

Wisdom Education (6068.HK)

Benefited from Greater Bay Area, Positive on Private education in Guangdong

Hong Kong | Education | Company Report

18 July 2018

Investment Summary

Wisdom education mainly provides private premium education, including elementary, middle, high schools and international programmes in South China in Dongguan, Huizhou, Panjin, Weifang and Jieyang respectively. Thanks to the robust growth in Guangdong's economy, the future development of Greater Bay Area and its high quality of education, we believe Wisdom will become the fastest growth K12 operators in the China education sector. Thus, we initiate an "Accumulate" rating on Wisdom, and a target price of HK\$7.81 based on earnings in 19F assuming 1x PEG (35% CAGR on earnings for FY18E-20E), with 13.2% potential upside. (Closing price at 16 Jul 2018)

Company Background

Founded in 2003, Wisdom is operating 7 schools in Dongguan, Huizhou, Jieyang, Weifang, and Panjin and providing private premium education for PRC curriculum programmes, including elementary, middle, high schools. Besides domestic curriculum, Wisdom also provides international programmes for high school students. It offers a wide-range of courses for students, such as sports, art, music and Chinese culture, in order to facilitate the well-rounded development of students.

1) Dongguan Guangming Secondary School

Established in 2003, the school is located Dongguan and offers both PRC curriculum programmes and international programmes. As of 1 Sep 2017, it had 10,507 students for middle and high school sections. The school's total developed site area was approximately 137,645.2 sq.m., and is located on the same campus site as Dongguan Guangming Primary School.

2) Dongguan Guangming Primary School

Established in 2004, the school is located Dongguan and only offers primary school education. As of 1 Sep 2017, it had 5,970 students. The school provides spoken English courses to all students in order to encourage students' proficiency in English. The school's total developed site area was approximately 24,192.0 sq.m., and is located on the same campus site as Dongguan Guangming School.

3) Dongguan Guangzheng Preparatory School

The school was called "H.S. Kama International School" previously, and changed to current name after acquisition in 2013. It is located Dongguan and offers both PRC curriculum programmes and international programmes. 10,620 students enrolled for primary, middle and high school sections as of 1 Sep 2017. The total developed site area of the school is developed is approximately 193,265.3 sq.m..

Accumulate (Initially)

CMP HKD 6.90

(Closing price at 16 Jul 2018)

TARGET HKD 7.81 (+13.2%)

COMPANY DATA

O/S SHARES (MN) :	2,043
MARKET CAP (HKDMN) :	14,096
52 - WK HI/LO (HKD):	7.50 / 2.72

SHARE HOLDING PATTERN , %

Mr. LIU Xuebin	45.61
Ms. LI Suwen	27.95

PRICE PERFORMANCE , %

	1M	3M	1Y
Wisdom Education	-0.43	15.00	140.00
HSI	-5.84	-5.86	8.15

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY16	FY17	FY18E	FY19E
Revenue	701	979	1253	1588
Net Profit	154	200	307	399
EPS, RMB	0.103	0.110	0.148	0.192
PER, x	57.58	53.83	40.17	30.92
BVPS, HKD	0.55	0.96	0.94	1.06
P/BV, x	10.70	6.17	6.28	5.60
ROE, %	20.5	15.5	16.4	19.2

Source: Company reports, Phillip Securities Est.

Research Analyst

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4) Huizhou Guangzheng Preparatory School

Established in 2014, the school is located in Huizhou and provides primary, middle and secondary school education. The school had 6,011 students for primary, middle and high school sections as of 1 Sep 2017. The total developed site area of the school was approximately 64,321.1 sq.m..

5) Panjin Guangzheng Preparatory School

Commenced in 2014, the school is located in Panjin and provides primary, middle and secondary school education. As of 1 September 2017, the school had a total student enrolment of 2,170 for primary, middle and high school sections. The total developed site area of the school is approximately 206,340.7 sq.m., and has a spacious football court on campus, offering football classes to students as football is a popular sport in Liaoning province.

