20F, thanks to the increasing GPM, and student enrollments.

Figure: Net profit forecast



Source: Phillip Securities (HK) Research

## Valuation

Thanks to the rise of middle class in China, its light asset development model and unique dual-diploma curriculum, we believe Maple Leaf will be one of the most promising players in the China education sector. Thus, we initiate an “accumulate” rating on Maple Leaf, and a target price of HK\$15.68 based on earnings in 19F assuming 1x PEG (30% CAGR on earnings for FY18E-20E), with 9.7% potential upside. (CNY/HKD = 1.17)

## Risk

1. VIE structure prohibited in China
2. New acquired schools were not able to add value

## Financials

FYE AUG	FY14	FY15	FY16	FY17	FY18F	FY19F
<b>Valuation Ratios</b>						
P/E (X), adj	240.07	80.91	54.11	41.10	35.85	27.32
P/B (X)	20.57	9.18	8.23	6.95	5.17	4.68
Dividend Yield (%)	N/A	0.7%	0.7%	1.0%	1.3%	1.6%
<b>Per share data (RMB)</b>						
EPS, (Basic)	0.051	0.151	0.226	0.298	0.341	0.448
EPS, (Diluted)	0.051	0.151	0.226	0.298	0.341	0.448
DPS (HKD)	0	0.095	0.1	0.146	0.180	0.236
BVPS	0.59	1.33	1.49	1.76	2.36	2.61
<b>Growth &amp; Margins (%)</b>						
<b>Grwoth</b>						
Revenue	14.7%	20.9%	27.1%	30.5%	34.2%	28.5%
EBIT	12.6%	245.7%	47.5%	37.7%	24.0%	30.5%
Net Income	20.7%	413.4%	49.6%	34.5%	24.1%	31.2%
<b>Margins</b>						
Gross margin	43.5%	45.7%	48.4%	49.8%	50.0%	51.0%
EBIT margin	11.8%	33.8%	39.3%	41.4%	38.3%	38.9%
Net Profit Margin	7.4%	31.5%	37.1%	38.2%	35.3%	36.1%
<b>Key Ratios</b>						
ROE	9.0%	18.0%	16.0%	18.4%	17.1%	18.0%
ROA	2.1%	8.5%	10.2%	10.8%	9.9%	10.6%
<b>Income statement (RMB mn)</b>						
Revenue	540	653	830	1083	1454	1868
Gross Profit	235	299	402	540	727	953
EBIT	64	221	326	449	556	726
EBT	48	217	326	441	546	717
Net profit	40	206	308	414	513	674
Minority Interest	0	0	0	3	5	7
Net profit for owners	40	206	308	410	508	667

Source: Company, Wind, Phillip Securities (HK) Research

Exchange rate (0.8553) is HKDCNY1Y forward contract price on July 3 from Wind.

(Financial figures as at 3 July 2018)

### PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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