

China Education Group (839.HK)

Favourable policies revive the valuation

Hong Kong | Education | Company Report

21 February 2019

Investment Summary

China Education Group has engaged in higher and vocational education. We believe “Implementation Plan of Reforms on National Vocational Education” that the State Council of PRC published makes the development of vocational education more certain, and alleviates the concern on the Law on the Promotion of Private Education, enhancing the valuation. Based on the net profit attributable to owners in 2019, we assume a P/E ratio of 30x (the average of the past), deriving a target price of HK\$13.44. We downgrade the rating to “Accumulate” in reflection of the recent uptrend in stock price, with a potential upside of 7.52%. (Closing price at 19 Feb 2019)

Business Update

On Feb 13 this year, the State Council of PRC published “Implementation Plan of Reforms on National Vocational Education” (Plan), proposing number of reforms, targets and concrete indicators.

The content of the Plan

The Plan comprises seven parts, 1. Improve the national vocational education system, 2. Establish national standards for vocational education, 3. Promote the Dual Education System between the schools and enterprises, 4. Construct a diversified school landscape, 5. Improve the protection policy on technical talents, 6. Strengthen the quality supervision and evaluation of vocational education and 7. Do well in the reform implementation on the organizations.

1. Improve the national vocational education system

The central government indicated that it is necessary to establish and improve the national vocational education system framework, including strict teaching standards and the quality of graduate students. In addition, in the future, it is necessary to improve the development level of secondary vocational education, so that secondary vocational education becomes an important foundation for high school education, in which government supports each city, state, and alliance in the concentrated poverty-stricken areas to build at least one secondary vocational school that meets the needs of local economic and social development and technical skills training. Besides, the Plan encourages the promotion of high-quality development of higher vocational education, and focuses on cultivating high-quality technical talents for service areas, and supports the establishment of a "high vocational examination" system. Finally, the Plan also encourages qualified undergraduate colleges to shift to the fields in applied sciences.

Accumulate

CMP HKD 12.50

(Closing price at 19 Feb 2019)

TARGET HKD 13.44 (+7.52%)

COMPANY DATA

O/S SHARES (MN) :	2,020
MARKET CAP (HKDMN) :	25,252
52 - WK HI/LO (HKD):	16.60 / 8.03

SHARE HOLDING PATTERN • %

Yu Guo	37.62
Xie Ketao	37.62

PRICE PERFORMANCE • %

	1M	3M	1Y
China Education	14.89	14.89	49.52
HSI	4.20	7.04	-9.28

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY17	FY18(8m)	FY19F	FY20F
Revenue	949	940	1,941	2,278
Net Profit	429	408	874	1037
EPS, RMB	0.282	0.177	0.389	0.462
PER, x	38.59	61.38	27.90	23.53
BVPS, RMB	3.70	3.04	3.31	3.64
P/BV, x	2.94	3.57	3.28	2.99
ROE, %	10.5	6.1	12.3	13.3

Source: Company reports, Phillip Securities Est.

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2. Establish national standards for vocational education

In order to improve the standards for education and teaching, the curriculum standards need to be in line with industry and professional standards and improve the professional standards of secondary and higher vocational school settings, teachers and principals. In addition, the pilot program of the 1+X certifications was launched to encourage vocational college students to obtain academic credentials and multiple types of vocational skill level certificates. Besides, after 2019, vocational training will be carried out in industries such as modern agriculture, advanced manufacturing, modern service industries, and strategic emerging industries, and the construction of national “credit bank” for vocational education will be accelerated to enable academic certificates and vocational skill level certificates to be traceable, checkable and convertible.

3. Promote the Dual Education System between the schools and enterprises

In principle, the professional catalogue of vocational colleges is revised once every 5 years. The school sets up the majors flexibly according to the catalogue, adjusts the major once a year, and revises the textbook every 3 years. In addition, from 2019 onwards, relevant professional teachers of vocational colleges and undergraduate colleges should recruit in principle from those who have more than 3 years of work experience or higher education qualifications or higher. Besides, Fresh graduates will no longer be recruited from 2020 onwards. Apart from that, one hundred “double-skilled” teacher training centers will be established. Vocational colleges and undergraduate college teachers will train at the enterprise or training center at least one month a year and implement the full-year rotation training system for teachers in a five-year cycle.

