

China New Higher Education Group Limited (2001.HK)

Excellent organic and tuition fee growth, but with a high debt ratio

16 May 2019

Hong Kong | Education | Company Report

Investment Summary

CNHEG announced its 2018 results. During the period, organic growth was strong, and tuition and accommodation fees increased steadily, but the debt ratio jumped significantly, which may affect the progress of acquisition in the future. In addition, Chinese Premier Li Keqiang mentioned in the government report that there will be a one million enrollment expansion for higher vocational colleges in 2019. At the same time, the State Council also announced the “National Vocational Education Reform Implementation Plan”, hoping to improve the quality of higher vocational education. Based on the DCF model, we derive a TP of HKD4.26, and giving a “Buy” rating, with 35.7% potential upside. (Closing price as at 14 May)

Company Update

The Group’s revenue in 2018 was RMB 561 million, a YoY increase of 35.5%, mainly due to the excellent organic growth of students in Yunnan and Guizhou, the higher average Accommodation fee per student and the consolidation of Henan and Northeastern schools. The net profit attributed to the owner was RMB 243 million, up 3.9% YoY, mainly due to the provision for the termination of the acquisition of Xinjiang schools. If this provision, listing fees and exchange gains are deducted, the adjusted net profit is RMB 285 million, a YoY increase of 20.3%.

During the period, the number of students in Yunnan and Guizhou schools increased by 13.7% to 44,583; the number of students in Northeast, Central China and Henan schools increased by 17.1% to 39,012. Among them, the number of students in Central China and Henan schools increased by nearly 50% and 16% respectively, but the number of students in Northeastern schools dropped slightly by 1%. It can be seen that the organic growth for those schools is strong. The number of students in Gansu and Guangxi schools is 8,218 and 9,953 respectively.

In terms of tuition and accommodation fees, due to the improved dormitory environment in Yunnan and Guizhou, the average accommodation fee per student has increased by 9.9% this year. Except for Guizhou schools, the tuition fee range of each school has also increased in the 2018/19 academic year. The average tuition fee is expected to be RMB 9,947, an increase of about 5% from the previous year’s RMB 9,492.

Buy

CMP HKD 3.14

(Closing price at 14 May 2019)

TARGET HKD 4.26 (+35.7%)

COMPANY DATA

O/S SHARES (MN) :	1,531
MARKET CAP (HKDMN) :	4,839
52 - WK HI/LO (HKD):	8.52 / 3.13

SHARE HOLDING PATTERN • %

Li Xiaoxuan	55.39
CMBC Capital Holdings	21.06
UBS Group AG	5.88
Greenwoods Asset Management	5.00

PRICE PERFORMANCE • %

	1M	3M	1Y
CNHEG	-15.14	-36.69	-53.27
HSI	-4.55	0.42	-9.48

RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY17	FY18	FY19F	FY20F
Revenue	414	561	930	1,041
Net Profit	233	254	383	404
EPS, RMB	0.173	0.169	0.238	0.251
PER, x	20.61	21.05	15.01	14.23
BVPS, RMB	1.28	1.30	1.38	1.55
P/BV, x	2.79	2.75	2.59	2.29
ROE, %	17.9	13.5	18.3	17.1

Source: Company reports, Phillip Securities Est.

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Figure: Tuition and accommodation fees

	Range of Tuition fee		Range of Accommodation fee	
	2018/19	2017/18	2018/19	2017/18
Yunnan School	11,000 - 22,000	11,000 - 20,000	750 - 2,800	750 - 1,200
Guizhou School	8,000 - 9,380	8,000 - 9,380	1,200 - 2,200	1,200
Northeast School	17,000 - 19,000	14,500 - 16,500	1,100 - 2,000	800 - 1,200
Henan School	4,600 - 7,800	2,600 - 7,800	900 - 1,600	900 - 1,400
Guangxi School	7,000 - 8,500	6,000 - 7,500	880 - 1,350	880 - 1,350
Central China School	8,500 - 19,000	7,500 - 18,000	1,200	1,200

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

Termination of the acquisition of Xinjiang schools

In October 2018, the group announced the termination of the acquisition of the Xinjiang University of Finance and Economics Business School because of local policy restrictions. As the group hopes to obtain the management fee of the school, it has paid RMB 148 million in investment prepayments for this acquisition. After the termination of the acquisition, the Group stated that the prepayment could become a bad debt, so an impairment provision of RMB 30 million was prepared for this year. However, the group expressed its confidence to recover the money.

