



China Education Group (CEG) Acquisition of Chongqing School further boosts leadership

- New acquisition of the Chongqing School would increase total enrollment to 170k
- It is the second acquisition conducted by CEG this year
- The acquired school has an above-peer capacity
- CEG continues to be a leader in the education industry; we believe it would achieve its target student enrollment of 200k by 2020E
- Maintain **BUY**, current TP represents 34.50x/22.78x 19E/20E P/E or 3.77x/3.38x 19E/20E P/B

New acquisition further diversifies CEG's portfolio. CEG announced the acquisition of a 100% sponsorship interest of Chongqing Nanfang Translators College of Sichuan International Studies University (四川外國語大學重慶南方翻譯學院) (Chongqing School), an independent college with a student enrollment of 13,252 and a campus size of 1,572mu. It is the second acquisition by CEG in 2019, following the acquisition of Quancheng University in Shandong. The latest acquisition in southwestern China will further expand CEG's schools' geographical profile. According to CEG, the total student enrollment of all portfolio schools would be 170,000 after the transaction.

Room for improvement for Chongqing School. According to CEG, there are six independent colleges in the Chongqing municipality. The campus size of Chongqing School is larger than the median of peers in the same region by 71%; also, its admission score is higher than the peer median. Its enrollment and tuition, however, are 28% and 13% lower than the peer median – an area where improvement can be made. In addition, as the Chongqing School has sufficient land and buildings to meet the requirement of separating from its affiliated university, we believe cost savings from terminating the annual royalty charges (8% of tuition income) would help improve margins.

Price/revenue multiple is similar to Quancheng University acquisition. According to the Group, the 19E EV/EBITDA multiple is 12.2x for the latest acquisition, which is lower than the generally required multiple of similar transactions reviewed by the Group. Based on the disclosed financial data, consideration paid by CEG represents 4.58x 2018 price/revenue, 79.32x 2018 price/normalized NP, and 9.37x 2018 price/normalized EBITDA. In terms of price/revenue multiple, the Chongqing School acquisition is similar to the acquisition of Quancheng University in Shandong announced in Jan 2019.

Maintaining leadership in the HK-listed PRC education sector. The new acquisition would further boost the Group's leading position in the HK-listed PRC education sector. None of the higher education peers has a student enrollment exceeding 100k and none has an acquisition pace comparable to CEG's. We believe the Group would be able to boost student enrollment through acquisitions and reach its target student enrollment of 200k by 2020E.

Growth momentum to be supported by acquisitions. We expected the Group's revenue and total net profit (to shareholders of the Company) CAGR to be 30.6% and 32.1% in 2018-21E, mainly supported by acquisitions of schools since 2018. Margins, however, could be pressured by the newly acquired school in the short term, whose operations are yet to be optimized. We expect GPM and NPM (to shareholders of the Company) to reach 56.1% and 42.9% in FY21E. (Continue next page)

Results and Valuation

FY ended Aug 31	FY18E	FY19E	FY20E	FY21E	FY22E
Revenue (RMB mn)	1,294	1,904	2,525	2,882	3,220
Chg (YoY %)	N/A	47.15	32.63	14.11	11.75
Total Net Profit – to shareholders of the Company (RMB mn)	536	722	1,088	1,236	1,405
Chg (% YoY)	N/A	34.71	50.68	13.67	13.64
Basic EPS (RMB cents)	28.68	35.91	54.11	61.51	69.91
Change (YoY %)	1.85	25.22	50.68	13.67	13.64
P/E (x)	37.45	29.91	19.85	17.46	15.36
BVPS (RMB cents)	319.88	343.07	380.72	423.82	473.17
P/B (x)	3.36	3.13	2.82	2.53	2.27
Dividend (RMB cents)	6.56	12.72	16.46	18.42	20.55
Dividend yield	0.61	1.18	1.53	1.71	1.91
ROAA (%)	N/A	6.84	8.63	9.26	9.70
ROAE (%)	N/A	11.32	15.57	15.86	16.11

