

China Education Group (839.HK)

Acquisition of the remaining equity interest of Quancheng University; the issuance of a HK\$2,355 million convertible bond

24 April 2019

Hong Kong | Education | Company Report

Investment Summary

China Education Group has engaged in higher and vocational education. Under the management of the Group which are experienced in operating schools, we believe the potential improvement will be huge for the new acquired schools. Besides, the low cost financing has ensured the acquisition in the future, so the growth from acquisition should remain strong. Based on the net profit attributable to owners in 2020, we assume a P/E ratio of 28x (the average of the past), deriving a TP of HK\$15.50 and maintain an “Accumulate” rating, with a potential upside of 18.68%. (Closing price at 18 Apr 2019)

Business Update

On Mar 20, the Group has announced to acquire the remaining 49.09% equity interest of Quancheng University at a total consideration of RMB 223 million. In 2018, the net profit after tax was RMB 0.4 million, with total assets of 778 million and net assets of 377 million. Quancheng University is located in Penglai city, Shandong province, and the Independent college of Jinan University. Currently, there were 38 Bachelor degree programs, 9 Junior College programs, covering a wide range of disciplines including Economics, Management, Literature, Science, Engineering and Arts. The student enrollment in 2018 were 8,529, in which about 6,900 were Bachelor-degree students. The tuition of the bachelor-degree program and junior college program were RMB 11,000 per year and RMB 8,000 per year respectively.

Among those independent colleges in Shandong, the admission marks for bachelor-degree in 2018 (science track) were the highest, 454. Besides, the tuition of the bachelor-degree program was only RMB 11,000, lower than the average of private universities and independent colleges in Shangdong (RMB 13,500), meaning there will still be room to grow. Finally, the utilization of the school was just 86%, and the remaining space available can further accommodate about 1,400 students. The maximum capacity of the campus is approximately 23,000 students more after the renovation and building new dormitories. Thanks to the potential increase in tuition and student enrollment, we believe it is a satisfactory acquisition target.

On Mar 21, the Group announced the issuance of a HK\$2,355 million five-year convertible bond with an annual interest rate of 2% and a conversion price of HK\$14.69 per share, representing a premium of 30% based on the closing price of the share price at the end of the trading period on March 21, 2019 (HK\$11.30).

Accumulate

CMP HKD 13.06

(Closing price at 18 Apr 2019)

TARGET HKD 15.50 (+18.68%)

COMPANY DATA

O/S SHARES (MN) :	2,020
MARKET CAP (HKDMN) :	26,384
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	6.18	20.04	27.54
HSI	2.43	11.20	-0.53

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY17	FY18(8m)	FY19F	FY20F
Revenue	949	940	2,017	2,419
Net Profit	429	408	884	1072
EPS, RMB	0.282	0.177	0.394	0.478
PER, x	40.02	63.65	28.61	23.59
BVPS, RMB	3.70	3.04	3.32	3.65
P/BV, x	3.04	3.71	3.40	3.09
ROE, %	10.5	6.1	12.4	13.7

Source: Company reports, Phillip Securities Est.

Research Analyst

Terry Li (2277 6527)

