

China Maple Leaf Education Limited (1317.HK)

Fair annual results along with larger policy risks

Hong Kong | Education | Company Report

11 December 2018

Investment Summary

China Maple Leaf Education Systems Limited is a leading international school operator, from preschool to grade 12 education (K-12) in China. In view of the recent policies, we believe the business risks in compulsory education and kindergarten will be very large. As a result, we downgrade Maple Leaf from "Accumulate" to "Neutral", with a target price of HK\$ 3.38, 0.8% potential upside. (Closing price at 7 December 2018)

Annual Results Update

The revenue of Maple Leaf was RMB 1.34 billion, up 23.8% YoY, but 7.7% lower than our estimate, where it is because the average tuition fee per student and the additional service revenue were lower-than-expected. In the period, the proportion to tuition fees revenue of high schools, middle schools, elementary schools, preschool and foreign national schools were 48%, 17%, 28%, 5% and 2% respectively. The average school enrollments in 2018 was 29,783, rose by 31.1% YoY, in line with our estimate. By the end of September, the Group was operating 92 schools, which are 14 high schools, 23 middle schools, 24 elementary schools, 28 preschools, and 3 foreign national schools. In addition, the gross profit margin dropped from 49.8% to 46.5%, due mainly to the surge in the cost of teaching staff, and it is also 3.5% lower than our estimate. However, Maple Leaf has done well in administrative cost control. The administrative expense as of revenue decreased from 14.3% to 11.6%, 2.4% lower than our estimate. Thus, the profit before tax was in line with our expectation, about RMB 548 million, while the net profit was RMB 538 million, 4.9% higher than our estimate.

Policy risks

On 10 Aug, Ministry of Justice of the PRC announced "中華人民共和國國民辦教育促進法實施條例（修訂草案）（送審稿）", where the article 12 and 45 have the largest influence on the compulsory education.

Article 12: The enterprise of education institute may not control non-profit private schools through mergers and acquisitions, franchise chain, agreement control, etc.

There are two key points in this article. First, it limits the business development in compulsory education. As the compulsory education must be non-profitable, it means compulsory education operators are not allowed to perform any mergers, acquisitions and Franchise. Second, as to the word "agreement control", although it was not well-defined in this draft, it literally related to the VIE structure of the listed education companies. If the VIE structure is prohibited, the education institutes will not be able to distribute profits through related party transactions, where listed companies like Maple Leaf will be adversely affected.

Neutral

CMP HKD 3.35

(Closing price at 7 December 2018)

TARGET HKD 3.38 (+0.8%)

COMPANY DATA

O/S SHARES (MN) :	2,979
MARKET CAP (HKDMN) :	9,980
52 - WK HI/LO (HKD):	7.63 / 3.01

SHARE HOLDING PATTERN • %

Shu Liang Sherman Jen	50.54
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PRICE PERFORMANCE • %

	1M	3M	1Y
Maple Leaf	2.70	6.67	5.19
HSI	-0.32	-3.37	-7.91

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY17	FY18	FY19E	FY20E
Revenue	1,083	1,341	1,538	1,772
Net Profit	414	538	542	636
EPS, RMB	0.153	0.190	0.188	0.221
PER, x	19.29	15.53	15.71	13.40
BVPS, RMB	0.93	1.29	1.40	1.52
P/BV, x	3.17	2.28	2.11	1.94
ROE, %	18.4	17.9	14.1	15.3

Source: Company reports, Phillip Securities Est.

Research Analyst
Terry Li (2277 6527)
terryli@phillip.com.hk

However, there are some other interpretations in market, where they believe this article does not aim to ban the M&A, instead it prohibits a sponsor managing several schools. It hopes to reduce the risk in education operation by the practice of one sponsor one school. Besides, based on the article in "學前教育改革發展意見" promulgated on Nov 15 by State Council (Social capital shall not control kindergartens held by state-owned assets or collective assets or non-profit kindergartens through mergers and acquisitions, entrusted operations, franchise chains, use of variable interest entities, and agreement control), the word "variable interest entities" and "agreement control" are mentioned separately, implying that agreement control does not mean VIE structure.

