

China Maple Leaf Educational Systems

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DBS Group Research . Equity

12 Jul 2017

BUY (Initiate Coverage)

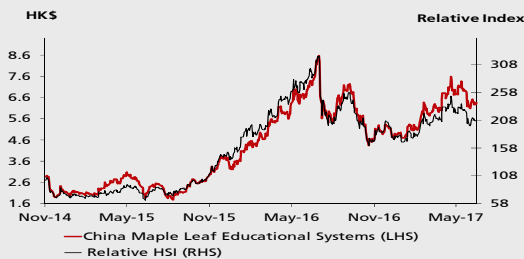
Last Traded Price (11 Jul 2017): HK\$6.36 (HSI : 25,878)

Price Target 12-mth: HK\$7.73 (22% upside)

Analyst

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Price Relative



Forecasts and Valuation

FY Aug (RMB m)	2016A	2017F	2018F	2019F
Turnover	830	1,014	1,356	1,628
EBITDA	298	359	473	580
Pre-tax Profit	326	394	474	585
Net Profit	308	371	446	538
Net Pft (Pre Ex) (core profit)	308	371	446	538
Net Profit Gth (Pre-ex) (%)	49.6	20.5	20.3	20.6
EPS (RMB)	0.23	0.28	0.33	0.40
EPS (HK\$)	0.27	0.32	0.38	0.46
EPS Gth (%)	35.3	20.1	20.3	20.6
Diluted EPS (HK\$)	0.27	0.32	0.38	0.46
DPS (HK\$)	0.11	0.14	0.17	0.20
BV Per Share (HK\$)	1.71	1.88	2.09	2.33
PE (X)	23.9	19.9	16.5	13.7
P/Cash Flow (X)	13.8	10.5	7.1	6.8
P/Free CF (X)	0.5	0.0	0.0	0.0
EV/EBITDA (X)	20.5	17.3	12.2	9.3
Net Div Yield (%)	1.7	2.2	2.7	3.2
P/Book Value (X)	3.7	3.4	3.1	2.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	16.0	17.4	19.0	20.5
Earnings Rev (%):		New	New	New
Consensus EPS (RMB)		0.28	0.35	0.42
Other Broker Recs:		B: 12	S: 0	H: 2

Source of all data on this page: Company, DBSV, Thomson Reuters, HKEX

Growth of international pathways

- Enhanced international exposure and focus on kindergartens to capture new opportunities
- Valuation is reasonable at 16x FY18F with room to further re-rate supported by strong earnings growth momentum of c.20%.
- Initiating coverage with BUY and HK\$7.73 TP

Strong growth to continue with nationwide and overseas expansion.

China Maple Leaf Educational Systems (Maple Leaf) operates the largest network of private international schools in China. We are positive on the company's ability to expand into the international education market. Its strategy is (i) to increase international exposure to enhance its school network; and (ii) focus in Tier 2 cities. The first enables it to catch the trend of students going overseas at a younger age while the second helps it to avoid the weakness of the British Columbia ("BC") curriculum in Tier 1 cities where International Baccalaureate ("IB") and Advanced Placement ("AP") curriculums are more popular.

Where we differ: Our FY18-20F revenue estimates are slightly more bullish than consensus while EPS projections are in line with the market. We are more optimistic about its future expansion and growth potential driven by its (i) expansion strategy and exposure to the international school market; (ii) easy-to-scale business model with its own logistic supply chain. We are more cautious on the growth in 'other income' including rent from the school acquired in Singapore.

Critical share price driver: We believe revenues will be boosted by growth in overseas schools, junior level schools and non-tuition related segments. Maple Leaf's 1H17 revenue grew 27.1% y-o-y to RMB 483m, driven by strong growth in these non-traditional core revenue generators in the past. We expect the company's growth momentum to continue and forecast 24% CAGR in 2016-2020 revenue led by an increasing focus on kindergartens.

Valuation:

Our TP of HK\$7.73 is based on DCF valuation assuming 12.7% WACC, and 3% terminal growth. Our TP implies 20.4x FY18F PE while the stock is currently trading at 16.6x FY18F compared with the peer average of 17.6x FY18F.