Source(s): Prospectus, ABCI Securities estimates

Company Report
Jun 27, 2019
Rating: BUY
TP: HK\$ 14.0

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Share price (HK\$)	12.20
52WK H/L (HK\$)	14.9/8.03
Est. share price return	14.78%
Est. dividend yield	1.18%
Est. total returns	15.97%
Previous rating&TP	BUY/HK\$ 14.0

Source(s): Bloomberg, ABCI Securities estimates

Key data

Issued shares (mn)	2,020.20
Mkt cap (HK\$ mn)	24,646.46
3-mth avg ADT (HK\$mn)	77.39
Shareholding (%)	
Yu Guo	37.125
Xie Ketao	37.125
Cornerstone investors	11.13

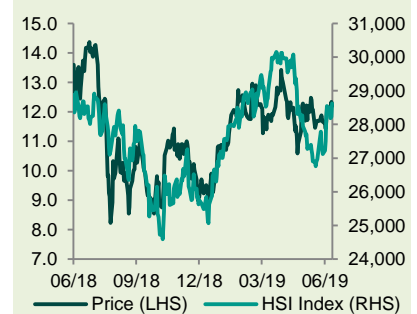
Source(s): Bloomberg, the Group, ABCI Securities

Price performance (%)

	Absolute	Relative (HSI)*
1-mth	1.67	(4.01)
3-mth	3.34	2.01
6-mth	32.24	17.55

Source(s): Bloomberg

1-yr price performance



Source(s): Bloomberg, ABCI Securities

Note: market data as of end-Jun 27, 2019



Maintain BUY, TP at HK\$ 14.0. Maintain **BUY** on strong execution capability in expanding its school portfolio. Our DCF-derived TP is maintained at HK\$ 14.0 (34.50x/22.78x 19E/20E P/E or 3.77x/3.38x 19E/20E P/B), as the new acquisition is only an additional step towards the student enrollment target of 200k, which has been priced in our model, and the new acquisitions would bring in more fluctuations in margin performance.

Risk factors: 1) Growth risk; 2) Geographical concentration risk; 3) Acquisition risk; 4) Cost risk; 5) Education quality and student dropout risk; 6) Expansion risk; 7) Regulatory risk; 8) Liquidity risk.

Exhibit 1: Chongqing School acquisition details

Consideration	Subject	Valuation metrics					Financial performance of target					
		EV/EBITDA (x)	P/E (x)		Unit student value (RMB)		Revenue (RMB k)		NP* (RMB k)		EBITDA* (RMB k)	
RMB 1,010mn	100% sponsorship interest of Chongqing School	2019	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018
		12.2	1905.7	79.3	15,416	16,647	198,634	220,600	530	12,733	90,565	107,741

Note: NP and EBITDA are normalized
Source(s): The Group, ABCI Securities

Exhibit 2: Student admission and employment of Chongqing School

Year	Quota	Admitted	Registered	Registration ratio	Initial employment rate
2016	3,559	3,559	3,211	90.2%	92.08%
2017	3,643	3,643	3,354	92.06%	94.72%
2018	3,722	3,722	3,504	94.14%	93.44%

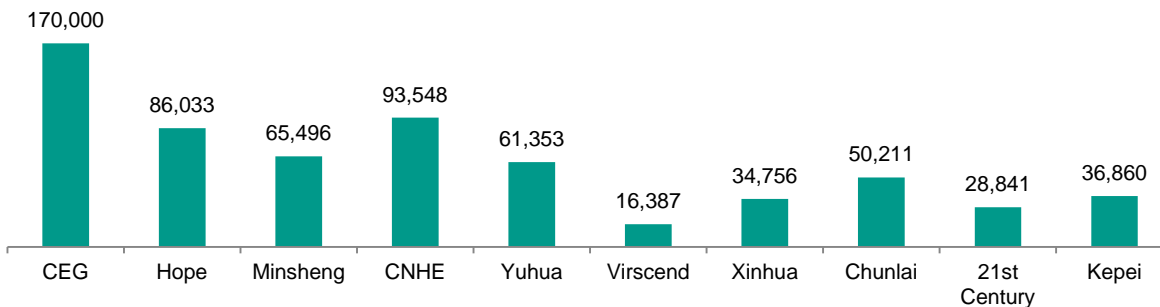
Source(s): The Group, ABCI Securities

Exhibit 3: Transaction multiple comparison

	Price/revenue(x)		Price/EBITDA*(x)	
	2017	2018	2017	2018
Chongqing School	5.08	4.58	11.15	9.37
Quancheng University	5.55	4.98	63.3	42.3