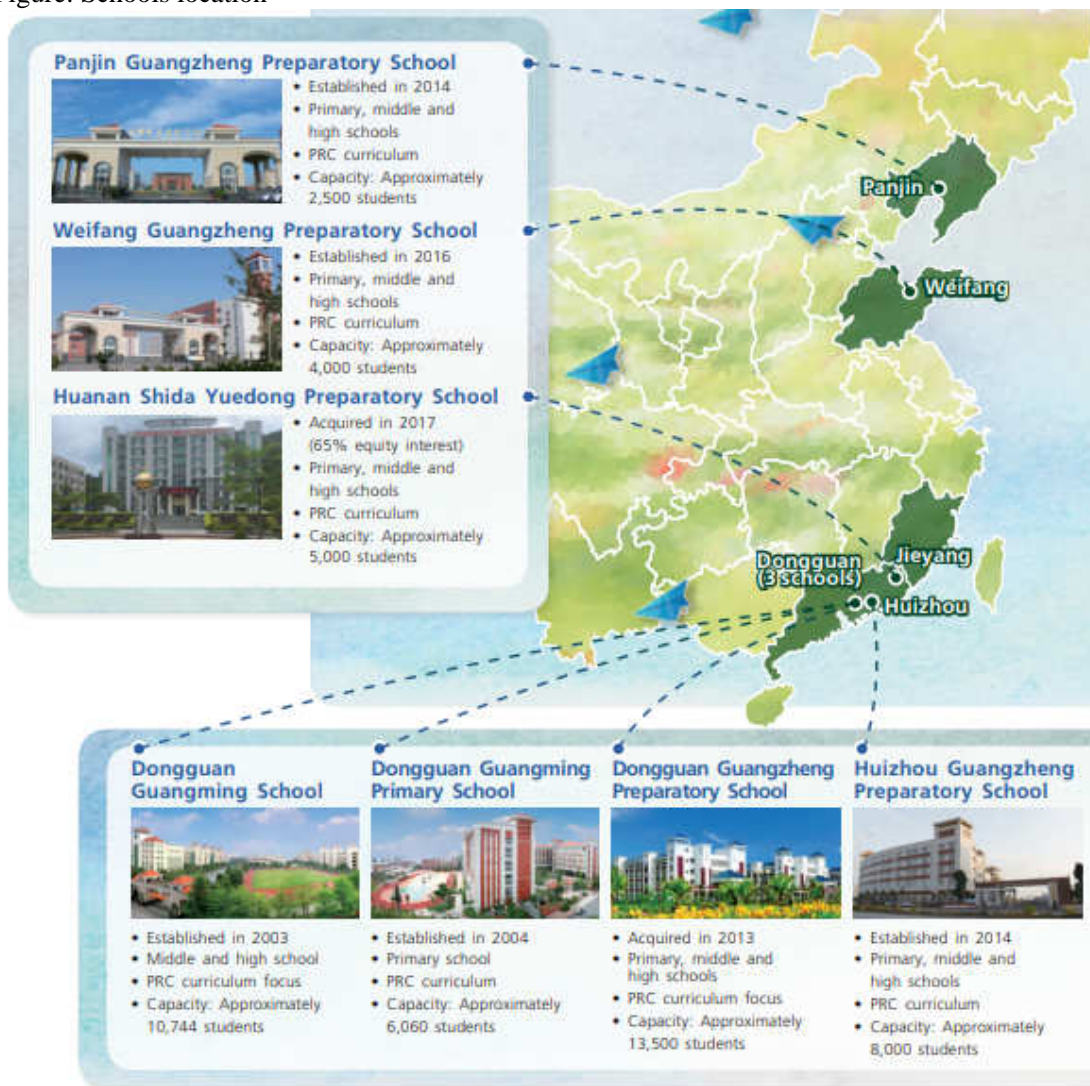
6) Weifang Guangzheng Preparatory School

Started operating in 2016, the school is located Weifang with primary, middle and secondary school education. As of 1 September 2017, the school had a total student enrolment of 1,401, together with approximately 104,758 sq.m. of developed site area.

7) Huanan Shida Yuedong Preparatory School (Jieyang School)

The school is located in Jieyang, and acquired 65% equity interest by Wisdom in September 2017. It offers primary, middle and secondary education. As of 1 September 2017, the school had a total student enrolment of 4,501 for primary, middle and high school sections.

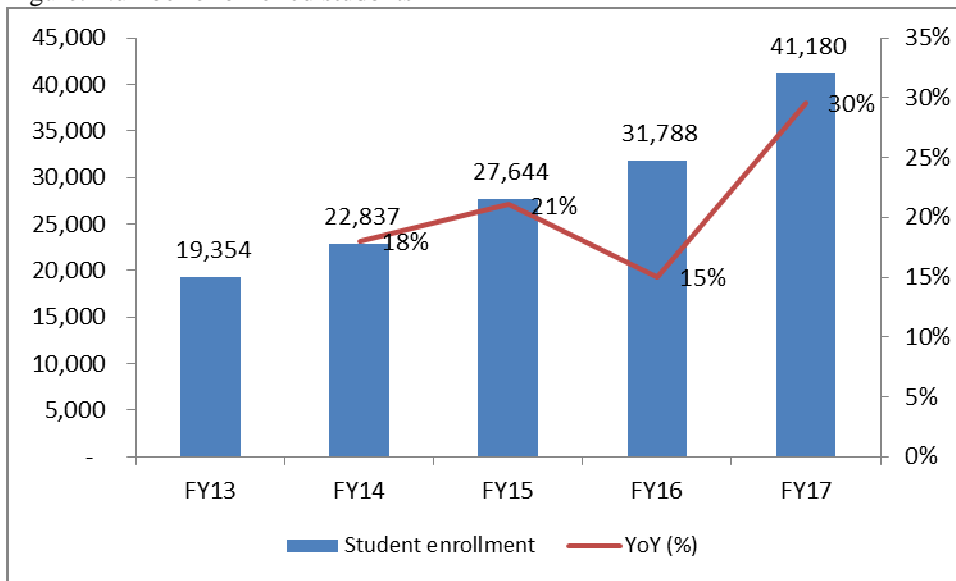
Figure: Schools location



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

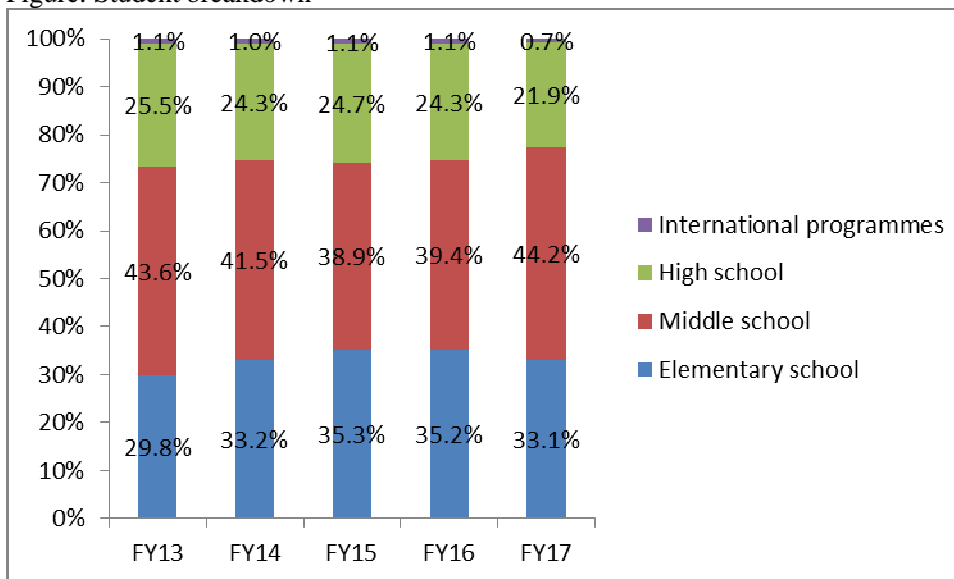
The student enrollment as of 1 Sep climbed from 19,354 in 2013 to 41,180 in FY17, with a CAGR of 21% YoY. The proportion of the middle school students remains the largest section, around 40% during FY13-17, demonstrating the importance of middle schools section to Wisdom. The utilization rate dropped significantly to 82.7% in FY17 due to the increase in capacity for Dongguan Guangzheng, Huizhou, Panjin and Weifang schools. Meanwhile, the number of teacher was 2,580 as of 1 Sep 2017, and the teacher-student ratio remains around 1:16, indicating Wisdom has retained the ratio in order to provide high quality education. For the 2016/2017 school year, approximately 90% of Wisdom's primary school graduates were admitted to its middle schools together with approximately 60% of middle school graduates to its high schools.

