

Xinhua Education (XEG)

A regional player in a booming market

- The Group is a higher education operator based in Hefei, Anhui, with two portfolio schools and 28,030 students for the 2017/18 school year
- FY17 revenue and core net profit (excluding listing expenses) rose by 11.4% YoY and 15.0% YoY
- The Group was selected as the cooperative partner to operate the School of Clinical Medicine by Anhui Medical University; the new school is expected to have a maximum capacity for 10,000 students in the future
- We expect total revenue to grow at 20.4% CAGR in FY17-20E, supported by the addition of School of Clinical Medicine, rising fees, and expanding student enrollment
- Initiate with **BUY**; current TP implies 31.63x/26.00x 18E/19E P/E or 3.13x/2.80x 18E/19E P/B

FY17 results showed healthy growth. In FY17, the Group's revenue was up 11.4% YoY. Its gross profit and core net profit (excl. listing expenses) increased by 7.4% YoY and 15.0% YoY. GPM declined from 59.1% in FY16 to 57.0% in FY17 due to the increase in various operating expenses. But core NPM rose from 56.9% in FY16 to 58.7% in FY17, thanks to the decrease in selling expenses/sales ratio and admin expenses/sales ratio.

A leading higher education player in Anhui and Yangtze River Delta (YRD) area¹. A top player in the higher education market in Anhui and YRD, the Group was ranked first in market share (by student enrollment) in these regions in 2016. For the 2017/18 school year, the Group's student enrollment was 28,030 with a student capacity of 31,502, which implies a utilization rate of 84.5%.

IPO pricing at HK\$ 3.26. Proceeds from IPO after exercising the overallotment option were ~HK\$ 1,265.7mn, according to the Group. There were two cornerstone investors, BOCOM International Prosperity Investment Limited and China New City Commercial Development Limited. As of end of May 30, 2018, share price soared by 23.6% post-IPO.

Growth supported by additional school, rising fees, and expanding enrollment. We believe with the addition of the School of Clinical Medicine, rising fee levels, and expanding student enrollment, revenue and core net profit would expand at 20.4% and 22.3% CAGRs in 2017-20E. We also expect GPM and NPM (to owners of the Company) to improve to 61.0% and 61.6% in FY20E from 57.0% and 50.9% in FY17.

Initiate with BUY; TP at HK\$ 4.90. Based on our DCF model, we set our TP at HK\$ 4.90, which represents 31.63x/26.00x 18E/19E P/E or 3.13x/2.80x 18E/19E P/B. As of end of May 30, 2018, the average 18E P/Es of the higher education sector and the entire education sector in HK market were 26.04x and 29.66x.

Risk factors: 1) Growth risk; 2) Cost risk; 3) Expansion risk; 4) Expansion bottleneck risk; 5) Education quality and student dropout risk; 6) Asset concentration risk; 7) Dividend payout policy implication; 8) Regulatory risk.

Results and Valuation

FY ended Dec 31	FY14A	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue (RMB mn)	250	282	303	338	419	502	590
Chg (YoY %)	N/A	12.6	7.7	11.4	24.0	19.7	17.7
Net Profit ²	133	150	173	172	249	303	363
Chg (% YoY)	N/A	12.6	15.1	(0.3)	44.9	21.7	19.9
Basic EPS (RMB cent)	N/A	N/A	14.38	14.33	15.49	18.85	22.59
Change (YoY %)	N/A	N/A	N/A	(0.3)	8.1	21.7	19.9
P/E (x)	N/A	N/A	22.94	23.02	21.29	17.50	14.60
BVPS (RMB cent)	N/A	N/A	63.89	62.16	156.34	175.19	197.78
P/B (x)	N/A	N/A	5.16	5.31	2.11	1.88	1.67
Dividend (RMB cent)	N/A	N/A	N/A	0.0	0.0	0.0	0.0
Dividend yield	N/A	N/A	N/A	0.00	0.00	0.00	0.00
ROAA (%)	N/A	16.2	17.4	14.6	11.8	9.8	10.4
ROAE (%)	N/A	28.9	25.4	19.5	14.2	11.4	12.1

Source(s): Bloomberg, The Group, ABCI Securities estimates

Ex. Rate: 1RMB= 1.2219

¹Yangtze River Delta area (YRD) discussed in the report includes Jiangsu, Zhejiang, Anhui and Shanghai in the PRC

²Refers to Net profit attributable to owners of the Company (RMB mn)

³Pricing and market data as of end of May 30, 2018

Company Report Initiation

May 31, 2018

Rating: BUY

TP: HK\$ 4.90

Analyst: Paul Pan

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Email: paulpan@abci.com.hk

Share price (HK\$)	4.03
52WK H/L (HK\$)	4.47/2.97
Est. share price return	21.59%
Est. dividend yield	0.00%
Est. total returns	21.59%
Previous rating/TP	N/A / N/A

Source(s): Bloomberg, ABCI Securities estimates

Key data

Issued shares (mn)	1,608.58
Mkt cap (HK\$ mn)	6,482.59
ADT since IPO (HK\$mn)	36.66
Shareholding (%)	
Mr. Wu Junbo	71.40
Mr. Wu Di	0.72
Huayuan Company	2.48
Public investors	25.40

Source(s): Bloomberg, the Group

Margin projections (%)

	FY18E	FY19E	FY20E
GPM	59.0	60.1	61.0
OPM	60.1	61.2	62.3
NPM*	59.5	60.5	61.6

Source(s): ABCI Securities estimates

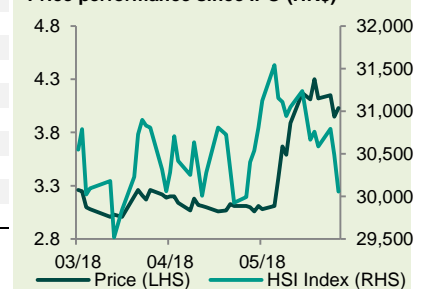
Price performance (%)

