EQUITY RESEARCH

China Kepei (1890 HK)

Organic Growth + Acquisition – Twin Engine Growth

Hong Kong | Education Sector | Company Initiation

6 Aug 2020

Investment Summary

The obvious advantages of Guangdong's higher education market

According to the Guangdong Provincial Bureau of Statistics, Guangdong Province has become China's most populous province in 2019, accounting for 8.23% of China's total population. At the end of 2019, the permanent population of Guangdong was 115 million, a year-on-year increase of 1.75 million, of which the natural growth population was 923,800, and the net inflow population from other places was 826,200. This huge population growth also means that the people of Guangdong Province demand higher education resources. On the other hand, the gross enrollment rate of higher education in Guangdong Province is currently lower than the average of all provinces in China. According to the Guangdong Academy of Education, the gross enrollment rate of higher education in Guangdong Province in 2019 was only 46%, while the average gross enrollment rate of higher education in China in 2019 was about 52%. Given the increasing demand for higher education in Guangdong Province, this gross enrollment rate gap reflects the current shortage of higher education market in Guangdong Province.

High market recognition and high teaching quality of the company’s colleges

Out of the market’s recognition of the quality of education provided by the company and the outstanding results of students, the company has won many awards since its establishment. On the other hand, the initial employment rate of the Guangdong Polytechnic College is among the best in Guangdong Province. According to the Guangdong Provincial Department of Education, the average initial employment rate for undergraduate degree graduate in Guangdong Province in 2018 and 2019 was 93.8% and 93.4%, respectively. In the 2017/2018 academic year and the 2018/2019 academic year, Guangdong Polytechnic College had 1,023 and 3,196 undergraduate degree graduates. The initial employment rates were 96.8% and 97.8%, respectively, which were 3.0 ppt and 4.4 ppt higher than the average of Guangdong Province. It highlights the broad market recognition of the undergraduates of the company's colleges.

“The Law for Promoting Private Education of the PRC” has no huge impact on the company

“The Law for Promoting Private Education of the PRC” has not been fully implemented yet. The company’s management believe that it will only have a limited negative impact on the company even if its fully implemented. It is expected that after the implementation of this policy, the company's effective tax rate will increase from 0.4% in 2019 to 10-15%, This impact is already known to the market and is limited. On the other hand, after the policy is promulgated, private education groups will be required to pay a premium for their land. According to the company's management, the land of the company's self-built colleges (Guangdong Polytechnic College, Zhaoqing School) comes from auction, so there is no need to pay premium for these land in the future. As for the land of Harbin Institute of Petroleum, the company will only need to make up about RMB 100 million in land premium in the future, and the payment can be made in installments for many years, so it does not pose any significant pressure on the company's future cash flow and performance.

We have set a target price of HKD 7.20

The company has equipped with acquisition capabilities while having strong organic growth potential. We believe its performance can improve hugely in the near future through the Organic Growth + Acquisition – Twin Engine. We forecast the EPS of the company are RMB 0.31/0.36 in 2020/2021 (HKD 0.34/0.40). We are setting a target price of HKD 7.20, which implies a 2020/2021 P/E ratio of 21.0x/17.9. We initiate with a “Accumulate” rating. (Market closing price as of 4th Aug) (exchange rate: RMB 0.9/HKD)

Risk: acquisition not as effective as expected, teaching quality diminished, change of related law policies, the number of students increased less than expected

Accumulate (Initiation)

CMP HKD 6.25

(Closing price as at 4 Aug)

TARGET HKD 7.20 (+15%)

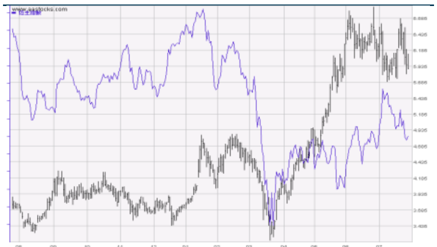
COMPANY DATA

O/S SHARES (MN) :	2,001
MARKET CAP (HKD MN) :	11,266
52 - WK HI/LO (HKD):	6.86/3.21

SHARE HOLDING PATTERN, %

Qiaoge Company Limited	33.74
Chenye Company Limited	14.99
Shuye Company Limited	18.74
SKYLINE MIRACLE LIMITED	7.33

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY18	FY19	FY20E	FY21E
Net Sales	576	714	1,080	1,236
Profit	342	456	617	726
EPS, CNY	0.23	0.23	0.31	0.36
P/E, x	24.5	24.7	18.2	15.5
BVPS, CNY	0.72	1.39	1.57	1.78
P/BV, x	7.9	4.0	3.6	3.2
DPS (HKD)	0.10	0.10	0.13	0.16
Div. Yield (%)	1.60	1.60	2.08	2.56

Source: Company reports, Phillip Securities Est.