Figure: Number of enrolled students



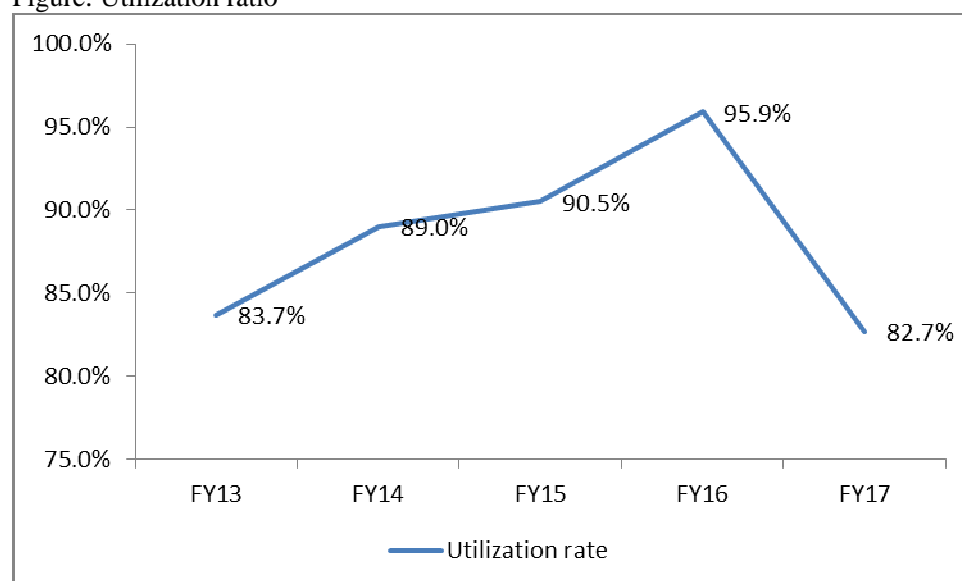
Source: Company report, Phillip Securities (HK) Ltd.

Figure: Student breakdown



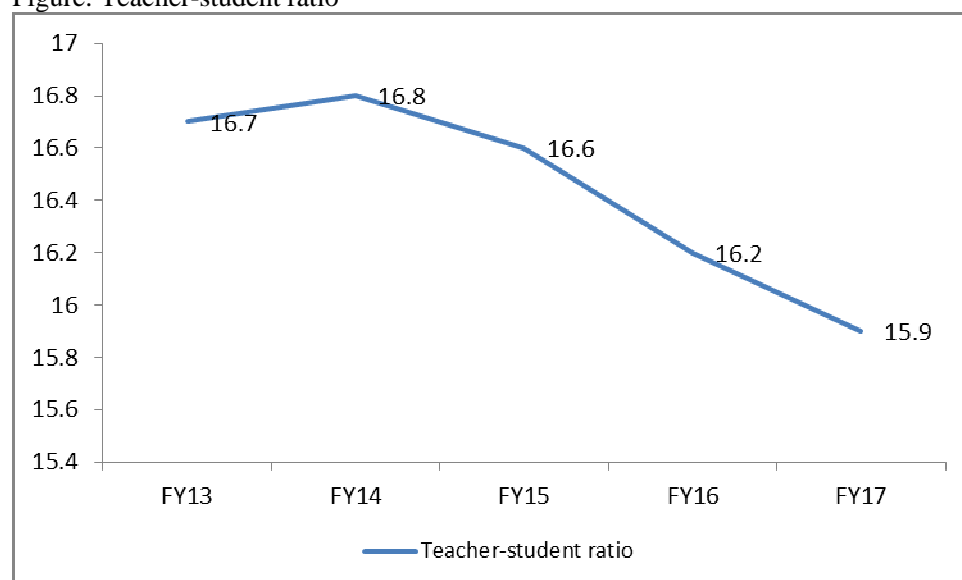
Source: Company report, Phillip Securities (HK) Ltd.

Figure: Utilization ratio



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

Figure: Teacher-student ratio



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

The overall average tuition and boarding fees per students (ARPU) has increased by 6.1% to \$21,114 RMB. All schools of Wisdom have raised its tuition fee in 2017, and Dongguan Guangming School had the largest increase among the schools, about 11.7%. Apart from tuition and boarding fees, the revenue from ancillary services hiked substantially to 308 million RMB in FY 17, 104.5% growth YoY, and its proportion of total revenue increased from 22% FY14 to 31.5% in FY 17, as Wisdom is eager to explore new source of revenue, and enhances the its service level to their students in the same time.