	Absolute	Relative*
1-mth	31.70	33.51
3-mth	N/A	N/A
6-mth	N/A	N/A

* Relative to HSI

Source(s): Bloomberg

Price performance since IPO (HK\$)



Source(s): Bloomberg, ABCI Securities



FY17 results review

Decent growth and margins

In FY17, the Group's revenue grew 11.4% YoY while gross profit increased 7.4% YoY. The reported net profit decreased 0.3% YoY. However, excluding the IPO expenses, core net profit would have risen 15.0% YoY, according to our estimates. Correspondingly, the Group's GPM decreased from 59.1% in FY16 to 57.0% in FY17, and core NPM (excluding listing expenses) increased to 58.7% in FY17. The GPM decreased mainly because of increases in various expenses. In particular, the cost of repair and student-related costs were up by 56.0% YoY and 128.5% YoY. Reduction in SG&A-to-sales ratio (16.0% in FY16 and 13.6% in FY17, excluding listing expenses) was the main driver in the improved core NPM.

Expanding student enrollment

Overall full-time student enrollment increased by 0.7% YoY in the 2017/18 school year. Full-time student enrollment of Xinhua University increased by 5.1% YoY, while that of Xinhua School decreased by 14.6% YoY. Declining enrollment in the latter was a result of the Group's efforts to focus more on undergraduate program development. We believe the Group's current utilization is relatively low compared to peers, which allows room for future growth.

Increased tuition and boarding fees

Increasing tuition and boarding fees also contributed to revenue growth in FY17. Average tuition fee per student for Xinhua University increased by 6.1% YoY to RMB 11,995, and the average tuition fee for Xinhua School increased by 27.7% YoY to RMB 5,279. Average boarding fees grew 12.0% YoY to RMB 1,323. We believe rising tuition and boarding fees drove much of the revenue growth in FY17.

IPO and use of proceeds

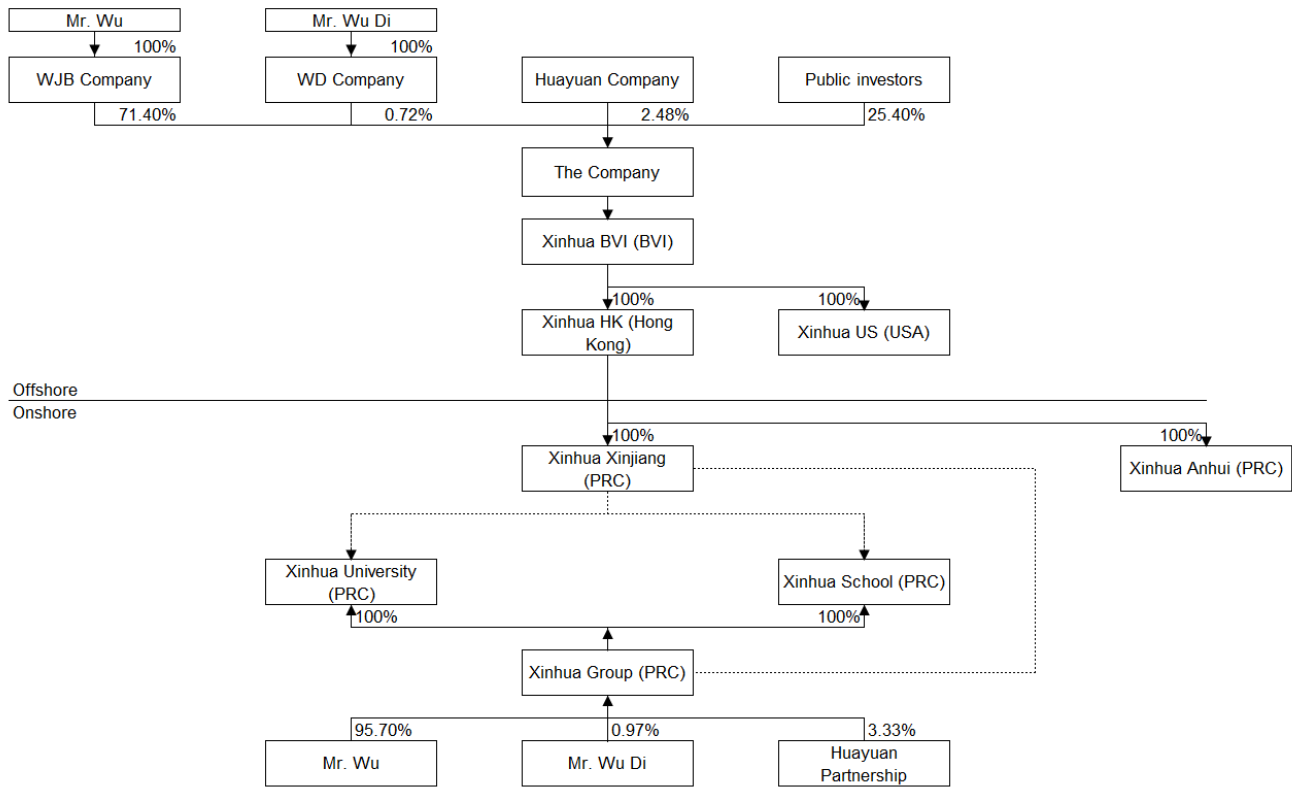
IPO price of HK\$ 3.26

The Group's IPO price was HK\$ 3.26, the mid-point of its offer price range. The overallotment option was partially exercised. Net proceeds after deducting the underwriting commission and issuing expenses and exercising the overallotment option were estimated to be HK\$ 1,265.7mn, according to the Group.

Immediately after the IPO and the exercise of overallotment option, public shareholders hold 25.40% of issued shares, while Mr. Yu and Mr. Wu Di (son of Mr. Wu) owned 71.40% and 0.72% of total issued shares. The two cornerstone investors participated in the IPO are BOCOM International Prosperity Investment Limited and China New City Commercial Development Limited. The following chart shows the corporate structure immediately after the IPO.