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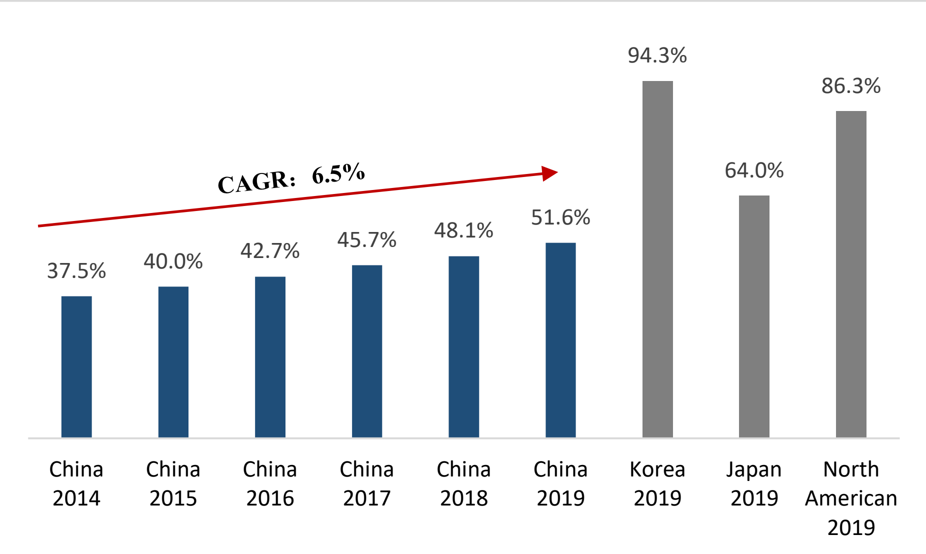
Industry Review and Forecast

The higher education market in China

Higher education institutions in China can be divided into two categories, namely, public higher education institutions which refers to higher education institutions established and operated by the PRC national or local governments, and private higher education institutions which normally are established by individuals or private entities. According to data from the Ministry of Education of China and UNESCO, the gross enrollment rate of higher education in China has been on the rise in recent years, from 37.5% in 2014 to 51.6% in 2019. Although China's higher education gross enrollment rate has increased rapidly in recent years, it is still lower than other developed countries (Korea/Japan/North America's 2019 gross enrollment rates for higher education were 94%/64%/86% respectively). With the pursuit of educational qualifications and the rising per capita disposable income in China, we expect China's gross enrollment rate of higher education will continue to grow in the future and is expected to catch up with other developed countries.

Figure 1: comparison of gross enrollment of China and other countries

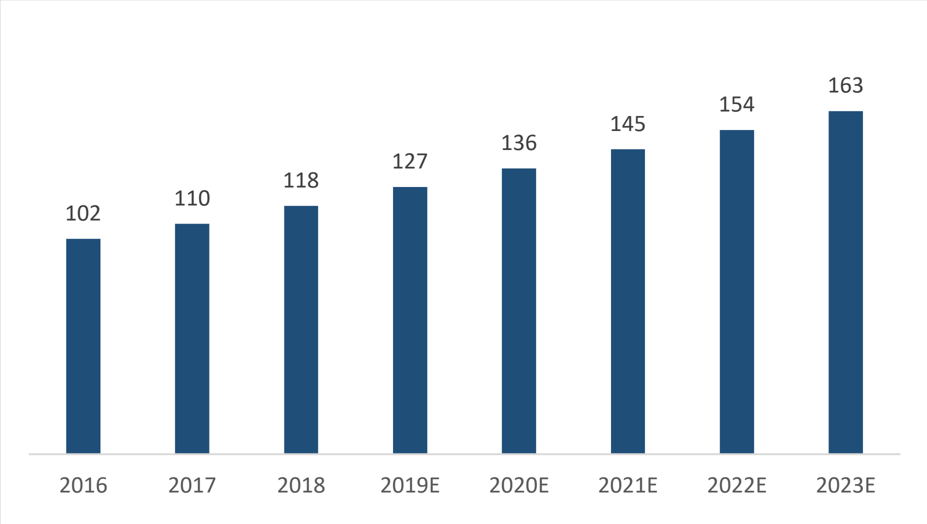


Source：The Ministry of Education of China , UNESCO, PSHK

The private higher education market in China

Private higher education in China can be divided into three categories: private regular universities or colleges (民辦普通大學或學院), private junior colleges (民辦普通專科) and independent colleges (獨立學院). According to the Frost & Sullivan Report, total student enrollment in private higher education in China increased from 5.9 million in 2014 to 6.5 million in 2018, representing a CAGR of approximately 2.6%, and is expected to increase from 6.5 million in 2018 to 6.7 million in 2023, representing a CAGR of approximately 0.5%. Although the number of students enrolled in China's private education will grow slowly in the future, with the increase in education expenditures of Chinese families, China's future private higher education income is expected to rise steadily. According to the Frost & Sullivan Report, the total revenue of the private higher education industry has been increasing steadily from RMB82.9 billion in 2014 to RMB118.0 billion in 2018, representing a CAGR of 9.2%, and is expected to increase from RMB118.0 billion in 2018 to RMB163.7 billion in 2023, representing a CAGR of 6.8%.

Figure 2: total revenue of private high education industry in China



Source： Frost and Sullivan, PSHK

The development trend of China's private higher education market

The major development trend of private higher education market in China includes the following.

1) **The trend of independent colleges transforming to private regular universities or colleges**

On May 18, 2020, the Ministry of Education of China has announced that all independent collages in China are required to formulate their plans for the transformation before the end of 2020. Their transformation path includes the following 3. 1) conversion to private 2) conversion to public or 3) closure of the company. With the continuous improvement of private education's ability to integrate high-quality academic and capital resources, and the continuous improvement of their educational quality and acceptance, the transformation of independent colleges into private universities is likely to become a major development trend.