Debt ratio driven up significantly

The Group's interest-bearing debts rose sharply in 2018, and the net interest-bearing debt-to-equity ratio rose sharply from 14% in 2017 to 41% in 2018. As a the growth of the current education sector mainly comes from acquisitions, the high debt to equity ratio indicates that the future group will not have much funds for the acquisition, implying a reduction in growth of the group. The Group also raised approximately HK\$390 million in the form of a placing on April 10 this year, which is believed to help ease the Group's debt burden..

Industry Update

One million enrollment expansion for higher vocational education

Chinese Premier Li Keqiang mentioned in the government report that in 2019, the enrollment expansion for higher vocational education will be one million. The enrollment targets of higher vocational colleges are mainly ordinary high school graduates, secondary vocational graduates, social candidates (farmers, laid-off workers, retired military personnel, new professional farmers, etc.). In addition to enrollment expansion, the Ministry of Education has also introduced a number of policies to encourage the development of higher vocational education, such as: eliminating the higher vocational school enrollment ratio of secondary vocational graduates, higher vocational education graduates and ordinary college graduates enjoying the same treatment and the central government allocated RMB 23.7 billion for the modern vocational education quality improvement plan.

In addition, earlier this year, the State Council also announced the "National Vocational Education Reform Implementation Plan", hoping to improve the quality of higher vocational education, and by 2022 to build 50 high-level higher vocational schools and 150 professional groups.

Valuation

We adopted a three-stage discounted cash flow model, assuming the short and long term growth rate are 10% and 2.5% respectively, with 10 declining years and 9.93% WACC. According to the range for WACC [8.93%,10.93%] and long term growth rate [1.5%,3.5%], the highest and lowest target price are HKD5.75 and 3.40 respectively. Due to the dilute effect from new placing and the depreciation of RMB, we lower our TP to \$4.26, implying a PE ratio of 15.8x and 15.0x in 2019/20. Owing to the slump in stock price recently, we update the rating to “Buy”, with 35.7% potential upside.

Figure: Sensitivity test

Long term growth rate	-----WACC-----				
	8.93%	9.43%	9.93%	10.43%	10.93%
1.5%	4.58	4.23	3.92	3.65	3.40
2.0%	4.81	4.42	4.08	3.78	3.52
2.5%	5.07	4.64	4.26	3.94	3.65
3.0%	5.38	4.89	4.48	4.12	3.80
3.5%	5.75	5.19	4.72	4.32	3.97

Source: Phillip Securities (HK) Ltd.

Risk

1. VIE structure prohibited in China
2. The faster than expected decrease in birth rate
3. New acquired schools were not able to add value
4. The Revised Draft of Law for Promotion of Private Education passed successfully

Financials

FYE DEC	FY15	FY16	FY17	FY18F	FY19F	FY20F
Valuation Ratios						
P/E (X), adj	39.35	36.55	20.61	21.05	15.01	14.23
P/B (X)	11.81	4.60	2.79	2.75	2.59	2.29
Dividend Yield (%)	N/A	N/A	1.8%	1.7%	2.3%	2.4%
Per share data (RMB)						
EPS, (Basic)	0.091	0.098	0.173	0.169	0.238	0.251
EPS, (Diluted)	0.091	0.098	0.173	0.169	0.238	0.251
DPS (HKD)	0	0	0.055	0.053	0.07	0.08
BVPS	0.30	0.78	1.28	1.30	1.38	1.55
Growth & Margins (%)						
Growth						
Revenue	32.7%	24.5%	21.5%	35.5%	65.6%	12.0%
EBIT	37.8%	6.7%	94.3%	22.5%	35.5%	12.8%
Net Income	27.7%	8.1%	108.0%	9.0%	50.7%	5.5%
Margins						
Gross margin	49.5%	48.0%	54.9%	51.0%	52.0%	53.0%
EBIT margin	51.0%	43.7%	69.9%	63.2%	51.7%	52.1%
Net Profit Margin	37.9%	32.9%	56.3%	45.3%	41.2%	38.8%
Key Ratios						
ROE	28.6%	18.1%	17.9%	13.5%	18.3%	17.1%
Income statement (RMB mn)						
Revenue	274	341	414	561	930	1,041
Gross Profit	136	164	228	286	483	552
EBIT	140	149	290	355	481	542
EBT	110	113	250	277	408	476
Net profit (excluding gain/loss from discontinued operations)	104	111	233	254	383	404
Minority Interest	(0)	0	(0)	12	19	20
Net profit for owners	104	112	233	243	364	384

Source: Company, Phillip Securities (HK) Research

Exchange rate (0.88) is HKDCNY1Y forward contract price on May14 from Wind.

(Financial figures as at 14 May 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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