Exhibit 1: Post-IPO corporate structure



Notes:

- 1) WJB Company is wholly owned by Mr. Wu.
 - 2) WD Company is wholly owned by Mr. Wu Di.
 - 3) Huayuan Company is owned by Mr. Wu as to 0.99%, Ms. Zhou Jiaju (spouse of Mr. Wu) as to 4.93%, Mr. Wu Shan (son of Mr. Wu) as to 3.28%, the three executive Directors (namely, Mr. Lu Zhen as to 9.85%, Mr. Wang Yongkai as to 9.85% and Ms. Wang Li as to 3.28%) and 26 other employees of the Group.
 - 4) The general partner of Huayuan Partnership is Mr. Wu. Huayuan Partnership is owned by Mr. Wu as to 0.99%, Ms. Zhou Jiaju as to 4.93%, Mr. Wu Shan (son of Mr. Wu) as to 3.28%, the three executive directors (namely, Mr. Lu Zhen as to 9.85%, Mr. Wang Yongkai as to 9.85% and Ms. Wang Li as to 3.28%) and 26 other employees of our Group.
- Source(s): The Group, ABCI Securities

Planned use of proceeds

The Group proposes to use 53.0% of the IPO proceeds for acquisition of other schools and 35.0% for improving the schools' educational facilities and equipment.

The Group would focus on acquisition of higher education institutions. The Group would mainly look for undergraduate colleges that can grant bachelor's degrees, including private higher education institutions, independent colleges, and secondary vocational schools in provincial capitals. The Group would also consider entities with educational assets or institutions in provincial capitals, municipalities under the direct administration of the central government, and major cities with independent budgets.

Exhibit 2: Planned use of proceeds

#	Percentage	Item
1)	53.0%	Acquisition of other schools to expand school network
2)	35.0%	Improvement of school facilities and educational equipment
3)	2.0%	Strengthening market position and enhance brand recognition
4)	10.0%	Funding working capital and general corporate purposes

Source(s): Prospectus, ABCI Securities

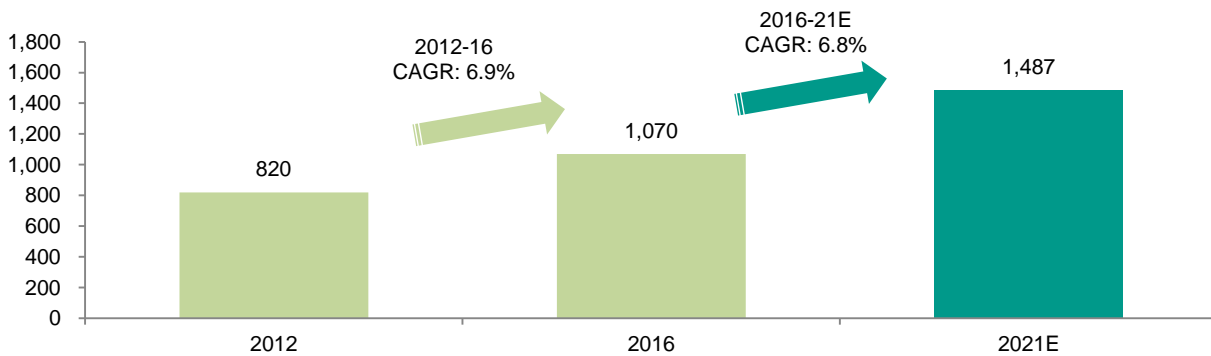


Investment highlights

1. Market trend to benefit future development

Per capita expenditure on education of urban household in China increased from RMB 820 in 2012 to RMB 1,070 in 2016, representing a CAGR of 6.9%, and is expected to reach RMB 1,487 in 2021, representing a CAGR of 6.8%, according to F&S report. We believe willingness to increase expenditure on education enables the education institutions in China to raise tuition and boarding fees.

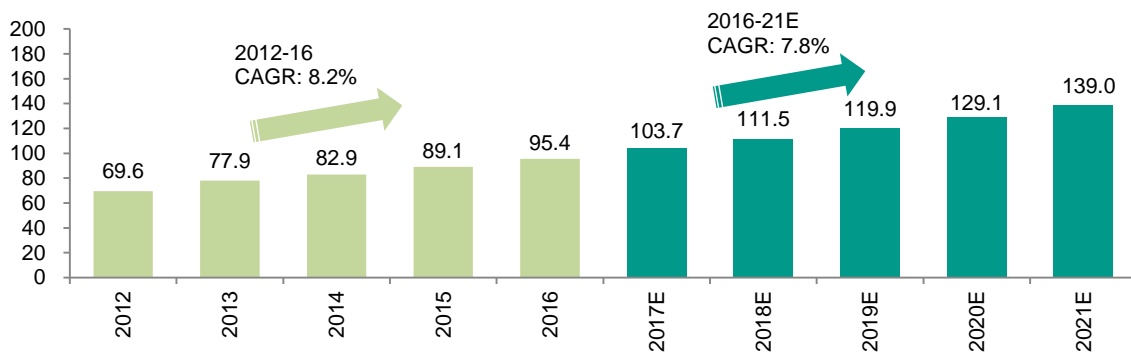
Exhibit 3: Annual per capita education expenditure of urban households in China (RMB)



Source(s): F&S report report, Prospectus, ABCI Securities

In addition, student enrollment and total revenue of the private higher education industry are also expected to increase to 8.0mn and RMB 139.0bn in 2021E, representing a 2016-21E CAGR of 4.8% and 7.8%, according to F&S report. Based on the data from F&S report, we believe private higher education industry would benefit from increasing demand.