terryli@phillip.com.hk

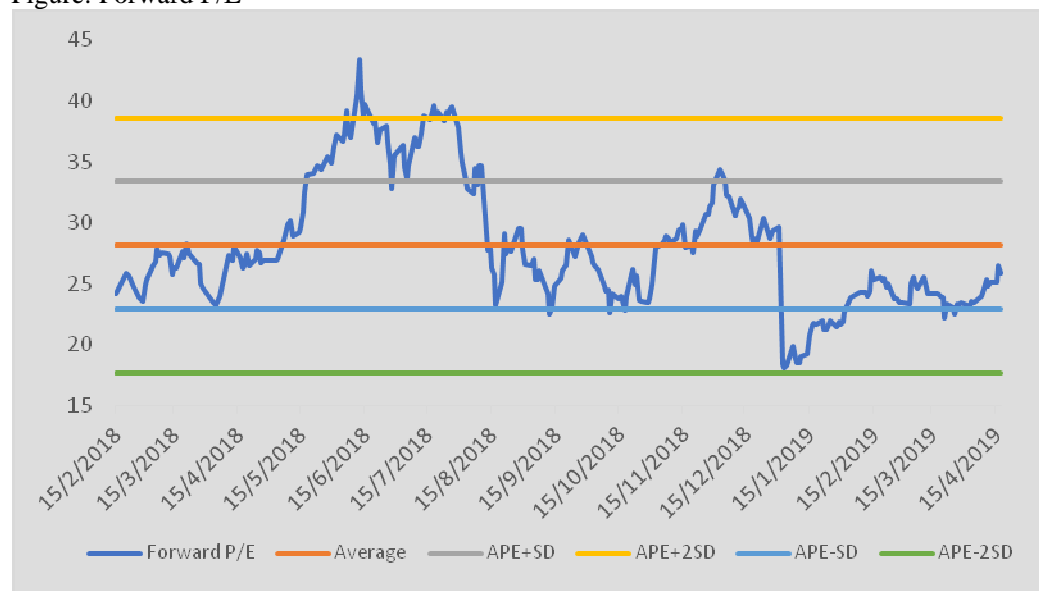
We think the bond issuance manifested the advantages of organized schools-running activities. Although the higher education industry are stable with an abundant cash flows, it is also capital-intensive. Therefore, they usually developed relying on debt financing. But, the interest rate was very high for those schools which are relatively weak in terms of balance sheet. This issues has reflected the advantages of organized schools-running activities, which could reduce geographical risk by running schools in different region. Moreover, it could enjoy a economies of scales thanks to its large scale, leading to the reduction in operating cost. As a result, they usually enjoy a lower financing rate. Besides, the the conversion price with high premium also reflects the optimistic views in stock price for the lender.

The previous gearing ratio target the Group provided was 40%-50%. We expect the gearing ratio will reach 35%-40% after this issuance of bonds, implying that there will still be room for further financing. In addition, as it is the convertible bonds to be issued, the gearing ratio may reduce once the conversion is done, enabling the Group for another financing. Assuming the acquisition price of a new school takes RMB 600-700 million, the capital financed will be enough for acquiring 3 new schools.

Valuation

Under the management of the Group which are experienced in operating schools, we believe the potential improvement will be huge for the new acquired schools. Besides, the low cost financing has ensured the acquisition in the future, so the growth from acquisition should remain strong. Based on the net profit attributable to owners in 2020, we assume a P/E ratio of 28x (the average of the past), deriving a TP of HK\$15.50 and maintain an “Accumulate” rating, with a potential upside of 18.68%.(HKD/CNY=0.8628)

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	48.63	41.09	40.02	63.65	28.61	23.59
P/B (X)	7.98	6.70	3.04	3.71	3.40	3.09
Dividend Yield (%)	N/A	N/A	N/A	0.6%	1.0%	1.3%
Per share data (RMB)						
EPS, (Basic)	0.232	0.274	0.282	0.177	0.394	0.478
EPS, (Diluted)	0.232	0.274	0.282	0.176	0.392	0.476
DPS (HKD)	N/A	N/A	N/A	0.074	0.137	0.166
BVPS	1.41	1.68	3.70	3.04	3.32	3.65
Growth & Margins (%)						
Growth						
Revenue	2.9%	1.8%	10.2%	-1.0%	114.6%	19.9%
EBIT	13.8%	15.1%	1.1%	-5.3%	132.9%	22.9%
Net Profit	12.4%	18.5%	4.0%	-4.8%	116.6%	21.3%
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%	46.7%	47.9%
Net Profit Margin	41.2%	47.9%	45.2%	43.4%	43.8%	44.3%
Key Ratios						
ROA	11.0%	11.3%	8.1%	5.3%	8.6%	8.6%
ROE	17.8%	17.7%	10.5%	6.1%	12.4%	13.7%
Income statement (RMB mn)						
Revenue	846	861	949	940	2,017	2,419
Gross Profit	430	457	560	580	1,257	1,517
EBIT	367	422	427	405	942	1,158
EBT	364	425	423	395	911	1,117
Net Profit	348	413	429	408	884	1,072
Minority Interest	1	1	(0)	43	88	107
Net profit for owners	348	411	429	358	796	965

Source: Company, Phillip Securities (HK) Research

Exchange rate (0.8628) is HKDCNY1Y forward contract price on April 18 from Wind.

(Financial figures as at 18 April 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

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2019 Phillip Securities (Hong Kong) Limited

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