But, we think those interpretations are too word-splitting. In fact, the keys of a policy are the stand and intention of the government. As early as 2016, when submitting the third trial of "民辦教育促進法修正案（草案）", Zhu Zhiwen, deputy minister of education, has said: "Compulsory education reflects the will of the state, the basic public service that the government must provide, and the obligation that the state must enforce. Compulsory education determines its unsuitable for-profit private schools. Otherwise it may affect the implementation of compulsory education government responsibility, affect the balanced development of compulsory education, and even increase the burden on the people." It clearly states the stand of government that compulsory education must be non-profitable. Besides that, on June 25, the Ministry of Education and other 13 departments announced the "民辦教育工作部際聯席會議2018年工作要點", which stated that it is necessary to monitor the behavior of private schools to prevent private schools from making profits in the name of non-profit. Therefore, we are more inclined to believe that the government is hoping to further regulate non-profit schools, thereby preventing private schools from making profits in the name of non-profit.

Article 45: Private schools shall disclose related party transactions. The Ministry of Education and Human resources and Social security shall strengthen the supervision of the signing of agreements between non-profit private schools and stakeholders, and the necessity, legitimacy and compliance of agreements involving major interests or long-term and repeated execution shall be conduct an audit review.

Although there has been regulation of related party transactions in the previous draft, there are further explanations for regulation in this edition. First, the information disclosure system for related party transactions has been extended from only non-profit private schools to all private schools. In addition, this article clearly states which government departments need to supervise related party transactions and conduct audits for their necessity, legitimacy and compliance. Among them, we think that the word "necessity" is relatively important because listed companies now transfer profits from schools in the name of various service companies, and the necessity of their transactions is doubtful. If the related party transactions are strictly regulated, the compulsory education business cannot distribute dividends to shareholders. As mentioned above, the government intends to prevent schools that are profit-making in the name of non-profits. We think this article in line with the government's position.

In addition, the State Council promulgated the "學前教育改革發展意見" on November 15 this year, in which Article 24 indicates that "the private kindergartens are not allowed to be listed by either alone or as part of assets. Listed companies may not invest in for-profit kindergartens through financing in stock market and is not allowed to purchase for-profit kindergarten assets by issuing shares or paying cash." This will undoubtedly have a great impact on the listed companies that operate kindergartens. In the future, there is an opportunity to delist or spin off to the listed companies.

In view of this, we believe that Maple Leaf's compulsory education and kindergarten risks are very large, and then it may need to spin off to the corporate structure.

Valuation

As mentioned above, we believe that Maple Leaf's compulsory education and kindergarten risks are very high. It is very likely that the business will not be able to pay dividends to shareholders in the future. However, since it is generally believed that there will be five-year grace period, we assume that compulsory education and kindergarten business spin off five year later. We give 4x P/E ratio for the business to reflect its value before divestiture.

High school and additional service revenue will become the main source of revenue for Maple Leaf in the future. Although the management expressed their target to build a pyramid-like student structure in the annual result meeting, it will increase investment in kindergartens, elementary schools and middle schools, but we believe that if the policies of that kindergarten cannot be the asset of a listed company and elementary and middle schools must be non-profitable have been taken into effect, we expect the Group's high school and other additional service to remain strong, as the group can only develop its high school business. We only give 0.9x PEG (a 18% of CAGR on adjusted net profit in 2019-21F) to reflect the increase in the effective tax rate and the payment of land transfer fees after the high school segment turning into for-profit.

We derive a target price of HK\$3.38, significantly 55.4% lower than the previous target price to reflect future policy risks; the rating has been downgraded from "accumulate" to "neutral" with a potential upside of 0.8%. (CNY/HKD = 0.882)

Figure: SOTP valuation

	高中及其他服務
2019 年預測收入 (,000)	874,348
2019-21 年的盈利複合增長率	18%
調整後純利率	40%
2019 年預測調整後純利 (,000)	349,739
流通在外股份 (,000)	2,979,185
PEG	0.9
滙率(CNY/HKD)	0.882
目標價	2.16
	義務教育及幼兒園
2019 預測收入 (,000)	663,914
調整後純利率	40%
2019 年預測調整後純利 (,000)	265,566
流通在外股份 (,000)	2,979,185
PE	4
滙率(CNY/HKD)	0.882
目標價	0.40
+ 淨現金	0.82
加總目標價	3.38

Source: Phillip Securities (HK) Ltd.