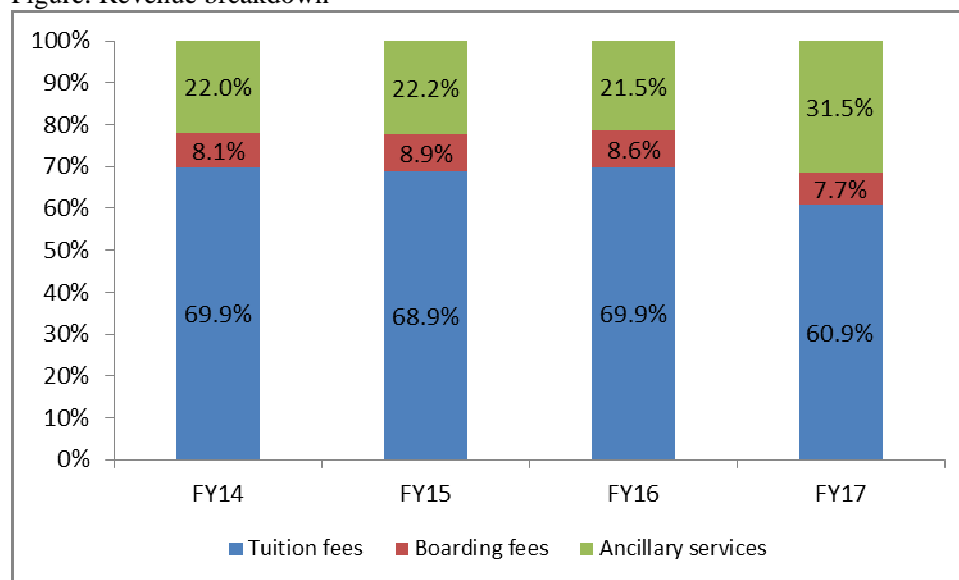
Figure: Average tuition and boarding fees per student

	FY16	FY17
Dongguan Guangming School	20,909	23,348
Dongguan Guangming Primary School	19,402	20,153
Dongguan Guangzheng Preparatory School	20,030	21,809
Huizhou Guangzheng Preparatory School	18,847	19,261

Panjin Guangzheng Preparatory School	13,983	14,293
Weifang Guangzheng Preparatory School	-	12,769
Overall	19,900	21,114

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

Figure: Revenue breakdown



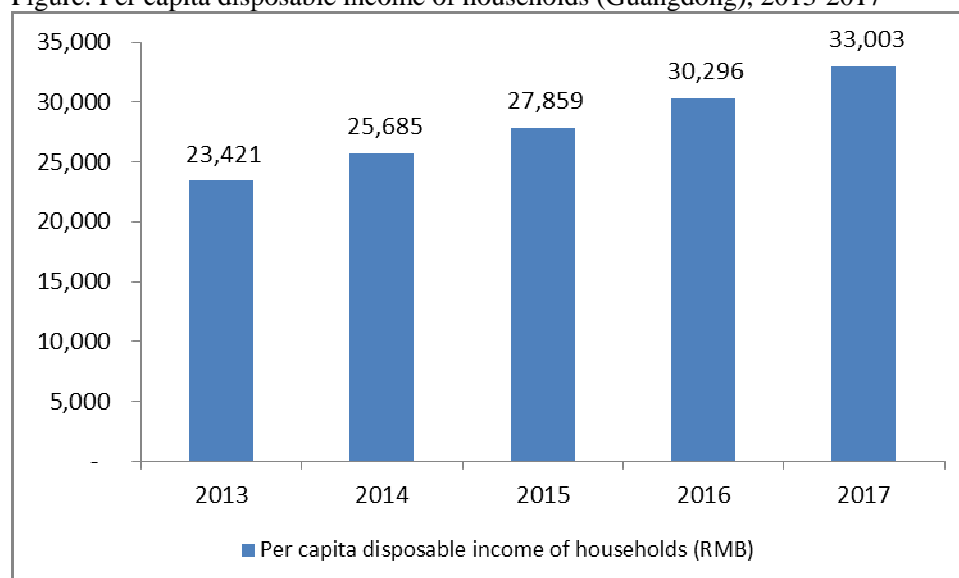
Source: Company report, Phillip Securities (HK) Ltd.

Industry Overview

Expanding market size of the private fundamental education in Guangdong thanks to economic development and rebounding birth rate

Due to the robust economic growth in Guangdong, the per capita disposable income of households has raised from \$23,421 RMB in 2013 to \$33,003 RMB in 2017, a CAGR of 9% during 2013-17. As the residents in Guangdong become wealthier, the parents may be more capable of sending their child to private schools that could provide higher quality education than public.

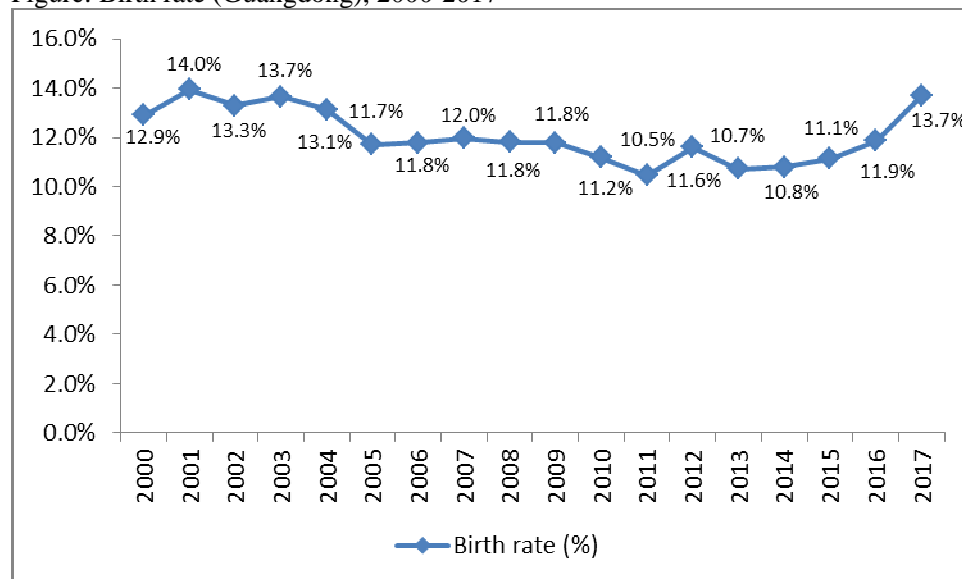
Figure: Per capita disposable income of households (Guangdong), 2013-2017