4. Construct a diversified school landscape

Government departments at all levels should deepen the reform of “放管服”, shifting the focus from operating vocational education to managing it. And, they should encourage qualified enterprises, especially large enterprises, to set up high-quality vocational education, with proper support from government. In 2020, 300 vocational education groups (alliance) will be initially established. The government will support and monitor the social parties to establish vocational education. Meanwhile, it also encourages the development of vocational colleges and vocational training institutions which adopt shareholding system or mixed ownership system.

5. Improve the protection policy on technical talents

Local governments should formulate and implement standards on funding per capita or public funding standards for vocational colleges according to regulations. New education funding should be tilted to vocational education, and social parties should be encouraged to donate and set up vocational education. The funding per capita of higher vocational education in all regions must be at least 12,000 RMB, where the level should be adjusted based on development needs and financial resources. Vocational education should also focus on the central and western regions, poverty-stricken areas and ethnic areas.

6. Strengthen the quality supervision and evaluation of vocational education

From 2019 onwards, vocational skill certificates will be checked and supervised regularly. The training evaluation organization behavior and training quality of vocational colleges will be monitored and evaluated. An annual report system for the quality of vocational education should be compiled and reported to the public. In addition, the government can entrust the National Vocational Education Guidance Advisory Committee as a third party to evaluate the school

management, education quality, mode of schooling, teacher training and student professional skills for the national vocational colleges, colleges and universities, school-enterprise cooperative enterprises, training evaluation organizations, where they conduct guidance, assessment, evaluation and so on.

7. Do well in the reform implementation on the organizations.

Strengthen the party's overall leadership over the education business, comprehensively implement the party's education policy and the requirements of the central education work leading group, and ensure the correct direction of vocational education reform and development. The Inter-Ministerial Joint Conference of Vocational Education of the State Council coordinated and coordinated the work of the national vocational education coordinated the major problems in the work, listened to the opinions and suggestions of the National Vocational Education Guidance Advisory Committee, deployed and implemented major issues in the reform and innovation of vocational education, and held two meetings each year. The member units report to the joint meeting on the relevant work.

The key points of the Plan

We believe the most crucial articles are 12, 13 and 16.

Article 12:

This article lifts the standards for teachers, such as relevant professional teachers of vocational colleges and undergraduate colleges should recruit in principle from those who have more than 3 years of work experience or higher education qualifications or higher and fresh graduates will no longer be recruited from 2020 onwards. We expect this will bring upward pressure to the staff costs. But, under the Law on the Promotion of Private Education, the Group will have greater freedom on their pricing, representing the Group could transfer the costs to the tuition fees. Thus, the profit margin will not be heavily affected.

Article 13:

This article clearly expresses its support for the social capital to enter vocational education, where the Plan supports and monitors the social parties to establish vocational education and encourages the development of vocational colleges and vocational training institutions which adopt shareholding system or mixed ownership system. We believe the stance of this article is in line with the Law on the Promotion of Private Education that published previously, in which both of them supports the presence of the private higher education colleges. After the draft of the Law on the Promotion of Private Education being published, the sub sector of high education plunged because of the over-interpretation from the market. The valuation could revive thanks to the clear supportive stance for higher education of the Plan which alleviates the concern from the market.

Article 16:

This article provides the guidance on the education funding. It should be tilted to on the central and western regions, poverty-stricken areas and ethnic areas. We believe the local government will launch more and more favourable policies, such as tax exemption or low land transaction fee. It is possible that there will be new acquisition target in central and western regions for the Group.