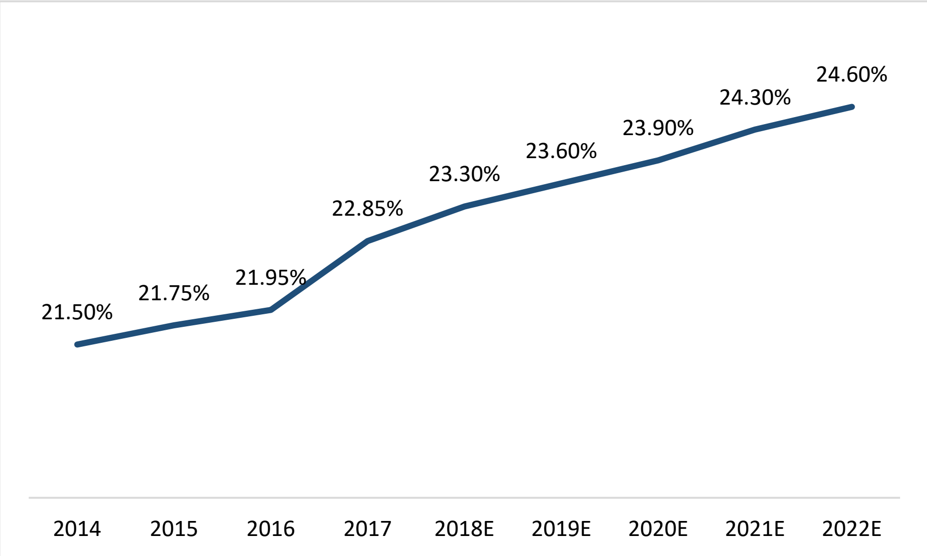
2) **Industry consolidation**

Higher education colleges need to invest a large amount of operating capital, including teachers, hardware, and management. Therefore, the financial resources of non-listed higher education colleges will be difficult to match those of higher education colleges under listed companies. As a result, the general way out for non-public higher education institutions in the future is to be acquired or to be listed independently. In addition, larger players in the industry have spent a lot of money on mergers and acquisitions in recent years to achieve high growth in performance. Although the Implementing Regulations for the Law for Promoting Private Education of the PRC (Revised Draft) (Draft for Review) 《民促法-送審稿》in Aug 2018 has limited the acquisition by the private education company on the Non-profit schools. However, it seems that China's private higher education group mergers and acquisitions are not subject to much restriction. After the announcement of the draft, there are still many schools that have been acquired by the private higher education group.

The steady increase of penetration rate of private higher education

According to Frost & Sullivan, the penetration rate of private higher education in China rose from 21.5% in 2014 to 22.8% in 2017. It is expected to maintain a steady upward trend in the future, and is expected to reach 24.6% in 2022. This means that compared with public universities, more and more Chinese students choose to study in private universities. The expected increase in penetration rate is mainly attributable to the fact that China's fiscal education expenditure will not be able to meet China's higher education needs alone in the future. It is expected that the Chinese government will gradually relax restrictions on private higher education (for example, in recent years, Guangdong Province has given private higher education the right to set prices independently).

Figure 3: The penetration rate of private higher education



Source：Frost and Sullivan, PSHK

The effect of COVID-19 on the private education sector

Compared with other traditional industries, the epidemic has little impact on the private higher education industry. The main reason is that higher education groups generally charge annual tuition fees at the beginning of the school year (September). Secondly, the vast majority of private higher education groups have launched online enrollment, so the epidemic is expected to have little impact on the enrollment of higher education groups next year. On the other hand, due to the impact of the epidemic, in order to stabilize employment, the Ministry of Education of China increased the enrollment scale of the country's "junior college to undergraduate" (專升本) to about 320,000 in February this year, rising to 570,000, which is beneficial to the development of China Higher Education Group.

Company Overview and its Competitive Advantages

The leading private higher education operator in South China

The Group is a leading provider of private higher education in South China focusing on profession-oriented education. As of the 2019/2020 school year, the Group had an aggregate of 57,924 students enrolled. There are two self-built colleges under the company, namely Guangdong Polytechnic College and Zhaoqing School. According to recent market research, Guangdong Polytechnic College ranked first among the private higher education institutions (excluding independent colleges) in South China in terms of the number of newly admitted students and student enrollment. Zhaoqing School ranked first in terms of student enrollment among the private specialized secondary schools in Guangdong Province.

Guangdong Polytechnic College was established in 2005 and mainly provides undergraduate, college and adult education courses. In the 2019/2020 academic year, the total number of students at Guangdong University of Technology is 50,315, including 23,823 students enrolled in undergraduate courses, 6,833 students enrolled in college courses, and 19,659 students enrolled in adult universities. It offers 41 majors covering a wide range of subject areas, including 29 undergraduate majors and 20 junior college majors. The core majors include standardization management, electrical engineering and automation, electronic information engineering and mechanical design. The tuition fees for the 2019-2020 academic year of Guangdong Polytechnic College for undergraduate courses, junior college courses, on-campus adult university courses, and off-campus adult university courses are 23,800, 17,300, 5,900-13,300 and RMB 680-980 respectively.

On the other hand, Zhaoqing School is a secondary vocational school established in 2000, providing secondary vocational education in 12 specialties, including automobile maintenance, e-commerce and electromechanical technology applications. As of the 2019/2020 academic year, the total number of students in the school is 7,609. The tuition fees for secondary vocational education courses of Zhaoqing School for the 2019-2020 academic year are RMB 7,200-11,100.