Source: National Bureau of Statistics of China, Phillip Securities (HK) Ltd.

In 2016, the government replaced the One-child policy with Two-child policy. The birth rate in Guangdong increased hugely to 13.7% in 2017, higher than the past 13 years. And, the birth population was 1.51 million, increased by 0.22 million YoY. Although the birth rate in China dropped in 2017 instead, we are positive to the future birth rate in Guangdong because the households in Guangdong generally have better resource to raise more than a child than other less developed provinces. We expect many parents in Guangdong are more than willing to have more than a child once they are permitted by law.

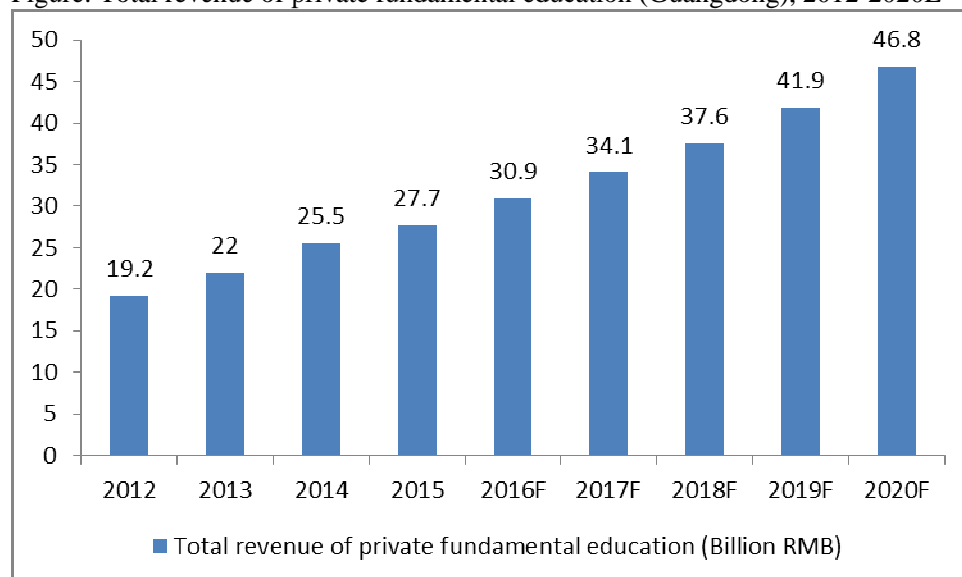
Figure: Birth rate (Guangdong), 2000-2017



Source: National Bureau of Statistics of China, Phillip Securities (HK) Ltd.

Thanks to economic development and rebounding birth rate in Guangdong, we expected the market size of private education in Guangdong will be expanding. According to Frost & Sullivan, it is estimated the total revenue of private fundamental education in Guangdong will reach 46.8 billion RMB in 2020, with a CAGR of 10.9% during 2016-20F. Private education operators will surely be benefited from this trend.

Figure: Total revenue of private fundamental education (Guangdong), 2012-2020E

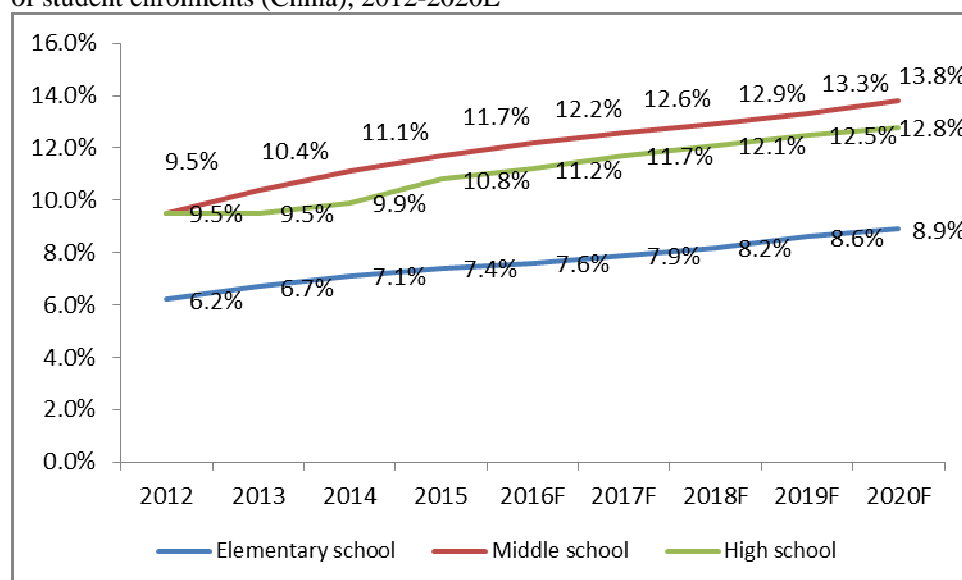


Source: Frost & Sullivan, Phillip Securities (HK) Ltd.