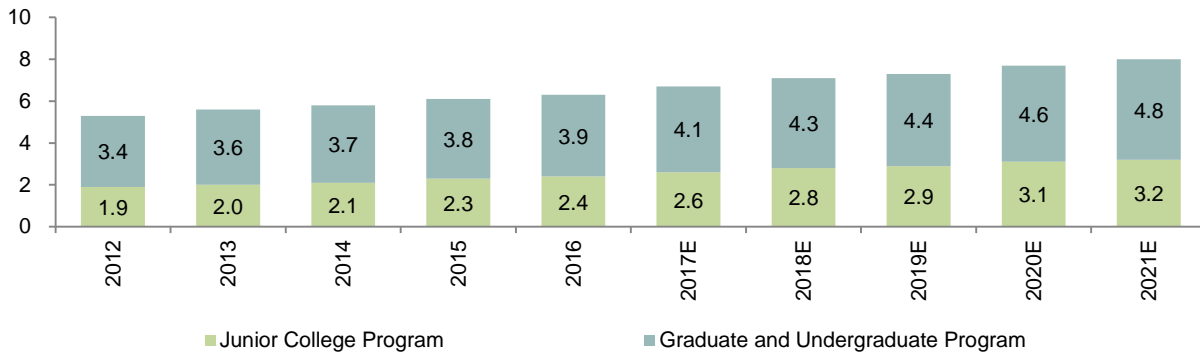
Exhibit 4: Total revenue of private higher education industry in China (RMB bn)



Source(s): F&S report, Prospectus, ABCI Securities



Exhibit 5: Total student enrollment in private higher education in China (mn ppl)



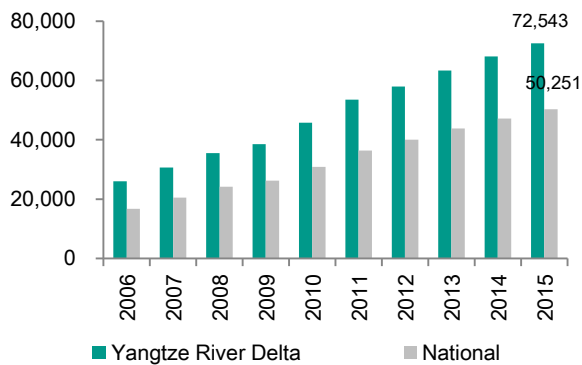
Source(s): F&S report, Prospectus, ABCI Securities

2. Location of portfolio schools serves as a long-term positive

The Group's portfolio schools are located in Anhui, which is part of the YRD region. YRD region had a GDP per capita of RMB 72,543 in 2015, 44% higher than the national average of RMB 50,251, according to the NBS. Furthermore, GDP per capita of the region has been 47% higher than that of the national average in the past decade.

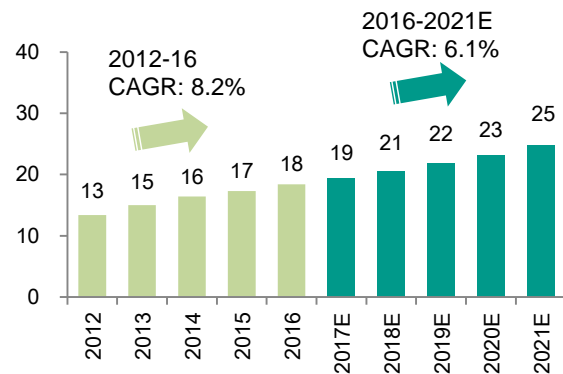
Private higher education industry in the YRD region has been growing at a rate similar to the national level in 2012-16. According to the F&S report, total revenue of private higher education in the YRD region expanded at 8.2% CAGR in 2012-16, and is expected to grow at 6.1% CAGR in 2016-21E.

Exhibit 6: GDP per capita in YRD (RMB)



Source(s): NBS, ABCI Securities

Exhibit 7: Total revenue of private higher education industry in YRD region (RMB bn)



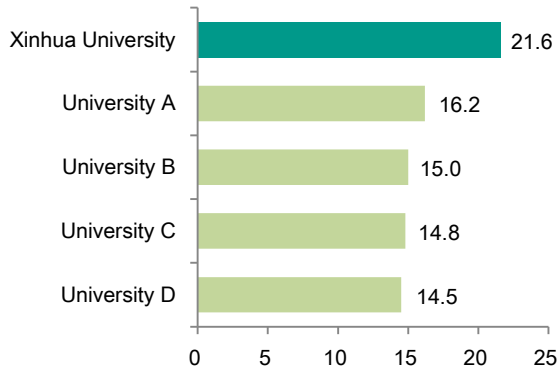
Source(s): F&S report, Prospectus, ABCI Securities



3. Leadership position in the YRD and Anhui Province

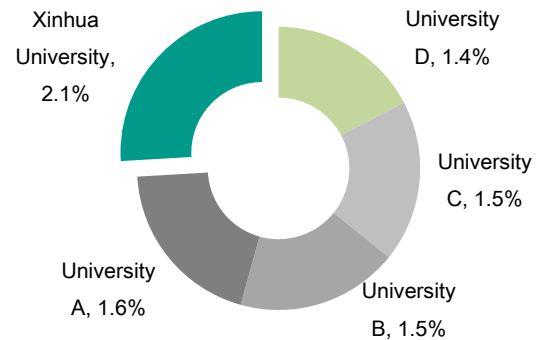
The Group is a leading player in the private higher education industry in the YRD and Anhui Province. According to the F&S report, in the private higher education market in 2016, Xinhua University was ranked first with a market share (in terms of student enrollment) of 2.1% in the YRD region; Xinhua University was also the top player in Anhui's private higher education market with a market share (in terms of student enrollment) of 10.1% in 2016. We believe that the Group's leadership in the two regions would be beneficial to its acquisition in the future.