Notes: Chongqing School's EBITDA is normalized; price assumes acquisition of 100% sponsorship interest
Source(s): The Group, ABCI Securities

Exhibit 4: 2018/19 school year student enrollment of higher education operators (ppl)



Notes: CEG's enrollment data assumes acquisition of Chongqing School is completed
Source(s): Companies, ABCI Securities

Exhibit 5: Forecast change

	Current				Previous			
	FY18E	FY19E	FY20E	FY21E	FY18E	FY19E	FY20E	FY21E
EPS – basic (RMB cents)	28.68	35.91	54.11	61.51	28.68	44.89	58.88	61.39
GPM (%)	61.6	55.7	55.7	56.1	61.6	54.9	57.6	57.4
NPM (to shareholders of the Company) (%)	41.4	37.9	43.1	42.9	41.4	48.3	48.5	47.5

Source(s): Companies, ABCI Securities estimates



Financial statement of the Group

Consolidated income statement (FY18E-FY22E)

FY ends at Aug 31 (RMB mn)	FY18E	FY19E	FY20E	FY21E	FY22E
Revenue	1,294	1,904	2,525	2,882	3,220
- Tuition fees	1,175	1,724	2,274	2,563	2,839
- Boarding fees	83	120	157	180	206
- Ancillary services	36	60	95	139	175
COGS	(497)	(843)	(1,119)	(1,265)	(1,404)
Gross profit	797	1,061	1,407	1,617	1,816
Selling expenses	(21)	(36)	(39)	(42)	(33)
Admin expenses	(212)	(332)	(421)	(486)	(551)
Others	34	55	183	197	226
Finance costs	(31)	19	(8)	(9)	(9)
Pretax profit	567	767	1,122	1,277	1,449
Tax	13	(42)	(28)	(34)	(37)
Net profit from operation	579	726	1,093	1,243	1,412
Net profit from discontinued operation	0	0	0	0	0
Total net profit	579	726	1,093	1,243	1,412
- Profit attributable to shareholders	536	722	1,088	1,236	1,405
- Minority interest	43	4	5	6	7
Dividend	133	257	333	372	415
EPS (RMB cents)					
- Basic	28.68	35.91	54.11	61.51	69.91
- Diluted	28.55	35.75	53.87	61.24	69.59
DPS (RMB cents)	6.56	12.72	16.46	18.42	20.55

Note: 1) The Group changed its FY-end to Aug 31 from Dec 31 in 2018 and only disclosed income statement data for Jan-Aug 2018, FY-17 data is not available and data from FY18 onward are estimates; 2) Individual items may not sum up to total due to rounding differences

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet (FY18A-FY22E)

FY ends at Aug 31 (RMB mn)	FY18A	FY19E	FY20E	FY21E	FY22E
Bank balances and cash	1,738	4,003	4,032	5,087	5,276
Trade receivables, deposits, prepayments and other receivables	130	18	182	72	205
Others	190	493	506	624	661
Current assets	2,059	4,515	4,721	5,783	6,143
PP&E	3,259	4,475	4,562	4,582	5,236
LT Prepaid lease payment	63	101	105	104	119
Goodwill	917	962	962	962	962
Intangible assets	994	1,024	1,055	1,086	1,119
Others	1,442	1,410	1,442	1,477	1,534
Non-current assets	6,675	7,973	8,127	8,211	8,970
Total assets	8,733	12,487	12,847	13,994	15,113
ST Contracted liabilities	1,038	1,552	1,882	2,039	2,340
ST Borrowing	0	0	0	0	0
Trade payables, other payables and accrued expenses	566	604	561	813	757
Others	143	159	168	171	179
Current liabilities	1,747	2,315	2,611	3,022	3,276
LT Borrowing	130	640	123	151	184
Convertible bonds	0	2,355	2,120	1,908	1,717
Others	394	246	303	351	378
Non-current liabilities	524	3,241	2,545	2,410	2,278
Equity to owners of the Company	6,143	6,608	7,363	8,228	9,218
Minority interest	319	323	328	334	341
Equity	6,462	6,931	7,691	8,562	9,559
Total liabilities and equity	8,733	12,487	12,847	13,994	15,113