Figure 4: Tuition fee and number of students of company’s self-built colleges

	Guangdong Polytechnic College	Zhaoqing School
19-20 Tuition fee	RMB 23,800 (undergraduate), RMB 17,300 (junior college), RMB 5,900-13,300 (On campus Adult education), RMB 680-980 (off campus adult education)	RMB 7,200-11,000
19-20 no of students	50,315	7,609

Source：Company, PSHK

On January 13, 2020, the company announced the acquisition of Harbin Institute of Petroleum. Harbin Institute of Petroleum is a private general undergraduate college established in 2003. As of January 2020, Harbin Institute of Petroleum has about 9,366 students studying for undergraduate courses, and the total area of property land use rights is about 666,667 square meters. The total amount of this transaction is approximately RMB 1.45 billion. In fiscal year 2019, the net profit Harbin Institute of Petroleum was approximately RMB 68 million. The company has completed the school takeover in March 2020.

Figure 5: Photos of company’s collages

Source：Google

The obvious advantages of Guangdong's higher education market

According to the Guangdong Provincial Bureau of Statistics, Guangdong Province has become China's most populous province in 2019, accounting for 8.23% of China's total population. At the end of 2019, the permanent population of Guangdong was 115 million, a year-on-year increase of 1.75 million, of which the natural growth population was 923,800, and the net inflow population from other places was 826,200. This huge population growth also means that the people of Guangdong Province demand higher education resources. On the other hand, the gross enrollment rate of higher education in Guangdong Province is currently lower than the average of all provinces in China. According to the Guangdong Academy of Education, the gross enrollment rate of higher education in Guangdong Province in 2019 was only 46%, while the average gross enrollment rate of higher education in China in 2019 was about 52%. Given the increasing demand for higher education in Guangdong Province, this gross enrollment rate gap reflects the current shortage of higher education market in Guangdong Province. As for tuition fees, according to the National Bureau of Statistics, the per capita disposable income of Guangdong Province in the first half of 2020 is RMB 20,774, which is much higher than the national average of RMB 15,666. It can be seen that with the strong demand for higher education, the average higher education fee in Guangdong Province is expected to increase. Further, since 2007, in order to support and promote the development of the higher education market in Guangdong Province to alleviate the shortage of higher education services in Guangdong Province, the Guangdong Provincial Government has allowed the independent pricing of private higher education.

Figure 6: 10 most populated province (million people)

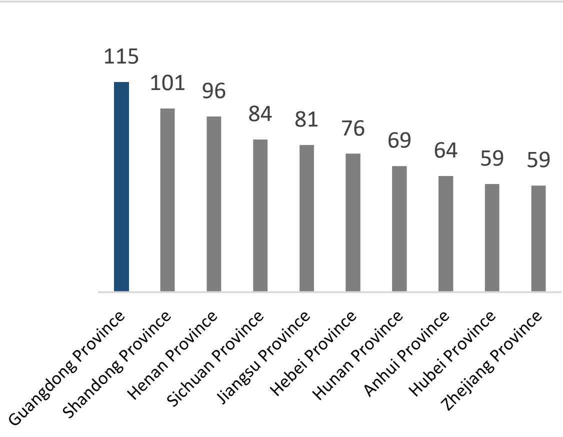
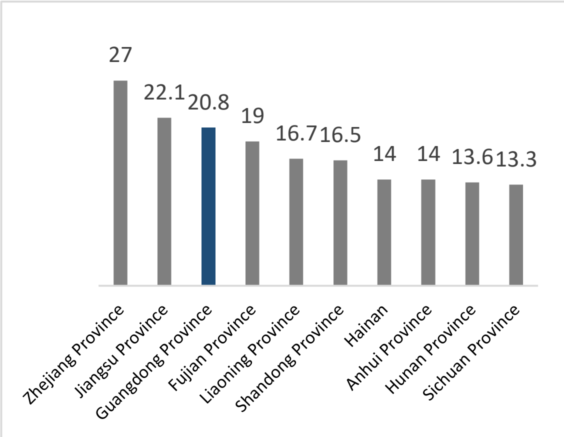


Figure 7: 10 highest capita disposable income province (thousand RMB)



Source：National Bureau of Statistics, PSHK

"The Law for Promoting Private Education of the PRC" has no huge impact on the company

" The Law for Promoting Private Education of the PRC" has not been fully implemented yet. The company's management believe that it will only have a limited negative impact on the company even if its fully implemented. It is expected that after the implementation of this policy, the company's effective tax rate will increase from 0.4% in 2019 to 10-15%. This impact is already known to the market and is limited. On the other hand, after the policy is promulgated, private education groups will be required to pay a premium for their land. According to the company's management, the land of the company's self-built colleges (Guangdong Polytechnic College, Zhaoqing School) comes from auction, so there is no need to pay premium for these land in the future. As for the land of Harbin Institute of Petroleum, the company will only need to make up about RMB 100 million in land premium in the future, and the payment can be made in installments for many years, so it does not pose any significant pressure on the company's future cash flow and performance.

High market recognition and high teaching quality of the company's colleges

Out of the market's recognition of the quality of education provided by the company and the outstanding results of students, the company has won many awards since its establishment. On the other hand, the initial employment rate of the Guangdong Polytechnic College is among the best in Guangdong Province. According to the Guangdong Provincial Department of Education, the average initial employment rate for undergraduate degree graduate in Guangdong Province in 2018 and 2019 was 93.8% and 93.4%, respectively. In the 2017/2018 academic year and the 2018/2019 academic year, Guangdong Polytechnic College had 1,023 and 3,196 undergraduate degree graduates. The initial employment rates were 96.8% and 97.8%, respectively, which were 3.0% and 4.4% higher than the average of Guangdong Province. It highlights the broad market recognition of the graduates of the undergraduate degree of the company's colleges.