Exhibit 8: Student enrollment of the top five YRD players in 2016 (k ppl)



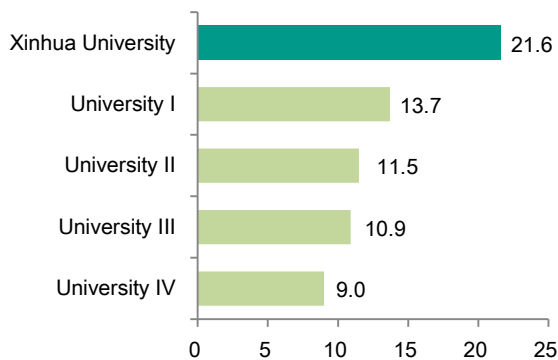
Source(s): F&S report, Prospectus, ABCI Securities

Exhibit 9: Market share of the top five YRD players in 2016



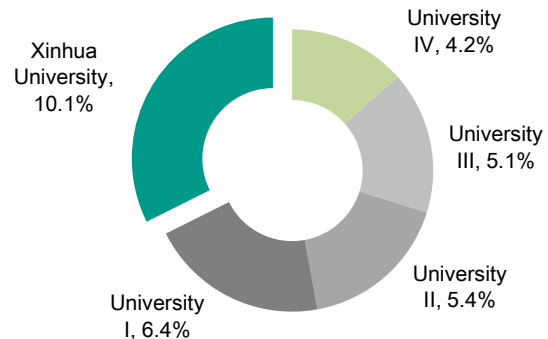
Note: Market share as defined by student enrollment
Source(s): F&S report, Prospectus, ABCI Securities

Exhibit 10: Student enrollment of the top five players in Anhui in 2016 (k ppl)



Source(s): F&S report, Prospectus, ABCI Securities

Exhibit 11: Market share of the top five players in Anhui in 2016



Note: Market share as defined by student enrollment
Source(s): F&S report, Prospectus, ABCI Securities

As shown in Exhibit 9 and 11, the Group's market share in the two regions (especially YTD region) was not substantially higher than that of other top players. This suggests a fragmented market in both regions and the Group would need to strategize to gain more market share quickly in order to preserve its leadership position.

4. Room for organic growth

Combined capacity of the Group's two schools increased to 31,502 for the 2017/18 school year. In particular, the capacity of the Xinhua University and Xinhua School increased from 22,312 and 4,380 for the 2014/15 school year to 27,056 and 4,446 for the 2017/18 school year. As a result of the expanding capacity, the Group's overall utilization was only 84.5% for 2017/18, meaning that there is room for growth in student enrollment.



Exhibit 12: Capacity and utilization rate of the Group's portfolio schools

Student capacity (persons)	2014/15	2015/16	2016/17	2017/18
Xinhua University	22,312	22,312	23,988	27,056
Xinhua School	4,380	4,104	4,902	4,446
Total	26,692	26,416	28,890	31,502
Utilization rate (%)	2014/15	2015/16	2016/17	2017/18
Xinhua University	89.7	93.1	89.9	83.8
Xinhua School	79.9	97.0	86.1	89.1
Total	88.1	93.7	89.2	84.5

Source(s): Prospectus, the Group, ABCI Securities calculation

In addition, the Group's schools have the capability to increase tuition and boarding fees in the future. As the Group devotes more resources to the undergraduate programs and a higher proportion of students would enroll in these studies, the number of students paying a higher tuition would increase. Also, the Group has raised its tuition for the past two school years; therefore, we believe future increase of tuition is possible.

Exhibit 13: Tuition range of the Group's portfolio schools (RMB)

Xinhua University	2014/15	2015/16	2016/17	2017/18
Four-year undergraduate Program	11,000-22,000	11,000-20,000	12,100-20,000	15,100-25,000
Three-year junior college program	7,000-18,000	7,000-18,000	7,700-18,000	10,700-21,000
Continuing education program	1,200-8,900	1,200-8,900	1,200-8,900	1,200-8,900
Xinhua School	2014/15	2015/16	2016/17	2017/18
General secondary vocational program	3,600-4,000	4,000-5,000	5,200-7,600	5,200-7,600
Undergraduate oriented secondary vocational program	4,200	5,200	8,000	8,000
Five-year junior college-oriented secondary vocational program	4,500	6,000	8,000	8,000

Source(s): The Group, ABCI Securities calculation

5. Addition of School of Clinical Medicine further propels growth

The Group was selected by Anhui Medical University as its first choice of cooperative partner to operate its affiliated School of Clinical Medicine, which is an independent college established with the eventual goal of being converting into a standalone school owned and operated solely by the cooperative partner.

According to the Prospectus, the Group would accommodate 800 to 1,000 students in the campus of Xinhua University for the 2018/19 school year. Meanwhile, a dedicated campus would be developed to accommodate 3,500 students after phase one of the new campuses is completed and would eventually have the capacity for 10,000 students.

Operation of this new school would incur certain costs. In FY17, the Group paid RMB 196.0mn in cash as a prepayment to enter into the agreement with Anhui Medical University. In FY18, a total of RMB 120.0mn of land costs is expected to be paid. The construction costs for the new campus are expected to be RMB100.0 mn, RMB100.0 mn, RMB130.0 mn and RMB100.0 mn for 2018E-21E.



Growth and profitability outlook

Decent growth driven by the unfilled capacity and the addition of School of Clinical Medicine

We believe the Group would maintain its growth in student enrollment supported by the spare capacity; also, the School of Clinical Medicine will further expand the capacity by 10,000 students in the future, according to the Group. We expect student enrollment to increase at 9.4% CAGR in from the school years of 2017/18 to 2020/21E, reaching 43.7k students.

We also believe fee growth is highly probable as the Group has been able to raise fees for the past two years. The emphasis on undergraduate programs would allow for higher fees. We project the average revenue per student would increase at 10.1% CAGR in 2017-20E to reach RMB 13.5k in 2020E.