Figure: The number of schools and its locations (By the end of November)

城市	開學時間	模式	預計容量	高中	初中	小學	學前	外籍	總計
大連	1995/96	自有	8,680	1	2	2	9	1	15
湖北武漢	2007/08	自有	4,400	1	1	1	1	1	5
天津(泰達)	2008/09	自有	4,500	1	1	1	1		4
重慶	2009/10	自有	3,300	1	1	1	1		4
江蘇鎮江	2011/12	自有	1,600	1	1	1			3
河南洛陽	2012/13	分成	2,700	1	1	1			3
內蒙古鄂爾多斯	2012/13	無償	1,100		1	1	1		3
上海	2013/14	自有	2,000	1	1				2
河南平頂山	2014/15	自有	1,200		1	1	1		3
天津(華苑)	2014/15	租賃	1,600		1	1			2
湖北荊州	2015/16	自有	1,500		1	1			2
浙江義烏	2015/16	自有	1,600	1	1	1		1	4
浙江平湖	2016/17	自有	2,000		1	1	1		3
陝西西安	2016/17	分成	1,275	1	1	1	1		4
江蘇淮安	2016/17	租賃	700		1	1			2
甘肅(加拿大 BC 省)	2016/17	租賃	80	1					1
海口	2016/17	自有	3,300	1	1	1	1		4
浙江湖州	2017/18	租賃	2,150		1	1	1		3
山東濰坊	2017/18	分成	2,100		1	1	1		3
重慶梁平	2017/18	租賃	1,500		1	1	1		3
江蘇鹽城	2017/18	分成	2,400	1	1	1			3
列治文(加拿大 BC 省)	2017/18	租賃	80	1					1
深圳	2017/18	租賃	1,500	1	1	1			3
海口併購項目	2018/19	自有	約 3,000		1	3	1		5
襄陽併購項目	2018/19	自有+租賃	2,000					7	7
總計				14	23	24	21	10	92

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

Risk

1. VIE structure prohibited in China
2. The grace period of policies is shorter than expected
3. New acquired schools were not able to add value

Financials

FYE AUG	FY15	FY16	FY17	FY18	FY19F	FY20F
Valuation Ratios						
P/E (X), adj	34.57	25.54	19.29	15.53	15.71	13.40
P/B (X)	3.92	3.89	3.17	2.28	2.11	1.94
Dividend Yield (%)	1.5%	1.5%	2.2%	2.7%	2.9%	3.4%
Per share data (RMB)						
EPS, (Basic)	0.085	0.116	0.153	0.190	0.188	0.221
EPS, (Diluted)	0.081	0.115	0.153	0.190	0.188	0.221
DPS (HKD)	0.049	0.05	0.073	0.091	0.096	0.113
BVPS	0.75	0.76	0.93	1.29	1.40	1.52
Growth & Margins (%)						
Grwoth						
Revenue	20.9%	27.1%	30.5%	23.8%	14.7%	15.2%
EBIT	245.7%	47.5%	37.7%	24.5%	5.2%	16.8%
Net Income	413.4%	49.6%	34.5%	30.1%	0.7%	17.2%
Margins						
Gross margin	45.7%	48.4%	49.8%	46.5%	46.8%	47.3%
EBIT margin	33.8%	39.3%	41.4%	41.6%	38.2%	38.7%
Net Profit Margin	31.5%	37.1%	37.9%	40.5%	34.9%	35.5%
Key Ratios						
ROE	18.0%	16.0%	18.4%	17.9%	14.1%	15.3%
ROA	8.5%	10.2%	10.8%	10.5%	9.0%	9.7%
Income statement (RMB mn)						
Revenue	653	830	1083	1341	1538	1772
Gross Profit	299	402	540	624	720	838
EBIT	221	326	449	558	587	686
EBT	217	326	441	548	577	676
Net profit	206	308	414	538	542	636
Minority Interest	0	0	3	-4	5	6
Net profit for owners	206	308	410	543	537	629

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

Exchange rate (0.8820) is HKDCNY1Y forward contract price on December 7 from Wind.

(Financial figures as at 7 December 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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Contact Information (Regional Member Companies)

SINGAPORE**Phillip Securities Pte Ltd**

Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG**Phillip Securities (HK) Ltd**

Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA**PT Phillip Securities Indonesia**

ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND**Phillip Securities (Thailand) Public Co. Ltd**

15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM**King & Shaxson Capital Limited**

6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA**PhillipCapital Australia**

Level 10, 330 Collins Street,
Melbourne, VIC 3000, Australia
Tel (613) 86339803
Fax (613) 86339899
Website: www.phillipcapital.com.au

MALAYSIA**Phillip Capital Management Sdn Bhd**

B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN**PhillipCapital Japan K.K.**

Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA**Phillip Financial Advisory (Shanghai) Co. Ltd**

No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE**King & Shaxson Capital Limited**

3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES**Phillip Futures Inc**

141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005