The enrollment expansion policy of "junior college graduate into undergraduate program" stimulates the company's organic growth

Benefiting from the expansion policy of "junior college graduate into undergraduate program", Guangdong Polytecnic College has a total of 3,600 junior college upgrade degrees in the 2020 academic year, and only 390 junior college upgrade degrees in 2019 academic year with final admission 83 students. If all the 3,600 junior college upgrade degrees in the 2020 academic year are admitted, the number of undergraduate students in Guangdong Polytecnic College will be increase by 3,513. Based on the tuition fee of undergraduate program in 2019, the increase number of undergraduate students will bring an additional RMB 83 million income to the company, accounting for 11.7% of total revenue in 2019.

The campus and dormitories continue to expand to increase the maximum capacity of the campus

The new Dinghu campus of Guangdong Polytecnic College has been established in Dinghu District, Zhaoqing. The first phase of the construction was completed in September 2017, expanding the capacity of the school by approximately 6,000 students. The second phase of the construction was completely in the third quarter of 2018, expanding capacity of another 4000 students. The third phase of the construction of the new Dinghu campus of Guangdong Polytechnic College is expected to be completed in the second half of 2020, and will further expand the capacity of Guangdong Polytechnic College by around 3,000 students. On the other hand, the company plan to upgrade the Gaoyao campus of Guangdong Polytechnic College, with focus on expansion and upgrade of dormitories and supporting facilities. The construction of the dormitories with a capacity of approximatively 7000 students is expected to be complete by the end of the year. We expect the capacity of Guangdong Polytechnic College in the next two years will increase from 29,000 to 39,000. The expansion of campus and dormitory has provided support and foundation for the company's future increase in the number of students on campus.

School-Enterprises collaboration plan to improve student's career prospect

The company cooperates with many well-known enterprises in Guangdong Province to provide valuable practical training for students of the company's colleges and to help students find employment after graduation. Through the School – Enterprise Collaboration Programs, the enterprises serve as an external training base and provide students with internship opportunities, while the school provides companies with well-trained graduates. In the future, the company plans to further expand and enrich school-enterprise cooperation projects, establish cooperation projects with more industry-leading companies, and deepen relationships with existing partners. In addition, the company has set up more than 100 practical training bases for students, which enable students to obtain first hand workplace simulation experience strength practical skills and adapt quickly to the growing and changing demand of the market. The company takes practical ability as the primary teaching goal, so that its graduates are well recognized by the market, which drives up the initial employment rate.

Figure 8: school enterprises scheme partner

Source：Company

Students' diversified academic options -"2+2" program

The company established the “2+2” program in collaboration with reputable overseas education institution, including Trinity Western University in Canada, Texas Wesleyan University in the US, University of Huddersfield in the UK and Midwestern State University in the US. This provides students with opportunity to complete their remaining two academic years with oversea partners of the college. The tuition for the first two years of the "2+2" program is collected by the company, while the tuition for the remaining two years is collected by overseas institutions. The tuition fees charged by Guangdong Polytechnic College for the "2+2" program are generally higher than the tuition fees for its general undergraduate and junior college programs, ranging from RMB 15,000 to RMB 30,000 per academic year. Students who have completed the "2+2" program will be awarded degrees from overseas universities and Guangdong Polytechnic College. The company's "2+2" program gives students diversified academic choices, enhances the enrollment competitiveness of Guangdong Polytechnic College, and also adds an additional source of income to the company.

Figure 9: “2+2” program

Source：Company

Harbin Institute of Petroleum is indeed a high-quality asset, the company will continue the external expansion in the future to achieve sustained high growth

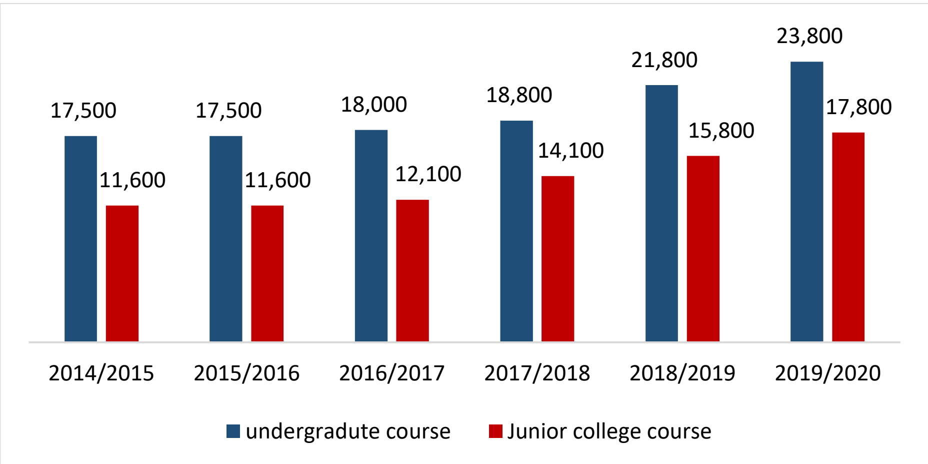
For private higher education colleges, due to the limited number of new students each year, it will be difficult to sustain a high growth in the future if only relying on organic growth. In recent years, many large-scale private higher education groups have expanded externally (purchasing high-quality target College) to achieve income growth.