Exhibit 14: Key assumptions for revenue

Revenue per student (RMB K)	FY17A	FY18E	FY19E	FY20E
	10.12	11.29	12.35	13.50
Student enrollment (persons)	2017/18A	2018/19E	2019/20E	2020/21E
	33,388	37,129	40,598	43,724

Source(s): Prospectus, ABCI Securities estimates

Margins to improve steadily

We project the Group's margins would continue to improve as revenue per student would grow faster than the cost per student. We expect GPM and core NPM would increase from 57.0% and 58.7% in 2017 to 61.0% and 61.6% in 2020E.

Valuation

DCF-derived TP at HK\$ 4.90

Assumptions in our DCF model include:

1. A beta of 0.68;
2. A risk-free rate of 2.33%;
3. An expected market return of 13.20%;
4. Terminal growth rate at 5%
5. Based on leverage position by end-FY17, we assume no borrowings would incur in the future

Based on our DCF model, we set the TP at HK\$ 4.90, which represents 31.63x/26.00x 18E/19E P/E or 3.13x/2.80x 18E/19E P/B.



Peer valuation analysis

Valuation of the education sector has been rising in recent months. As of end of May 30, 2018, the average 18E P/E of the higher education segment and the overall education segment was 26.04x and 29.66x. The fundamental education players maintained a premium valuation, as their average 18E P/E was 33.28. However, we believe that the lower valuation of the higher education players reflects their generally lower returns.

Exhibit 15: Bloomberg consensus valuation of the education sector

	English name	Chinese name	FY end	P/E (x)		P/B (x)		Yield (%)		ROAA (%)		ROAE (%)	
				18E	19E	18E	19E	18E	19E	18E	19E	18E	19E
6068 HK	Wisdom	睿见教育	31-Aug	39.20	27.98	5.58	4.65	0.94	1.31	7.65	8.84	15.31	18.12
1317 HK	Mapleleaf	枫叶教育	31-Aug	30.84	24.78	5.32	4.75	1.31	1.73	11.38	12.15	18.64	20.13
6169 HK	Yuhua	宇华教育	31-Aug	28.74	22.68	4.55	4.00	1.77	2.30	11.03	12.26	16.42	18.29
1565 HK	Virscend	成实外教育	31-Dec	34.33	24.80	4.68	4.20	1.17	1.61	9.26	11.74	14.17	17.40
839 HK	CEG	中教控股	31-Dec	37.03	27.19	3.44	3.06	0.81	1.10	8.30	9.44	10.15	11.91
1569 HK	Minsheng	民生教育	31-Dec	18.92	15.98	1.92	1.75	0.49	0.79	8.21	8.67	10.24	10.69
2001 HK	CNHE	中国新高教	31-Dec	26.94	20.41	4.33	3.72	1.07	1.45	10.01	10.59	17.14	19.26
2779 HK	Xinhua	新华教育	31-Dec	21.29	17.50	2.11	1.88	0.00	0.00	11.78	9.81	14.18	11.37
<i>Average of Wisdom, Maple Leaf, Yuhua, & Virscend</i>				<u>33.28</u>	<u>25.06</u>	<u>5.03</u>	<u>4.40</u>	<u>1.30</u>	<u>1.74</u>	<u>9.83</u>	<u>11.25</u>	<u>16.13</u>	<u>18.48</u>
<i>Average of CEG, Minsheng, CNHE, & Xinhua</i>				<u>26.04</u>	<u>20.27</u>	<u>2.95</u>	<u>2.60</u>	<u>0.59</u>	<u>0.84</u>	<u>9.58</u>	<u>9.63</u>	<u>12.93</u>	<u>13.31</u>
<i>Average of education sector</i>				<u>29.66</u>	<u>22.66</u>	<u>3.99</u>	<u>3.50</u>	<u>0.94</u>	<u>1.29</u>	<u>9.70</u>	<u>10.44</u>	<u>14.53</u>	<u>15.90</u>

* As of end of May 30, 2018

Source(s): Bloomberg, ABCI Securities estimates



Risk factors

Growth risk

Since the Group's revenue is mainly derived from tuition fee income, decline in student enrollment and inability to raise tuition in the future would negatively impact the Group's growth performance. According to our calculation based on data from the Prospectus, a 10% increase/decrease in tuition fee income would lead to 15.7% increase/decrease in the FY16 profit; a 5% increase/decrease in tuition fee income would lead to 7.8% increase/decrease in the FY16 profit.

Exhibit 16: Sensitivity analysis of tuition fee income

Tuition fee (decrease)/increase by	(FY ends at Dec 31)		
	FY14	FY15	FY16
	Profit for the FY/period (decrease)/increase (RMB k)		
(10%)	(22,386)	(25,178)	(27,039)
(5%)	(11,193)	(12,589)	(13,520)
5%	11,193	12,589	13,520
10%	22,386	25,178	27,039
	Percentage of profit for the corresponding FY/period (%)		
(10%)	(16.8)	(16.8)	(15.7)
(5%)	(8.4)	(8.4)	(7.8)
5%	8.4	8.4	7.8
10%	16.8	16.8	15.7

Source(s): Prospectus, ABCI Securities calculation

Cost risk

The cost of school personnel is a major cost component for the Group. According to our calculation based on data from the Prospectus, a 10% increase/decrease in such a cost would lead to 5.3% decrease/increase in the FY16 profit; a 5% increase/decrease in tuition fee income would lead to 2.7% decrease/increase in the FY16 profit. Compared to the sensitivity of tuition, the cost of school personnel has a smaller impact on net profit.

Exhibit 17: Sensitivity analysis of teaching staff costs

Salaries and benefits paid to school personnel (decrease)/increase by	(FY ends at Dec 31)		
	FY14	FY15	FY16
	Profit for the FY/period (decrease)/increase (RMB k)		
(10%)	8,332	9,011	9,210
(5%)	4,166	4,505	4,605
5%	(4,166)	(4,505)	(4,605)
10%	(8,332)	(9,011)	(9,210)
	Percentage of profit for the corresponding FY/period (%)		
(10%)	6.3	6.0	5.3
(5%)	3.1	3.0	2.7
5%	(3.1)	(3.0)	(2.7)
10%	(6.3)	(6.0)	(5.3)

Source(s): Prospectus, ABCI Securities calculation

Expansion risk

The acquisition strategy for the Group's expansion may lead to fluctuating growth and margins. The targets may not perform as expected. In addition, if the Group has to expand through building new schools, construction and land acquisition costs may be required.