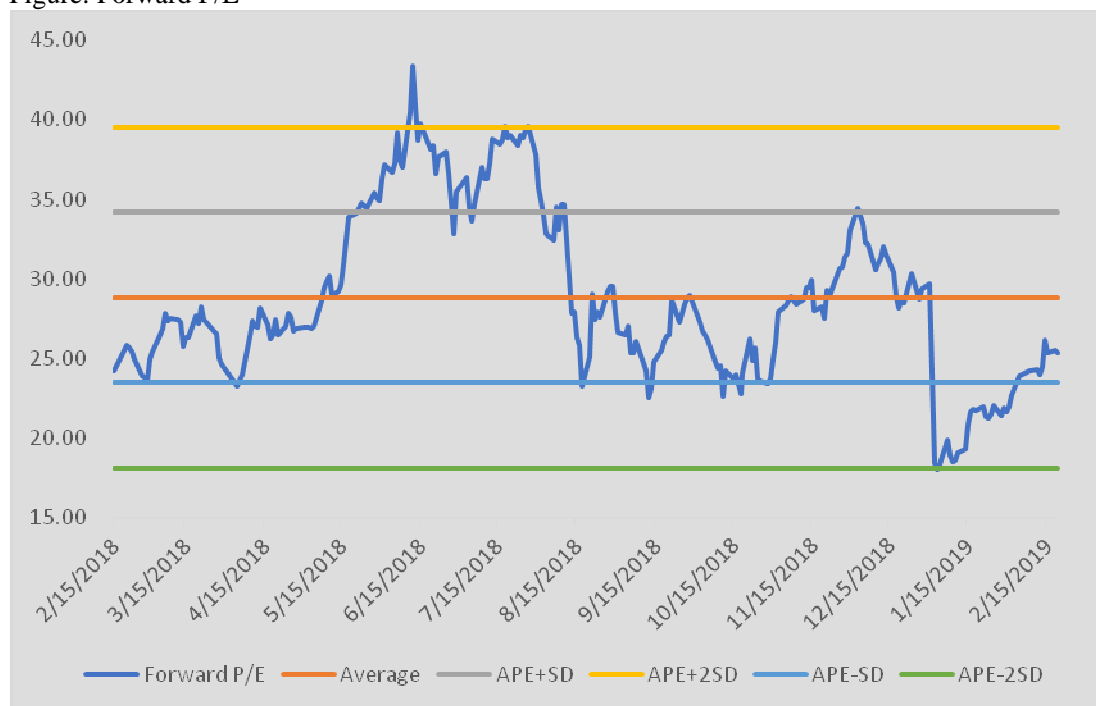
In conclusion, the advantages from the Plan outweigh the disadvantages. Although the staff costs may be driven up due to the higher standards, the Plan clearly support social capital to enter vocational education, and propose favourable

policies, which is able to enhance the valuation that dropped previously due to the draft of the Law on the Promotion of Private Education.

Valuation

We believe the Plan makes the development of vocational education more certain, and alleviates the concern on the Law on the Promotion of Private Education, enhancing the valuation. Based on the net profit attributable to owners in 2019, we assume a P/E ratio of 30x (the average of the past), deriving a target price of HK\$13.44. We downgrade the rating to “Accumulate” in reflection of the recent uptrend in stock price, with a potential upside of 7.52%.(HKD/CNY=0.8693)

Figure: Forward P/E



Source: Bloomberg, Phillip Securities (HK) Research

Risk

1. A plunge in birth rate in China
2. A sharp change in policies to education sector
3. The Group fails to improve the operation of the acquired schools

Financials

FYE AUG	FY15	FY16	FY17	FY18(8m)	FY19F	FY20F
Valuation Ratios						
P/E (X), adj	46.89	39.62	38.59	61.38	27.90	23.53
P/B (X)	7.69	6.46	2.94	3.57	3.28	2.99
Dividend Yield (%)	N/A	N/A	N/A	0.6%	1.1%	1.3%
Per share data (RMB)						
EPS, (Basic)	0.232	0.274	0.282	0.177	0.389	0.462
EPS, (Diluted)	0.232	0.274	0.282	0.176	0.388	0.460
DPS (HKD)	N/A	N/A	N/A	0.074	0.134	0.159
BVPS	1.41	1.68	3.70	3.04	3.31	3.64
Growth & Margins (%)						
Growth						
Revenue	2.9%	1.8%	10.2%	-1.0%	106.5%	17.4%
EBIT	13.8%	15.1%	1.1%	-5.3%	124.7%	20.4%
Net Profit	12.4%	18.5%	4.0%	-4.8%	114.1%	18.6%
Margins						
Gross margin	50.8%	53.0%	59.0%	61.7%	62.3%	62.7%
EBIT margin	43.4%	49.0%	45.0%	43.0%	46.8%	48.0%
Net Profit Margin	41.2%	47.9%	45.2%	43.4%	45.0%	45.5%
Key Ratios						
ROA	11.0%	11.3%	8.1%	5.3%	9.0%	9.1%
ROE	17.8%	17.7%	10.5%	6.1%	12.3%	13.3%
Income statement (RMB mn)						
Revenue	846	861	949	940	1,941	2,278
Gross Profit	430	457	560	580	1,209	1,428
EBIT	367	422	427	405	909	1,094
EBT	364	425	423	395	901	1,080
Net Profit	348	413	429	408	874	1,037
Minority Interest	1	1	(0)	43	87	104
Net profit for owners	348	411	429	358	787	933

Source: Company, Phillip Securities (HK) Research

Exchange rate (0.8693) is HKDCNY1Y forward contract price on February 19 from Wind.

(Financial figures as at 19 February 2019)

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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