The rising private school penetration in primary and secondary education

Private school has played a more important part in the education sector. According to Frost & Sullivan, the penetration rate of elementary, middle, and high school has kept increasing during 2012-15. It is expected the rate will reach 8.9%/13.8%/12.8% for elementary/middle/high schools respectively in 2020F. The proliferation of private schools can be attributed to its higher quality of education than public schools. Private schools usually had a greater motivation for improvements, as they are motivated to react towards the market and provide high quality teaching in order to charge higher tuition fees; while the actions of public schools are usually guided by government. Besides, private schools could adjust and diversify its curriculum to provide a broader and flexible curriculum, attracting high quality students, but public schools is limited due to the requirements of governmental departments.

Figure: Private schools penetration in primary and secondary education by number of student enrolments (China), 2012-2020E



Source: Frost & Sullivan, Phillip Securities (HK) Ltd.

Entry barrier

Lengthy and complex regulatory approvals from government

In order to establish a private school in China, the operators need to comply with the Education Law of the PRC, the Law for Promoting Private Education and the Implementation Rules for the Law of Promoting Private Education of the PRC, which is considered to be lengthy and complex, creating an entry barrier to the potential operators.

High capital requirement

The establishment of private schools requires high initial capital expenditure in both land use right and campus. The on-going investment is also needed, for example renovation or facilities upgrade, thereby posing an entry barrier to new operators.

Availability of land

Sufficient area of land is crucial for school establishment and development, as the area directly affect the class size and the quality of education. The difficulty of

acquiring land has been manifested across developed cities due to the skyrocketed price of land. Thus, it could form an entry barrier for the existing school operators.

Prohibition for foreign investors

According to Foreign Investment Industries Guidance Catalog (Amended in 2015), foreign investors are prohibited from investing primary and middle school. They are only allowed to invest in preschool, high school, and high education by cooperating with domestic parties, where domestic parties should play the dominant role. The prohibition for foreign investors could reduce the competition from oversea, protecting the existing operators in the industry.

Long term growth drivers

Locating in top cities in Guangdong, benefited from Guangdong-Hong Kong-Macao Greater Bay Area

Guangdong-Hong Kong-Macao Greater Bay Area is a plan for the development of a city cluster in the Guangdong, including Hong Kong, Macau, Guangzhou, Shenzhen, Zhuhai, Foshan, Zhongshan, Dongguan, Zhaoqing, Huizhou and Jiangmen. The Greater Bay Area has become one of the key development strategies for China and will lead to the inflow of labors with strong competitiveness to Guangdong. We believe the demand for private premium education can be boosted by both the economic development and the inflow of talents.

Currently, 4 out of 7 schools are located in the Greater Bay Area, which are Dongguan Guangming Secondary, Dongguan Guangming Primary, Dongguan Guangzheng and Huizhou Guangzheng. And, Wisdom confirmed to establish a school in Jiangmen, but yet to disclose the expected year of opening. Besides, Wisdom's schools in Jieyang, Chaozhou, and Yunfu are nearby the Greater Bay Area, so it should be benefited even if those schools are not exactly located in the Greater Bay Area. The mgt confirmed they will focus on Guangdong, in order to seize this opportunity in the Greater Bay Area.

Brand effect spilling out with replicating operation model

Dongguan Guangming Secondary and Primary School is currently one of the top schools in Guangdong. In 2017/2018, almost 20,000 students applied for the 900 primary one places, demonstrating a high recognition from parents. We believe the brand effect of Wisdom in Guangming could be spilled out if its operation model can be replicated to schools in other cities. In order to do this, Wisdom sends its mgt staff from old schools to new one, implementing its operation models in new schools. Besides, it standardizes teacher recruitment criteria to ensure the education quality for their schools. In 2017 PRC national higher education entrance examination, 4 out of 10 students admitted to Tsinghua University were from schools other than Dongguan Guangming Schools (3 for Huizhou Guangzheng and 1 for Dongguan Guangzheng), indicating the success in Dongguan Guangming school was gradually shown in other schools.

Excellent graduation track record

Parents pay expensive tuition fee for high quality of education, so we believe the quality of education is one of the crucial competitive edges for private education operators. For past four schools years (2013/14, 2014/15, 2015/16 and 2016/17), over 90% of Wisdom's high school graduates were admitted to universities in China. In 2016/17, around 25% of its graduates were admitted to first-tier

universities in China identified in the “University Application and Enrolment Guidelines for Guangdong Province” issued by the Education Examinations Authority of Guangdong Province. Besides, Wisdom’s graduates also accomplish remarkable achievements. In both 2016 & 2017 PRC national higher education entrance examination, 10 graduates were admitted to Peking University and Tsinghua University. Moreover, one of its high school graduates was ranked in the top 10 and one was ranked in the top 20 in Guangdong province in terms of the total exam scores achieved in 2016. Wisdom’s excellent graduation track record indicates its high quality of education, which differentiates Wisdom from other private education operators.

Sufficient capacity for upcoming demand

Except Dongguan Guangming Secondary and Primary School, Wisdom’s schools all have sufficient land to expand in order to cope with the upcoming demand. Although Dongguan Guangming Secondary and Primary School has no extra land for expansion, Wisdom has purchased a campus that is near Dongguan Guangming to serve as its additional campus, which is expected to increase the capacity by 1,000. The target total capacity (in case all the land has been developed) is 112,928, while the existing students as of 1 Sep 2017 is 41,180, referring the utilization rate is only 37%. It indicates that even if there is no new greenfield schools or acquisitions, Wisdom still has sufficient capacity to deal with the upcoming demand.