Expansion bottleneck risk

The Group's expansion is largely dependent on the portfolio schools' capacity and the admission quota approved by the relevant authorities. If the portfolio schools do not have spare capacity, the Group would not be able to generate additional enrollment growth on existing portfolio schools. If the



Group was not able to obtain sufficient admission quota from the relevant authorities, the Group's growth would be compromised.

Education quality and student dropout risk

The Group has experienced decline in student dropouts. Total student dropout decreased from 122 in 2014/15 to 89 in 2016/17. Tuition and boarding fees refund, however, increased at the same time. If the Group cannot maintain its education quality in the future, the Group may face increasing student dropouts, which would affect its revenue growth.

Exhibit 18: Student dropout and related refunds

	2014/15	2015/16	2016/17	2017/18*
Student dropout				
Total	122	115	89	25
Xinhua University	56	61	62	9
Xinhua School	66	54	27	16
Tuition and boarding fee refund (RMB k)	FY14	FY15	FY16	9M17
Total	324.0	452.3	416.2	307.6
Xinhua University	190.7	307.1	244.3	157.3
Xinhua School	133.3	145.2	171.9	150.3

* Data of student dropout for 2017/18 school year was as of Sep 30, 2017.

Source(s): Prospectus, ABCI Securities

Asset concentration risk

The Group's current portfolio school and the School of Clinical Medicine are located in Anhui province. The geographical concentration of the schools makes the Group more susceptible to the demographic and economic changes in the region.

Dividend payout policy implication

The Group has not specified a pre-determined dividend policy. In addition, it did not pay out dividend for the FY17. We assume no dividend payout going forward in our modeling. Such an assumption may deviate from the future dividend payout by the Group.

Regulatory risk

There are uncertainties on the classification of and conversion between for-profit and non-profit private schools. The provincial government of Anhui Province promulgated the Implementation Opinion on Encouraging Social Groups to Engage in Education and Promote the Healthy Development of Private Education (安徽省人民政府關於鼓勵社會力量興辦教育促進民辦教育健康發展的實施意見) on Oct 27, 2017. The Anhui Opinion requires that private higher education institutions are required to finish registration under the new classification before 2022. However, no registration timeline for Xinhua School has been promulgated by the local authorities since the registration timeline for private education institutions for other education levels is to be determined by each city and each county under the direct administration of Anhui Province.



Financial statement of the Group

Consolidated income statement

FY end: Dec 31 (RMB mn, excl. per share data)	FY14A	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Revenue	250	282	303	338	419	502	590
- Tuition fees	224	252	270	301	375	450	530
- Boarding fees	26	30	33	37	44	51	60
Cost of sales	(111)	(124)	(124)	(145)	(172)	(200)	(230)
Gross profit	139	158	179	192	247	301	360
Selling expenses	(4)	(5)	(6)	(5)	(7)	(8)	(9)
Admin expenses	(35)	(42)	(43)	(67)	(53)	(62)	(73)
Other income	41	40	44	54	64	75	90
Operating profit	141	151	175	174	252	307	368
Net finance costs	0	0	0	0	0	0	0
Pretax profit	141	151	175	174	252	307	368
Tax	(7)	(1)	(2)	(2)	(3)	(4)	(4)
Net profit	133	150	173	172	249	303	363
EPS							
Basic and diluted (RMB cent)	N/A	N/A	14.38	14.33	15.49	18.85	22.59
DPS	N/A	N/A	N/A	0.00	0.00	0.00	0.00

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

FY end: Dec 31 (RMB mn)	FY14A	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Bank balances and cash	98	104	106	293	1,785	2,085	2,393
AFS investments	0	247	120	236	247	260	273
Others	285	53	242	12	8	15	14
Current assets	383	404	468	541	2,041	2,359	2,680
PP&E	422	439	470	492	572	681	877
LT Lease prepayment	98	96	93	90	88	85	83
Others	2	5	4	203	205	150	75
Non-current assets	523	540	567	786	865	916	1,034
Total assets	906	944	1,036	1,327	2,905	3,276	3,714
ST Deferred revenue	147	154	167	192	253	278	348
ST Borrowing	210	1	0	0	0	0	0
Others	104	194	102	134	137	179	184
Current liabilities	461	349	269	326	390	458	532
LT Deferred income	1	0	0	1	0	0	1
Non-current liabilities	1	0	0	1	0	0	1
Equity to owners of the Company	444	595	767	1,000	2,515	2,818	3,181
Minority interest	0	0	0	0	0	0	0
Equity	444	595	767	1,000	2,515	2,818	3,181
Total liabilities and equity	906	944	1,036	1,327	2,905	3,276	3,714

Source(s): The Group, ABCI Securities estimates



Consolidated cash flow statement

FY end: Dec 31 (RMB mn)	FY14A	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Pretax profit	141	151	175	174	252	307	368
Depreciation and amortization	29	35	42	49	55	63	72
Change in working capital	7	20	(4)	46	64	62	73
Others	3	(7)	(3)	(12)	(12)	(17)	(17)
Cash flow from operating activities	180	199	210	257	359	415	496
Capex	(43)	(55)	(62)	(258)	(251)	(165)	(243)
Others	55	81	(145)	127	118	50	55
Cash flow from investing activities	12	26	(207)	(131)	(133)	(115)	(188)
Borrowings	(110)	(210)	(1)	0	0	0	0
Others	(24)	(10)	(1)	61	1,266	0	0
Cash flow from financing activities	(134)	(219)	(1)	61	1,266	0	0
Net change in cash	58	6	2	187	1,492	300	308
Cash and cash equivalent - beg	41	98	104	106	293	1,785	2,085
Cash and cash equivalent - end	98	104	106	293	1,785	2,085	2,393

