

Overseas Education Ltd (OEL SP)

Share Price: SGD0.64

MCap (USD): 188M

Singapore

Target Price: SGD0.72 (+13%)

ADTV (USD): 0.0M

Consumer Disc.

HOLD

 (Downgrade)

Short of Students; D/G to HOLD

- We D/G to HOLD from BUY and cut forecasts due to a lack of upside share catalysts and the lacklustre business outlook.
- Departures are up and new enrolments down thus far in 2015 and unlikely to pick up next year, though fees are rising. Accordingly, we have cut our enrolment forecast.
- The bottom line impact is a 17-29% cut to our FY15-17 EPS estimates. We also lower our DCF-based TP 34% to SGD0.72.

Issues Continue After Move to Pasir Ris

We recently visited OEL and according to management, the number of students returning to their home country continues to increase. This is a trend that has accelerated in the last few months. Enrolments have been weak this year, down 17% YoY in 1H15, and will be about 700 vs. 900/yr during FY13-14. Accordingly, we revise down our number of enrolments to 2,675-3,000 for FY15-17 (from 3,140-3,100), but still expect a 3.5% increase in tuition fees. Our channel checks show that "first-tier" schools still operate at full capacity with waiting lists, suggesting sluggish expatriate arrivals has more impacted "second-tier" schools like OEL.

Over-supply Risk

Some industry players, such as Australian International School and German European School are expanding their facilities expecting an increase in demand. However, if the number of expatriate arrivals remains sluggish, there could be industry over-supply.

No Short-term Catalysts; Downgrade to HOLD

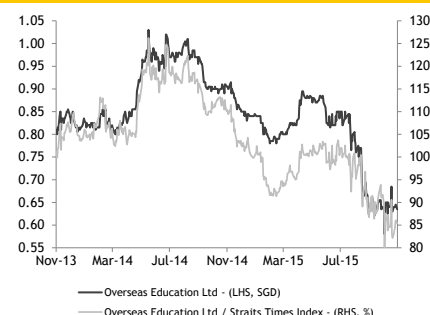
In absence of catalysts and a poor economic outlook, we downgrade the stock to HOLD from BUY. We also cut our EPS estimates by 17-29% for FY15-17. Our new DCF-TP of SGD0.72 (9.1% WACC, 1% growth) is down from SGD1.09 (6.8% WACC, 1% growth). This is equivalent to 18x FY16 P/E and 15x FY17 P/E.

FYE Dec (SGD m)	FY13A	FY14A	FY15E	FY16E	FY17E
Revenue	102.5	101.4	101.7	99.8	103.0
EBITDA	30.8	29.4	33.6	38.9	43.1
Core net profit	22.6	22.0	18.8	16.5	19.9
Core EPS (cts)	5.7	5.3	4.5	4.0	4.8
Core EPS growth (%)	(27.0)	(6.9)	(14.5)	(12.1)	20.5
Net DPS (cts)	2.9	2.6	2.3	2.0	2.4
Core P/E (x)	11.2	12.0	14.0	16.0	13.2
P/BV (x)	1.7	1.7	1.6	1.5	1.4
Net dividend yield (%)	4.5	4.2	3.6	3.1	3.8
ROAE (%)	21.1	14.5	11.6	9.7	11.0
ROAA (%)	14.6	8.1	5.3	4.6	5.4
EV/EBITDA (x)	6.6	12.7	10.1	8.3	7.1
Net debt/equity (%)	net cash	15.6	45.0	34.4	21.7

Key Data

52w high/low (SGD)	0.92/0.58
3m avg turnover (USDm)	0.0
Free float (%)	35.6
Issued shares (m)	415
Market capitalization	SGD263.8M
Major shareholders:	
-PERRY DAVID ALAN	32.6%
-WONG LOK HIONG	31.3%
-Eastspring Investments (Singapore) Ltd.	7.0%

Share Price Performance



	1 Mth	3 Mth	12 Mth
Absolute(%)	(0.8)	(20.6)	(30.2)
Relative to index (%)	(6.8)	(14.5)	(23.2)

Maybank vs Market

	Positive	Neutral	Negative
Market Recs	3	1	1
	Maybank Consensus		% +/-
Target Price (SGD)	0.72	0.89	(19.1)
'15 PATMI (SGDm)	19	21	(8.3)
'16 PATMI (SGDm)	17	19	(13.0)

Source: FactSet; Maybank

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Headwinds Continue After Move to Pasir Ris