The company acquired 100% of Harbin Institute of Petroleum in January 2020. Harbin Institute of Petroleum has 1,000 acres of teaching land and is located in the core area of Harbin with convenient transportation. The school has a total of 31 undergraduate courses. There are 9,366 undergraduate students in the 2019/2020 academic year, an increase of 5% year-on-year. The school's education quality is high. In 2019, the registration rate and employment rate were 97.1% and 96.2%, ranking first and second among private colleges in Heilongjiang Province. Harbin Institute of Petroleum's 2019 net profit is approximately RMB 68 million, up by 88% yoy. The school's current net profit margin is at a low level comparing to the company's self-built schools, about 44%, and it is expected to be further improved through collaboration with Guangdong Polytechnic College. The school is relatively financial healthy, with only 11% of debt to asset ratio in 2019. The future tuition fees and the number of students of Harbin Institute of Petroleum are also expected to increase. The school's 1,000 acres of land can accommodate up to 20,000 students, which is double the amount of the 2019 students. On the other hand, the current average tuition fee of the school is about 10% lower than the provincial average, and it is expected to rise to the provincial average in the future. At present, the company has completed the school takeover, and the net profit of the school can be consolidated. But the assets of Harbin Institute of Petroleum can only be consolidated after the change of the organizer is completed (It is expected to be completed by the end of the year). We believe that the Harbin Institute of Petroleum is definitely a quality asset, and it is expected to create synergy effect with other colleges under the company. Looking forward, even though the company has RMB 1.45 billion cash outflow this year for the acquisition of Harbin Institute of Petroleum, but the company will have cash inflow for tuition fee in September this year. The company also has RMB 2.3 billion of bank credit line. Hence, we believe that it will have more than enough cash to continue making acquisition in the future.

Tuition fees charged by the company's colleges have risen rapidly in recent years, and this trend is expected to continue in the future

The tuition fees charged by the company's colleges have generally been on the rise in recent years, and the increase in the tuition fees of Guangdong Polytechnic College's undergraduate and junior college courses are even more impressive. We believe that the tuition fees of the company's colleges still have room to rise in the future. The main reason is that Guangdong Province currently has a huge demand for higher education. In addition, Guangdong Province's per capita disposable income in 2019 is the third in the country, which implies that the students in Guangdong Province has a strong ability to pay for education. Further, since the colleges under the company are very well known for their high initial employment rate, therefore the company will have a higher bargaining power in tuition fee pricing. We believe the company can increase tuition fee in the future while still maintaining their enrollment competitiveness.

Figure 10: The lower boundary of tuition fee (RMB)



Source：Company, PSHK

Financial Analysis and Forecast

Revenue Analysis

The company's total revenue rose from RMB 455 million in 2017 to RMB 714 million in 2019, with a CAGR of 25%. Among them, the total tuition income of the company's undergraduate courses increased the most, with a CARG of 44.5% from 2017 to 2019. The main reason is that Guangdong Polytechnic College has only started their undergraduate program in 2014-25 academic year. Therefore, before the 2018-2019 academic year, the students of the undergraduate courses have not covered the 4 grades of the course (no graduates have yet to leave the school). Secondly, the huge demand for higher education by Guangdong students and the high-quality teaching of Guangdong Polytechnic College have prompted the company to increase tuition fees in the past few years while still increasing the number of undergraduate enrollment each year. We expect the company will benefit hugely from the policy of the expansion of "upgrade from junior college to undergraduate" enrollment. We expect the undergraduate students will increase by 4,517 students (including 3,517 students from junior college upgrade degree) or 14.7%, reaching 28,340 students. This increase will normalize to 5% in 2021. On the other hand, we expect an increase of 12% yoy in the undergraduate tuition fee in 2020 and 2021. Based on these expectation, we forecast the revenue from undergraduate course are RMB 598 million and RMB 706 million in 2020 and 2021, up by 33% and 18% yoy.

On the other hand, the company has reduced the students of Junior college program in order to vacate and allocate more resources to undergraduate courses. The company's revenue from junior college tuition fee has decreased from RMB 133 million to RMB 113 million, with a CAGR of -7.5%. We believe the company will be affected by the policies of expansion in higher vocational college enrollment. The junior college students are expected to increase by 7%/6% in 2020/2021, with the junior college tuition fee expected to increase by 5%. We estimate that the company's junior college tuition revenue for 2020/2021 will be RMB 127/RMB 142 million, up by 12%/11% yoy.

The asset and revenue of Harbin Institute of Petroleum are expected to be consolidated into the financial statement of the company by the end of the year. The 2019 revenue of Harbin Institute of Petroleum was RMB 155 million. We expect the revenue growth will be 8%/10% in 2020/2021 and the revenue will reach RMB 168 million / RMB 184 million.

We expect the company's total revenue for 2020/2021 to be RMB 1,079 million/ RMB 1,236 million, a year-on-year increase of 51%/15%. The company's past and forecast revenue details are as follows.

Figure 11: Revenue breakdown (million RMB)

	2017	2018	2019	2020E	2021E
Tuition fee					
Undergraduate program	215.1	330.5	449.0	598.2	705.9
Junior college program	132.5	116.3	113.4	127.4	141.8
Adult college program	21.8	27.5	42.1	71.6	85.9
Upgrade of junior college students	5.1	5.3	4.2	3.8	3.4
Secondary vocational education	39.0	41.5	46.9	44.5	42.3
Total Tuition fee	413.4	521.1	655.6	845.5	979.3
Boarding fees	36.5	44.2	52.4	60.3	66.3
Other education service fees	5.5	10.1	6.2	6.2	6.2
Harbin Institute of Petroleum				167.6	184.4
Total Revenue	455.4	575.5	714.2	1,079.6	1,236.2