Note: 1) The Group changed its FY-end to Aug 31 from Dec 31 in 2018 and only disclosed balance sheet data as of Aug 31, 2018, FY17 data adjusted for the new FY-end is not available and data from FY19 onward are estimates; 2) Individual items may not sum up to total due to rounding differences

Source(s): The Group, ABCI Securities estimates



Consolidated cash flow statement (FY18E-FY22E)

FY ends at Aug 31 (RMB mn)	FY18E	FY19E	FY20E	FY21E	FY22E
Net profit for the period	579	726	1,093	1,243	1,412
Depreciation	134	152	167	179	191
Change in working capital	485	318	268	189	230
Others	156	237	260	151	256
Cash flow from operating activities	1,356	1,432	1,788	1,762	2,089
Capex	(405)	(545)	(434)	(415)	(350)
Others	(785)	(1,251)	(230)	275	(964)
Cash flow from investing activities	(1,190)	(1,796)	(665)	(140)	(1,315)
Change in borrowings	86	2,867	(753)	(186)	(161)
Interest paid	(31)	19	(8)	(9)	(9)
Others	(133)	(257)	(333)	(372)	(415)
Cash flow from financing activities	(77)	2,628	(1,094)	(567)	(585)
Net change in cash	88	2,264	29	1,055	189
Cash and cash equivalent - beg	1,650	1,738	4,003	4,032	5,087
Cash and cash equivalent - end	1,738	4,003	4,032	5,087	5,276

Note: 1) The Group changed its FY-end to Aug 31 from Dec 31 in 2018 and did not disclose cash flow statement data adjusted for the new FY-end, data from FY18 onwards are estimates; 2) Individual items may not sum up to total due to rounding differences

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios (FY18E-FY22E)

FY ends at Aug 31	FY18E	FY19E	FY20E	FY21E	FY22E
Growth (YoY %)					
Revenue	N/A	47.2	32.6	14.1	11.7
- Tuition fees	N/A	46.7	31.9	12.7	10.8
- Boarding fees	N/A	44.9	30.8	14.3	14.6
- Ancillary services	N/A	65.7	57.1	46.8	26.0
Gross profit	N/A	33.1	32.6	14.9	12.3
Pretax profit	N/A	35.4	46.2	13.8	13.5
Total net profit (to owners of the Company)	N/A	34.7	50.7	13.7	13.6
Profitability ratios (%)					
GPM	61.6	55.7	55.7	56.1	56.4
Pretax margin	43.8	40.3	44.4	44.3	45.0
Total NPM (to shareholders of the Company)	41.4	37.9	43.1	42.9	43.6
Revenue contribution (%)					
Tuition fees	90.8	90.5	90.0	88.9	88.2
Boarding fees	6.4	6.3	6.2	6.2	6.4
Ancillary services	2.8	3.2	3.7	4.8	5.4
Return ratios (%)					
ROAA	N/A	6.8	8.6	9.3	9.7
ROAE	N/A	11.3	15.6	15.9	16.1
Liquidity ratio (x)					
Current ratio	1.2	1.9	1.8	1.9	1.9
Cash ratio	1.0	1.7	1.5	1.7	1.6
Leverage ratios (%)					
Total debt to Equity	3.7	44.8	30.6	25.3	21.0
Total debt to Total assets	2.7	24.9	18.3	15.5	13.3
Net (debt)/cash to Equity	(23.2)	(13.0)	(21.9)	(34.1)	(34.2)
Net (debt)/cash to Total assets	(17.2)	(7.2)	(13.1)	(20.9)	(21.7)

Source(s): The Group, ABCI Securities estimates



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