Figure: Target total capacity vs Existing students as of 1 Sep 2017

School	Existing students as of 1 Sep 2017	Target total capacity
Existing Schools		
Dongguan Guangming Secondary and Primary School	16,477	17,804
Dongguan Guangzheng Preparatory School	10,620	18,000
Huizhou Guangzheng Preparatory School	6,011	9,464
Panjin Guangzheng Preparatory School	2,170	6,200
Weifang Guangzheng Preparatory School	1,401	8,000
Jieyang School	4,501	18,000
Greenfield Schools Under Construction		
Yunfu Guangzheng Preparatory School	N/A	10,680
Guang’an Guangzheng Preparatory School	N/A	9,280
Proposed New Schools Under Planning		
Chaozhou	N/A	8,000
Jiangmen	N/A	7,500
Total	41,180	112,928

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

Increasing proportion on Ancillary services

As all Wisdom’s schools are boarding school, students must stay on the campus for long period. Wisdom provides as many ancillary services as possible, such as Supermarket, School bus, School uniform purchase, or Study tour, so that it can create new source of revenue other than tuition and boarding fees. With the rise of student enrollment, the revenue of ancillary services should climb correspondingly. The mgt predicts that the proportion of ancillary services to total revenue could reach 40% ultimately.

Earnings forecast

We forecast the students enrollment to be 51,932/58,731 in FY18/19, with 20.1%/13.1% YoY.

Figure: Student enrollment forecast

Student enrollment	2018/9F	2019/9F
Dongguan Guangming Secondary and Primary School	17,630	17,630
Dongguan Guangzheng Preparatory School	12,213	13,923
Huizhou Guangzheng Preparatory School	7,814	9,377
Panjin Guangzheng Preparatory School	2,713	3,255
Weifang Guangzheng Preparatory School	2,242	2,466
Weifang Weizhou Foreign Language School	2,194	2,347
Jieyang School	5,626	6,020
Yunfu Guangzheng Preparatory School	750	1,125
Guang'an Guangzheng Preparatory School	750	1,088
Chaozhou School	-	750
Jiangmen School	-	750
Total	51,932	58,731
YoY (%)	20.1%	13.1%
Student enrollment (YoY%/Number)	2018/9F	2019/9F
Dongguan Guangming Secondary and Primary School	7.0%	0.0%
Dongguan Guangzheng Preparatory School	15.0%	14.0%
Huizhou Guangzheng Preparatory School	30.0%	20.0%
Panjin Guangzheng Preparatory School	25.0%	20.0%
Weifang Guangzheng Preparatory School	60.0%	10.0%
Weifang Weizhou Foreign Language School	7.0%	7.0%
Jieyang School	25.0%	25.0%
Yunfu Guangzheng Preparatory School	750	50.0%
Guang'an Guangzheng Preparatory School	750	45.0%
Chaozhou School	0	750
Jiangmen School	0	750

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

We expect the ARPU will rise around 5%, as Wisdom confirmed they will raise the tuition fee in school year 18/19, which will reflect in financial year of 2019.

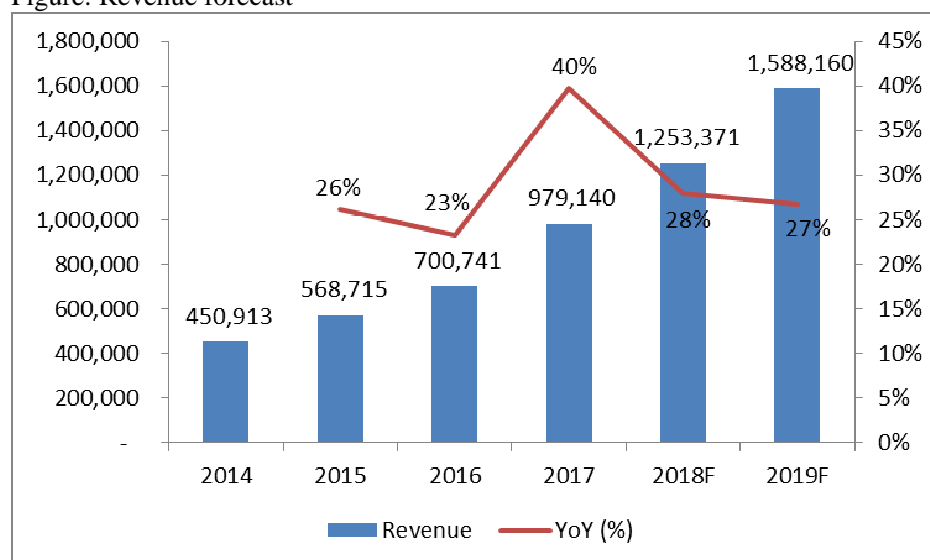
Figure: ARPU forecast

Average revenue per student	2018F	2019F
Dongguan Guangming Secondary and Primary School	22,077	23,181
Dongguan Guangzheng Preparatory School	22,136	23,243
Huizhou Guangzheng Preparatory School	19,550	20,527
Panjin Guangzheng Preparatory School	14,507	15,233
Weifang Guangzheng Preparatory School	12,961	13,609
Weifang Weizhou Foreign Language School	13,000	13,650
Jieyang School	10,467	10,990
Yunfu Guangzheng Preparatory School	10,000	10,500
Guang'an Guangzheng Preparatory School	10,000	10,500
Chaozhou School	-	10,000
Jiangmen School	-	10,000
Average	14,966	14,676

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

We projected the revenue to be 1.25/1.59 billion RMB, with the growth of 28%/27% in 2018/19F.