Key Risks to Our View:

Weaker-than-expected increase in student numbers and tuition; legal risk of lawsuit with its consultant Zhixin

At A Glance

Issued Capital (m shrs)	1,379
Mkt. Cap (HK\$/US\$m)	8,774 / 1,123
Major Shareholders	
Jen Shu Liang Sherman (%)	53.8
Buena Vista Fund Management, LLC (%)	7.2
Free Float (%)	39.0
3m Avg. Daily Val. (US\$m)	5.2
ICB Industry	Consumer Services / General Retailers

CRITICAL FACTORS TO WATCH

Critical Factors

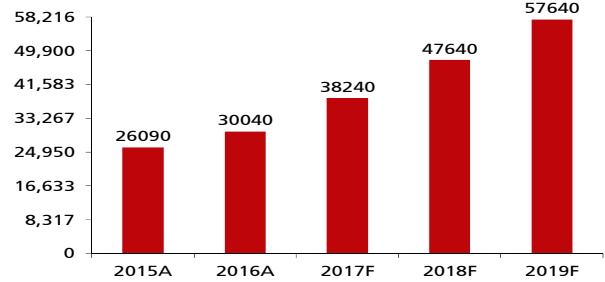
Raising capacity by proactively expanding its footprint in new cities. By 1H17, the company has 56 schools and 22,693 students in total. By September 2017, Maple Leaf will open 14 new schools in Tier 2 cities in China such as Yancheng, Weifang and Chongqing. The main deciding factor is the local disposable income level. Maple Leaf schools are currently located in Tier 2 and Tier 3 cities and the company has plans to take advantage of the economic growth in Tier 1 cities like Beijing and Shenzhen in the longer term. Meanwhile, Maple Leaf plans to expand its current campus in Chongqing and Tianjin in FY17/18, adding another 2,100 in capacity, or 5.5% of FY17 level.

Acquisitions have accelerated in recent years. Besides building new schools and enlarging existing schools, Maple Leaf completed the acquisition of a 47.5% stake in Hainan National Science Park Experimental School in Haikou city, the capital of Hainan Island, in May 2017. This has increased Maple Leaf's student numbers by more than 3,000 with a potential for further capacity expansion. Aside from domestic opportunities, Maple Leaf is also proactively seeking overseas expansion opportunities. In August 2016, the company acquired a school in Singapore, with an initial capacity of up to 600 students. The acquired school students will account for 10.6% of total students in FY18.

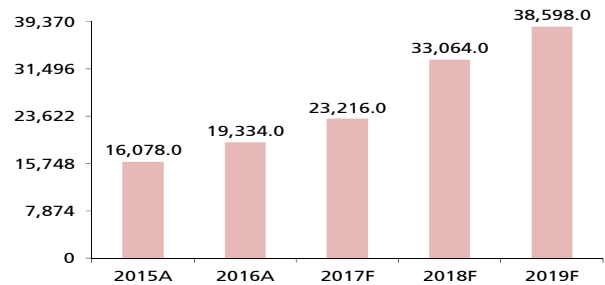
Utilisation to improve from established international curriculum and strengths in dual diploma programs. Student enrolments are fast increasing driven by capacity expansion, which has helped to improve utilisation. As at Mar 31, 2017, student enrolments reached 22,693, representing 17.4% growth from 2016. The company's rapid capacity expansion did not lower Maple Leaf's utilisation rate. Though Maple Leaf's utilisation rate of 60-65% in recent years is relatively low compared to some other schools, it has been improving. Maple Leaf's competitive advantage lies in bilingual education and dual diplomas offered by its high schools. Students are able to obtain high school diplomas from both the PRC and British Columbia in Canada upon completing their programs.

Tuition level to rise as the average tuition level is low versus the industry. In 2016, the average tuition level at all schools was RMB 39,240 per year, 5% higher than RMB 37,483 in 2015. The tuition fee is affordable for middle class families. To compare, 80% of international schools in China charged more than RMB 50,000 per year in 2016. The non-tuition revenues including revenue from uniforms, books, and summer camps etc, have also been growing rapidly by 8% CAGR during 2011 to 2016. In the longer term, there is little pricing pressure even if the company raises high school tuition fees to between RMB 80k to 100k per year. We expect the average tuition level to slightly drop in FY18 as a result of low tuition in new acquired schools, but to pick up gradually afterwards.