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

FY ends at Dec 31	FY14A	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Growth (YoY %)							
Revenue	N/A	12.6	7.7	11.4	24.0	19.7	17.7
- Tuition fees	N/A	12.5	7.4	11.3	24.7	19.9	17.7
- Boarding fees	N/A	13.8	10.0	12.8	18.3	17.3	17.3
Gross profit	N/A	13.8	13.6	7.4	28.5	21.8	19.5
Operating profit	N/A	7.5	15.9	(0.5)	44.8	21.8	19.8
Pretax profit	N/A	7.5	15.9	(0.5)	44.8	21.8	19.8
Total net profit (to owners of the Company)	N/A	12.6	15.1	(0.3)	44.9	21.7	19.9
Profitability ratios (%)							
GPM	55.5	56.0	59.1	57.0	59.0	60.1	61.0
OPM	56.2	53.6	57.7	51.5	60.1	61.2	62.3
Pretax margin	56.2	53.6	57.7	51.5	60.1	61.2	62.3
NPM (to owners of the Company)	53.2	53.2	56.9	50.9	59.5	60.5	61.6
Revenue composition (%)							
Tuition fees	89.5	89.4	89.2	89.0	89.5	89.7	89.8
Boarding fees	10.5	10.6	10.8	11.0	10.5	10.3	10.2
Return ratios (%)							
ROAA	N/A	16.2	17.4	14.6	11.8	9.8	10.4
ROAE	N/A	28.9	25.4	19.5	14.2	11.4	12.1
Liquidity ratio (x)							
Current ratio	0.8	1.2	1.7	1.7	5.2	5.2	5.0
Quick ratio	0.8	1.2	1.7	1.7	5.2	5.2	5.0
Cash ratio	0.2	0.3	0.4	0.9	4.6	4.6	4.5
Leverage ratios (%)							
Total debt to Equity	47.3	0.1	0.0	0.0	0.0	0.0	0.0
Total debt to Total assets	23.2	0.1	0.0	0.0	0.0	0.0	0.0
Net debt/(cash) to Equity	25.1	(17.5)	(13.8)	(29.3)	(71.0)	(74.0)	(75.2)
Net debt/(cash) to Total assets	12.3	(11.0)	(10.2)	(22.1)	(61.4)	(63.7)	(64.4)

Source(s): The Group, ABCI Securities estimates



Appendix I: Directors and senior management

Directors						
Name	Age	Position	Date of joining the Group	Date of appointment as a Director	Roles and responsibilities	Relationship with other Director(s) or senior management
Mr. Wu Junbao (吳俊保)	52	Chairman and non-executive Director	September 1999	October 27, 2017	Providing opinion and judgment to the Board	None
Mr. Lu Zhen (陸真)	42	Executive Director, director and executive vice president of Xinhua Group	October 2014	October 27, 2017	Day-to-day management as well as operation and management of education related matters	None
Mr. Wang Yongkai (王永凱)	60	Executive Director and executive president of Xinhua Group	March 2003	October 27, 2017	In charge of business management as well as investment and financing management	None
Ms. Wang Li (王麗)	40	Executive Director, deputy principal of Xinhua University	July 2000	October 27, 2017	In charge of administrative and human resources matters	None
Ms. Zhang Kejun (張可君)	68	Independent non-executive Director	December 2005	October 27, 2017	Providing independent opinion and judgment to the Board	None
Mr. Yang Zhanjun	48	Independent non-executive Director	October 2017	October 27, 2017	Providing independent opinion and judgment to the Board	None
Mr. Chau Kwok Keung (鄒國強)	41	Independent non-executive Director	October 2017	October 27, 2017	Providing independent opinion and judgment to the Board	None

Source(s): Prospectus, ABCI Securities

Senior management						
Name	Age	Position	Date of joining the Group	Date of appointment as senior management	Roles and responsibilities	Relationship with other Director(s) or senior management
Mr. Huang Yuan (黃源)	54	Vice president of Xinhua Group	January 2015	January 2015	In charge of internal audit	None
Mr. Ni Zheng (倪徵)	41	Chief officer of International operations	December 2012	December 2012	In charge of overall management of international operations	None
Ms. Wang Jihong (王繼紅) (also known as Wang Ke (王可))	59	Chief strategy officer, deputy principal of Xinhua University	August 2002	December 2003	In charge of strategic planning	None

Source(s): Prospectus, ABCI Securities



Appendix II: History and milestones of the Group

Year	Event
1999	➤ Xinhua Group was established
2000	➤ The establishment of Anhui Xinhua Vocational College was approved by The People's Government of Anhui Province (安徽省人民政府)
2002	➤ The establishment of Xinhua School was approved by the Anhui Education Department
2005	➤ Anhui Xinhua Vocational College transformed into Xinhua University and became the first private higher education institution in Anhui Province entitled to provide undergraduate education in addition to higher vocational education
2006	➤ Xinhua School was recognized by the MOE as a National Key Secondary Vocational School (國家級重點中等職業學校)
2010	➤ Xinhua University was the only private higher education institution in the 50 higher education institutions recognized by MOE in 2010 for its achievement in graduate employment for the year 2009-2010 (2009-2010 年度全國畢業生就業典型經驗高校), and was the only higher education institution in Anhui Province granted with this award
2013	➤ Xinhua University passed the undergraduate education assessment conducted by the MOE
2015	➤ Xinhua University was accredited as a regional high level university in applied sciences (地方應用型高水平大學建設單位)
2016	➤ Xinhua University was recognised as one of the private universities with brand strength
2017	➤ Expanding school network in China through entering into an agreement to jointly operate the School of Clinical Medicine with Anhui Medical University

Source(s): Prospectus, ABCI Securities



Disclosures

Analyst Certification

I, PAN Hongxing, Paul, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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