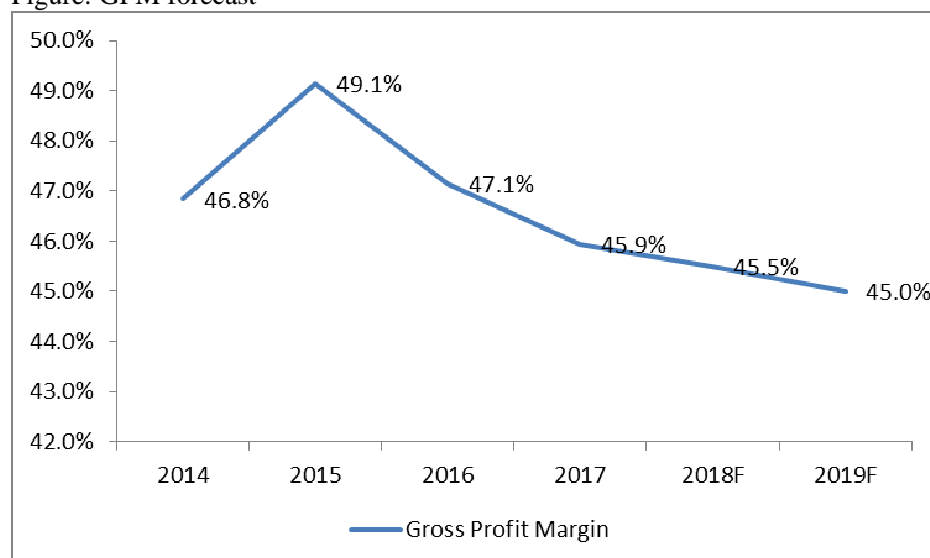
Figure: Revenue forecast



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

Since the GPM of ancillary services is lower than tuition, as we expected the GPM to drop to 45.5%/45% with the increasing proportion of ancillary services.

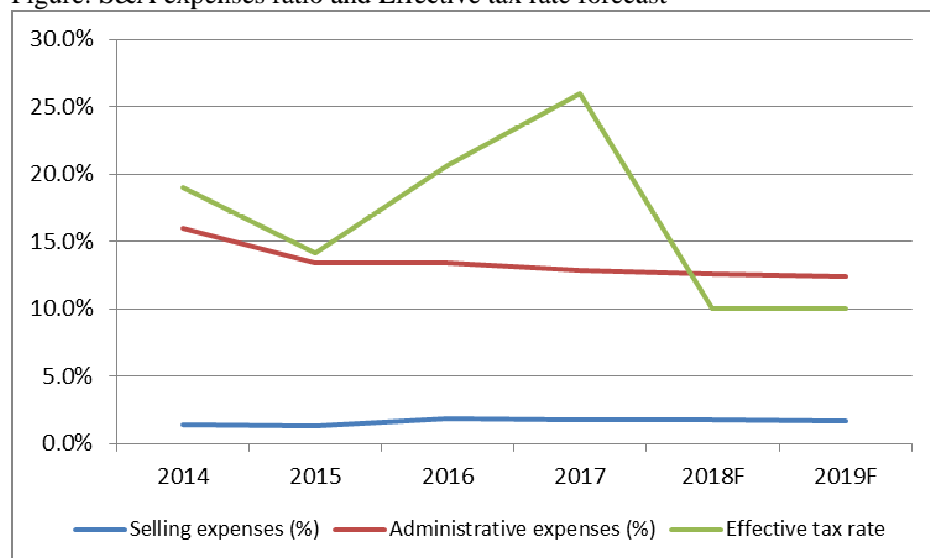
Figure: GPM forecast



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

Thanks to the operating leverage, we expect the selling expenses ratio to be 1.6%/1.5% in 2018/19F; while the administrative expenses ratio to be 12.6%/12.4% in 2018/19F. Wisdom has categorized its schools to be not-for-profit, so we predicted the effective tax rate to be 10% in both 2018/19F.

Figure: S&A expenses ratio and Effective tax rate forecast



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

Valuation

Thanks to the robust growth in Guangdong's economy, the future development of Greater Bay Area and its high quality of education, we believe Wisdom will become the fastest growth K12 operators in the China education sector. Thus, we initiate an "Accumulate" rating on Wisdom, and a target price of HK\$7.81 based on earnings in 19F assuming 1x PEG (35% CAGR on earnings for FY18E-20E), with 13.2% potential upside. (CNY/HKD = 1.16)

Risk

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

Financials

FYE AUG	FY15	FY16	FY17	FY18F	FY19F
Valuation Ratios					
P/E (X), adj	48.76	57.58	53.83	40.17	30.92
P/B (X)	13.16	10.70	6.17	6.28	5.60
Dividend Yield (%)	N/A	N/A	0.8%	1.0%	1.3%
Per share data (RMB)					
EPS, (Basic)	0.122	0.103	0.110	0.148	0.192
EPS, (Diluted)	0.122	0.103	0.110	0.147	0.191
DPS	0	0	0.05	0.059	0.077
BVPS	0.45	0.55	0.96	0.94	1.06
Growth & Margins (%)					
Grwoth					
Revenue	26.1%	23.2%	39.7%	28.0%	26.7%
EBIT	44.0%	-0.7%	40.7%	43.4%	25.3%
Net Income	100.5%	-15.3%	29.7%	53.6%	29.9%
Margins					
Gross margin	49.1%	47.1%	45.9%	45.5%	45.0%
EBIT margin	35.4%	28.6%	28.8%	32.2%	31.9%
Net Profit Margin	32.1%	22.0%	20.4%	24.5%	25.2%
Key Ratios					
ROE	30.7%	20.5%	15.5%	16.4%	19.2%
Income statement (RMB mn)					
Revenue	569	701	979	1,253	1,588
Gross Profit	280	330	450	570	715
EBIT	201	200	282	404	506
EBT	212	195	270	342	444
Net profit	182	154	200	307	399
Minority Interest	(0)	(0)	(0)	6	8
Net profit for owners	182	154	200	301	391

Source: Company, Phillip Securities (HK) Research

Exchange rate (0.8588) is HKDCNY1Y forward contract price on July 16 from Wind.

(Financial figures as at 16 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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