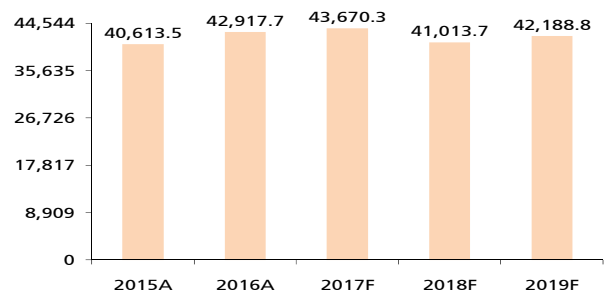
Total Capacity



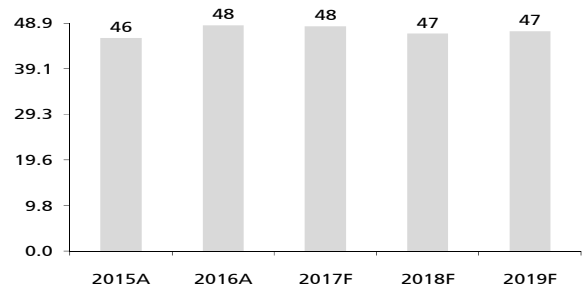
Number of students



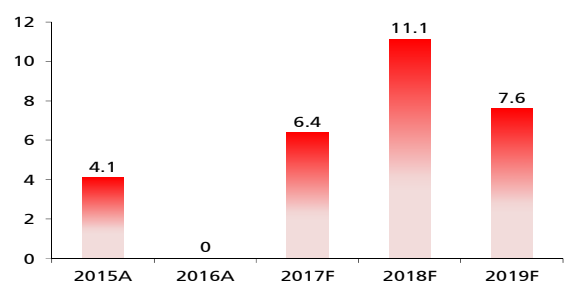
ASP



Gross margin (%)



Financing costs



Source: Company, DBS Vickers

Balance Sheet:

Balance sheet is healthy with low leverage and light asset model. In 2015 and 2016, the leverage ratio was near or equal to zero. As at the end of 1H17, the company had a total of RMB 433m in bank borrowings (gross gearing: 20%), mainly to finance its acquisition in Singapore. We expect gross gearing be lower than 20% in the coming years, at 15%/10% in FY17/18.

Capital expenditure driven up by acquisition costs while capex per-unit of capacity is low. 1H17 saw a significant increase in capex to around RMB 400m compared with 1H16's RMB 76.3m. The increase was mainly due to the RMB 330 m purchase of the campus in Singapore. We forecast capex levels to be around RMB 500m each year from FY17 to FY19 to support capacity expansion and potential acquisitions.

Share Price Drivers:

International education becoming more and more popular in China. As a leading player in the international school market, Maple Leaf is ready to leverage on the future boom of international education with its wide presence in China, well-established brand and affordable tuition fees.

Potential M&A opportunities. It is likely that more acquisitions will happen in the future as the company has an ambitious expansion plan supported by strong operating cash flows.

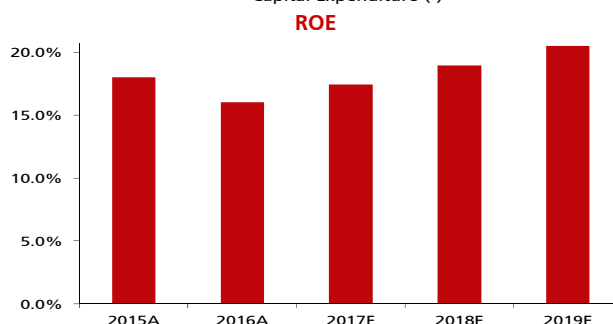
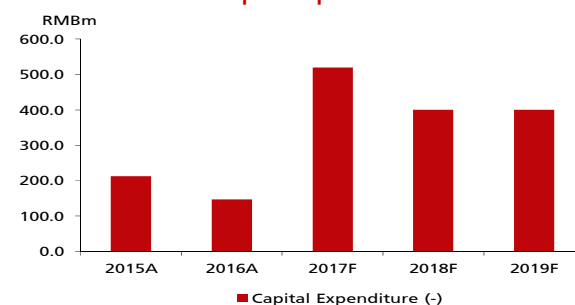
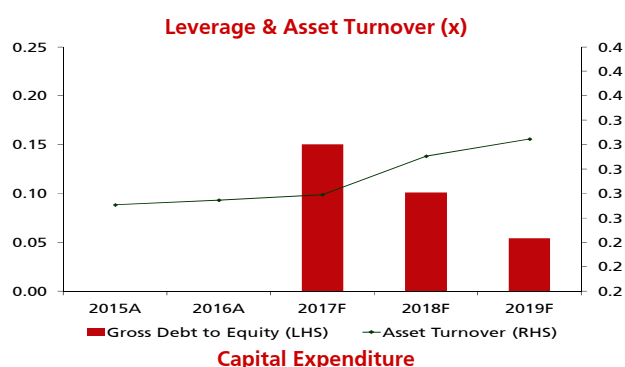
Key Risks:

1. Weaker-than-expected growth in student numbers and tuition fees
2. Legal risk with Zhixin

Maple Leaf has a dispute with its two consultants, Diangxianghui and Zhixin, on execution of options held by them. This dispute caused a sudden collapse in Maple Leaf's share price in July 2016. The dispute has been resolved with Dingxianghui, however, the lawsuit with Zhixin is still in progress and Maple Leaf may have to pay for legal expenses. The potential expense is not disclosed but the management believe that the impact would not be material to the company.

Company Background

Established in 1995 in Dalian, Maple Leaf operates China's leading independent, international school system and offers international education for students from preschool to high school. It operates the largest network of private international schools in China and is also Canada's first and largest offshore school system. Its schools provide a western academic orientation and preparation for admission to western universities, especially the Canadian ones, blended with Chinese educational traditions and culture.



Source: Company, DBS Vickers

China Maple Leaf Educational Systems

Key Assumptions

FY Aug	2015A	2016A	2017F	2018F	2019F
Total Capacity	26,090.0	30,040.0	38,240.0	47,640.0	57,640.0
Number of students	16,078.0	19,334.0	23,216.0	33,064.0	38,598.0
ASP	40,613.5	42,917.7	43,670.3	41,013.7	42,188.8

Source: Company, DBS Vickers

Segmental Breakdown (RMB m)

FY Aug	2015A	2016A	2017F	2018F	2019F
Revenues (RMB m)					
Tuition fees	555	695	852	1,177	1,406
Textbook	28	34	43	55	67
Summer and winter camps	35	39	51	66	86
Other Educational Services	31	36	13	58	69
Others	4	26	55	0	0
Total	653	830	1,014	1,356	1,628

Source: Company, DBS Vickers

Income Statement (RMB m)

FY Aug	2015A	2016A	2017F	2018F	2019F
Revenue	653	830	1,014	1,356	1,628
Cost of Goods Sold	(354)	(428)	(524)	(723)	(859)
Gross Profit	299	402	489	633	769
Other Opng (Exp)/Inc	(132)	(149)	(178)	(237)	(277)
Operating Profit	166	253	311	396	492
Other Non Opng (Exp)/Inc	45	52	73	70	76
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	5	18	10	9	16
Dividend Income	0	3	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	217	326	394	474	585
Tax	(11)	(18)	(24)	(28)	(47)
Minority Interest	0	0	0	0	0
Preference Dividend	0	0	0	0	0
Net Profit	206	308	371	446	538
Net Profit before Except.	206	308	371	446	538
EBITDA	213	298	359	473	580
Growth					
Revenue Gth (%)	20.9	27.1	22.2	33.8	20.1
EBITDA Gth (%)	38.3	40.2	20.4	31.7	22.5
Opg Profit Gth (%)	45.1	51.8	23.1	27.2	24.5
Net Profit Gth (%)	413.4	49.6	20.5	20.3	20.6
Margins & Ratio					
Gross Margins (%)	45.7	48.4	48.3	46.7	47.2
Opg Profit Margin (%)	25.5	30.5	30.7	29.2	30.2
Net Profit Margin (%)	31.5	37.1	36.6	32.9	33.0
ROAE (%)	18.0	16.0	17.4	19.0	20.5
ROA (%)	8.5	10.2	10.2	10.2	10.7
ROCE (%)	10.2	12.3	12.6	13.9	15.7
Div Payout Ratio (%)	13.0	41.6	44.0	45.0	45.0
Net Interest Cover (x)	NM	NM	NM	NM	NM

Source: Company, DBS Vickers

Interim Income Statement (RMB m)