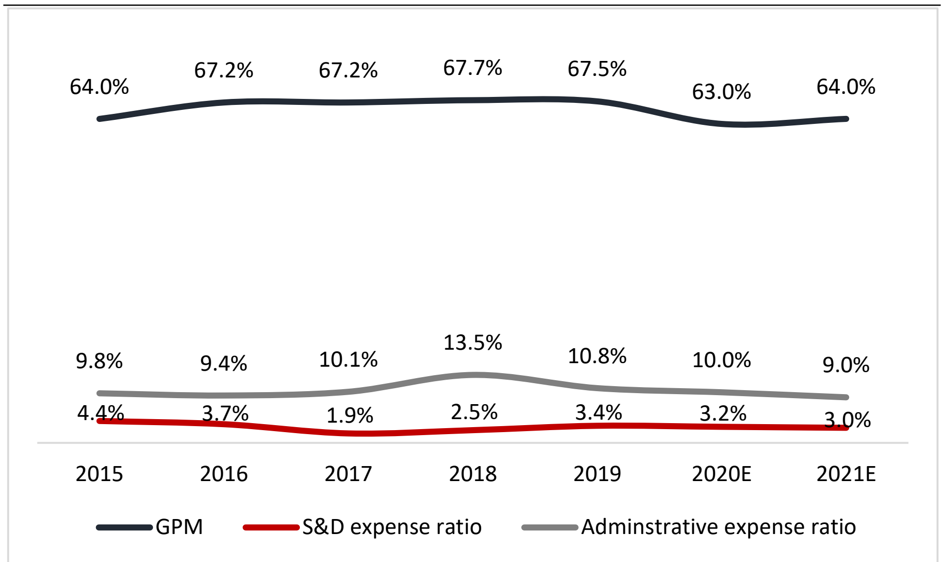
Source：Company, PSHK

Cost of Sale and expenses

The company's gross profit margin has been fairly stable in the past few years, ranging from 67% to 68%. We expect the gross profit margin of the company in 2020 and 2021 will be than 67%, mainly attributed by the lower profit margin of Harbin Institute of Petroleum. We believe that the profit margin of Harbin Institute of Petroleum will slowly increase in the future as a result of the synergies effect between Harbin Institute of Petroleum and the company's other college. We forecast the gross margin of the company are 63%/64% in 2020/2021.

As for expenses, we believe that the company's selling and distribution expense ratio will fall steadily. The main reason is that the company's advertising expenses as a percentage of revenue is expected to gradually decline as the company's popularity increases. We forecast this expense ratio are 3.2%/3.0% in 2020/2021, down by 0.21/0.20 ppt yoy. On the other hand, we believe that the company's administrative expenses ratio in 2020/2021 will gradually decline year-on-year due to the company's economies of scale, to 10%/9% respectively.

Figure 12: GPM and expense ratio



Source：Company, PSHK

Valuation

We have set a target price of HKD 7.20

The industry's average 2020 P/E is 18.8x. The 2020 P/E of the industry leaders, China Education (839.HK), China Yuhua (6169.HK) and Hope Education (1765.HK) are 30.0x, 28.8x and 27.9x respectively. The company has equipped with strong acquisition capabilities while having huge organic growth potential. We believe its performance can improve hugely in the near future through the Organic Growth + Acquisition – Twin Engine. The company's future growth rate can even be matched with the future growth rate of the market leaders. Hence, from the valuation perspective, we expect the company's valuation is expected to catch up with the market leaders and increase gradually from a mid-tier level to the top-tier level. We are giving out a 2020 P/E ratio of 21x to the company.

We forecast the EPS of the company are RMB 0.31/0.36 in 2020/2021 (HKD 0.34/0.40). The target price is HKD 7.20, which implies a 2020/2021 P/E ratio of 21.0x/17.9x. We initiate with a "Accumulate" rating. (Market closing price as of 4th Aug) (exchange rate: RMB 0.9/HKD)

Figure 13： Comps Table

Company	Stock Code	Closing Price	Market Cap	P/E			P/B		
				TTM	2020	2021	TTM	2020	2021
		HKD	million RMB						
China Kepei	1890 hk equity	6.25	11,266	24.5x	18.6x	15.2x	4.0x	3.2x	2.8x
China Education	839 hk equity	15.16	27,593	34.9x	30.0x	24.8x	4.0x	3.9x	3.5x
China Yuhua	6169 hk equity	7.84	23,589	47.1x	28.8x	19.4x	6.3x	5.6x	4.7x
Hope Education	1765 hk equity	2.79	16,980	28.9x	27.9x	20.4x	3.7x	3.4x	3.1x
Edvantage Group	382 hk equity	5.94	5,450	20.0x	17.9x	14.0x	3.4x	2.8x	2.4x
Huali University	1756 hk equity	3.12	3,373	6.3x	11.0x	8.8x	0.6x	1.3x	1.1x
Minsheng Education	1569 hk equity	1.11	4,218	11.8x	9.3x	7.9x	1.1x	0.9x	0.9x
China New Higher	2001 hk equity	5.72	7,942	19.8x	15.2x	12.5x	3.2x	2.7x	2.3x
China Xinhua	2779 hk equity	2.36	3,420	12.6x	10.6x	9.3x	1.3x	1.2x	1.0x
			Average	**22.9x**	**18.8x**	**14.7x**	**3.1x**	**2.8x**	**2.4x**
			Median	**20.0x**	**17.9x**	**14.0x**	**3.4x**	**2.8x**	**2.4x**