FY Aug	1H2015	2H2015	1H2016	2H2016	1H2017
Revenue	300	353	380	450	483
Cost of Goods Sold	(176)	(178)	(201)	(227)	(256)
Gross Profit	124	175	179	223	227
Other Oper. (Exp)/Inc	(66)	(66)	(65)	(84)	(84)
Operating Profit	57	109	115	138	143
Other Non Opg (Exp)/Inc	N/A	N/A	N/A	N/A	N/A
Associates & JV Inc	N/A	N/A	N/A	N/A	N/A
Net Interest (Exp)/Inc	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	57	109	115	138	143
Tax	N/A	N/A	N/A	N/A	N/A
Minority Interest	N/A	N/A	N/A	N/A	N/A
Net Profit	57	109	115	138	143
Net profit bef Except.	57	109	115	138	143

Growth

Revenue Gth (%)	23.5	18.7	26.7	27.4	27.1
Opg Profit Gth (%)	4.6	82.1	99.7	26.6	25.1
Net Profit Gth (%)	4.6	82.1	99.7	26.6	25.1

Margins

Gross Margins (%)	41.2	49.6	47.1	49.5	47.0
Opg Profit Margins (%)	19.1	30.9	30.1	30.7	29.6
Net Profit Margins (%)	19.1	30.9	30.1	30.7	29.6

Source: Company, DBS Vickers

Balance Sheet (RMB m)

FY Aug	2015A	2016A	2017F	2018F	2019F
Net Fixed Assets	1,398	1,506	1,980	2,320	2,651
Invts in Associates & JVs	0	0	0	0	0
Other LT Assets	263	436	521	501	481
Cash & ST Invts	1,122	1,238	1,495	1,827	2,157
Inventory	1	9	10	14	16
Debtors	32	37	32	32	32
Other Current Assets	0	0	0	0	0
Total Assets	2,816	3,226	4,038	4,694	5,338
ST Debt	0	0	0	0	0
Creditors	982	1,184	1,439	1,929	2,337
Other Current Liab	0	0	0	0	0
LT Debt	0	0	335	250	150
Other LT Liabilities	22	21	34	40	80
Shareholder's Equity	1,812	2,021	2,229	2,474	2,770
Minority Interests	0	0	0	0	0
Total Cap. & Liab.	2,816	3,226	4,038	4,694	5,338
Non-Cash Wkg. Capital	(949)	(1,137)	(1,397)	(1,884)	(2,289)
Net Cash/(Debt)	1,122	1,238	1,160	1,577	2,007
Debtors Turn (avg days)	15.9	15.3	12.5	8.6	7.2
Creditors Turn (avg days)	N/A	N/A	N/A	N/A	N/A
Inventory Turn (avg days)	0.8	5.2	7.5	6.7	7.1
Asset Turnover (x)	0.3	0.3	0.3	0.3	0.3
Current Ratio (x)	1.2	1.1	1.1	1.0	0.9
Quick Ratio (x)	1.2	1.1	1.1	1.0	0.9
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	N/A	N/A	119.4	160.0	400.0
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS Vickers

China Maple Leaf Educational Systems

Cash Flow Statement (RMB m)

FY Aug	2015A	2016A	2017F	2018F	2019F
Pre-Tax Profit	217	326	394	474	585
Dep. & Amort.	46	46	48	78	87
Tax Paid	(1)	(2)	(11)	(23)	(6)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	(4)	(30)	0	0	0
Chg in Wkg.Cap.	205	165	261	487	405
Other Operating CF	(18)	27	11	15	12
Net Operating CF	444	533	703	1,031	1,083
Capital Exp.(net)	(212)	(147)	(519)	(400)	(400)
Other Invts.(net)	169	186	(3)	(3)	(3)
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(196)	(6)	(331)	0	0
Net Investing CF	(240)	33	(853)	(403)	(403)
Div Paid	(27)	(125)	(163)	(201)	(242)
Chg in Gross Debt	(224)	0	335	(85)	(100)
Capital Issues	761	0	0	0	0
Other Financing CF	(77)	(240)	234	(10)	(8)
Net Financing CF	434	(366)	406	(296)	(350)
Currency Adjustments	4	15	0	0	0
Chg in Cash	642	216	257	333	330
Opg CFPS (RMB)	152.65	34.84	223.61	447.35	811.98
Free CFPS (RMB)	247.28	10.44	227.46	473.67	361.93

Source: Company, DBS Vickers

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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