Market closing price as of 4th Aug
Source: Bloomberg, PSHK

Financials

Key Financial Data

FYE DEC	FY18	FY19	FY20E	FY21E
Valuation Ratio				
P/E ratio (x)	24.5	24.7	18.2	15.5
P/B ratio (x)	7.9	4.0	3.6	3.2
Dividend yield	1.60%	1.60%	2.08%	2.56%
Per share data (RMB)				
EPS	0.23	0.23	0.31	0.36
Book value per share	0.72	1.39	1.57	1.78
Dividend per share (HKD)	0.10	0.10	0.13	0.16
Growth & Margin				
Revenue Growth	26.4%	24.1%	51.2%	14.5%
Operating income growth	45.9%	31.1%	35.3%	17.6%
net income growth	48.1%	33.4%	35.3%	17.6%
Gross Profit Margin	67.7%	67.5%	63.0%	64.0%
Operating profit Margin	61.0%	64.4%	57.7%	59.2%
Net Profit Margin	59.4%	63.9%	57.2%	58.7%
Key Ratios				
ROE	24%	16%	20%	20%
ROA	15%	13%	16%	17%

Market closing price as of 4th Aug

Consolidated Statement of Profit and Loss

	2017	2018	2019	2020E	2021E
Tuition fee					
Undergraduate program	215.1	330.5	449.0	598.2	705.9
Junior college program	132.5	116.3	113.4	127.4	141.8
Adult college program	21.8	27.5	42.1	71.6	85.9
Upgrade of junior college students to undergraduate students	5.1	5.3	4.2	3.8	3.4
Secondary vocational education	39.0	41.5	46.9	44.5	42.3
Total Tuition fee	413.4	521.1	655.6	845.5	979.3
Boarding fees	36.5	44.2	52.4	60.3	66.3
Other education service fees	5.5	10.1	6.2	6.2	6.2
Harbin Institute of Petroleum				167.6	184.4
Total Revenue	455.4	575.5	714.2	1079.6	1236.2
Cost of Sale	-149.2	-185.9	-232.4	-399.5	-445.0
Gross profit	306.2	389.5	481.8	680.2	791.2
Other income and gain	8.7	58.0	81.0	85.1	89.3
Selling and distribution expense	-8.5	-14.5	-24.3	-34.5	-37.1
Administrative expense	-46.0	-77.5	-77.3	-108.0	-111.3
Other expense	-13.1	-4.6	-0.8	0.0	0.0
P/L of JV and other investment	-6.8	0.0	-0.3	0.0	0.0
Opearting Profit	240.5	350.9	460.1	622.7	732.1
Finance cost	-9.6	-9.0	-1.9	-2.2	-2.5
Profit before tax	230.9	342.0	458.2	620.5	729.6
Income tax	0.0	0.0	-1.9	-3.1	-3.6
Profit for the year	230.9	342.0	456.3	617.4	726.0
share outstanding			2000.799	2000.799	2000.799
EPS (RMB)		0.23	0.23	0.31	0.36
DPS (HKD)		0.1	0.1	0.13	0.16

Consolidated statement of financial position

	2017	2018	2019	2020E	2021E
Non current asset					
Property, plant and equipment	1,001.5	1,274.4	1,422.6	1,564.9	1,721.3
Right of use of asset	0.0	0.0	208.0	201.9	195.9
Others	161.9	329.1	349.7	1,753.2	1,729.9
Total non-current assets	1,163.4	1,603.4	1,980.3	3,519.9	3,647.2
Current asset					
Trade receivables	18.1	22.7	29.7	43.4	49.7
Cash and cash equivalents	369.1	432.9	1,111.7	45.8	393.5
Others	457.6	271.3	301.4	304.4	307.6
Total current assets	844.7	726.8	1,442.9	393.6	750.8
Total asset	2,008.1	2,330.3	3,423.1	3,913.5	4,398.0
Non current Liabilities					
Interest bearing bank loans	325.0	100.0	100.0	115.0	130.0
Others	4.8	4.0	12.2	12.2	12.2
Total non current liabilities	329.8	104.0	112.2	127.2	142.2
Current Liabilities					
Other payables and accruals	220.2	115.6	105.9	116.5	128.2
Others	289.6	678.1	415.1	522.5	574.5
Total current liabilities	509.8	793.7	521.0	639.0	702.7
Total Liabilities	839.5	897.7	633.2	766.2	844.9
Equity					
Share capital	0.0	0.0	0.1	0.1	0.1
Reserve	1,168.6	1,432.6	2,789.8	3,147.1	3,553.0
Total Equity	1,168.6	1,432.6	2,789.9	3,147.3	3,553.1
Total liabilities and Equity	2,008.1	2,330.2	3,423.1	3,913.5	4,398.0

Cash Flow Statement

	2017	2018	2019	2020E	2021E
Profit before tax	230.9	342.0	458.2	620.5	729.6
change in working capital	95.5	95.8	41.9	102.2	54.1
depreciation and amortisation	38.8	57.3	72.8	74.0	80.7
Others	33.4	-11.5	-33.9	44.7	22.1
Cash flow from operating activities	398.5	483.6	539.0	841.5	886.5
Cash flow from investing	-171.0	-514.1	-413.9	-1660.2	-231.2
Cashflow from financing	55.2	67.9	543.1	-247.3	-307.6
foreign exchange effect	0.0	26.4	10.6	0.0	0.0
Cash at beginning	86.3	369.1	432.9	1111.7	45.8
Cashflow during the year	282.8	63.9	678.8	-1066.0	347.7
Cashflow at the end	369.1	432.9	1111.7	45.8	393.5

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 ± 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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