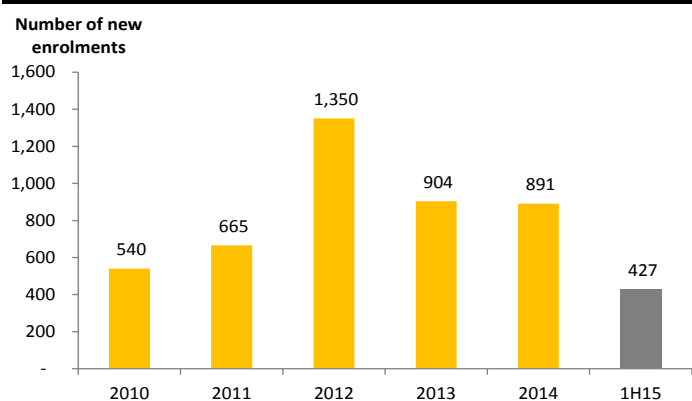
The move to Pasir Ris caused an estimated 700 Junior students to leave OEL in the last two years. We do not expect a further exodus from Junior students now that the campus is set. However, we expect difficulties for OEL to continue for the following reasons.

Student departures continue to increase. The number of international students returning to their home country has been unexpectedly high this year, according to management. It is a trend that has accelerated in the last few months. About 460 students left the school in 1H15 as their families relocated outside of Singapore. More and more expatriates are returning to their home country, as MNCs cut costs to rationalize their business in Asia. We believe this could continue to affect OEL this and next year as the number of student departures increases.

Weak Number of New Enrolments. While the number of departures is increasing, the number of new enrolments has been declining. OEL enrolled a total of 427 students in 2H15, a 17% decline from 1H14. And this comes despite the first half typically being stronger than the second half. (Enrolment seasonality results from the semester year beginning in Aug.)

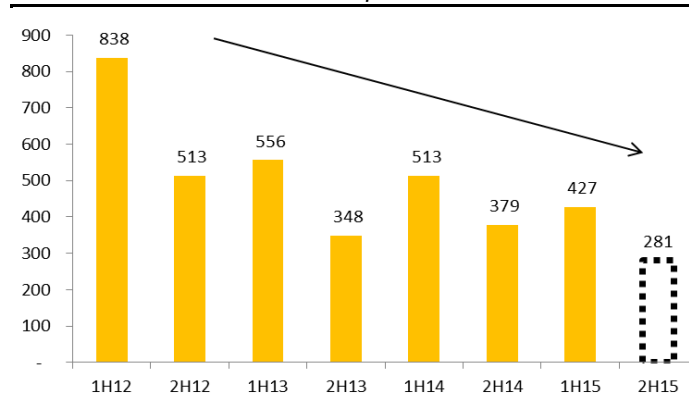
We note that, unlike other schools, OEL has a flexible policy that allows students to enrol at any time of the year. Other international schools have already closed their application process for this academic year. This could help OEL enrol more students during the year. But overall, we expect the number of new enrolments to remain weak at 280 in 2H15 factoring in the seasonality.

Figure 1: New student enrolments (yearly)
OEL managed to enrol 427 new students, despite weak macroeconomics...



Source: Maybank, Company

Figure 2: New student enrolments (half yearly)
...but the down trend is clear. Expect 281 new enrolments 2H15.



Source: Maybank, Company

Revised Assumptions:

- We forecast that OEL will enrol around 700 new students pa in FY15-16, vs. around 900 pa in FY13-14. We expect demand to improve slightly from 1H17 as the economy improves.
- We assume that the number of departure will continue to be high in 2016, with about 600 students leaving the school pa. We expect this number to ease in 2017 with 425 departures.
- We keep our tuition fee assumption unchanged at 3.5% increase per year, in line with industry peers.

Figure 3: Student enrolments and tuition fee assumptions

	2014	2015E	2016E	2017E	Comments
New student enrolments		708	705	755	In 1H15, OEL enrolled 427 new students. Expect this number to remain weak for FY16-17.
Student departures		(990)	(600)	(425)	In 1H15, 230 Junior students left, and 460 students returned to their home country.
Graduating students		(220)	(230)	(230)	
Number of students at semester-end	3,250	2,750	2,623	2,725	
Number of students (average)	3,413	3,000	2,687	2,674	
Net addition		(413)	(313)	(13)	
Growth (%)		-12.1%	-10.4%	-0.5%	
Tuition fee increase (%)		10.2%	3.5%	3.5%	Expect OEL to increase tuition fees in line with industry peers.

Source: Maybank

“Second-tier” Schools More Affected

We conducted channel checks at the other eight international schools in Singapore, and found out that “first-tier” schools are still operating at full capacity, and some with long waiting lists. This suggests that the shortage of international students in Singapore has affected “second-tier” schools like OEL more than the “first-tier”.

Figure 4: Other main international schools in Singapore

“First-tier” international schools	
Singapore American School (SAS)	SAS has more than 3,800 students from more than 50 nations, of which 60-70% are Americans. SAS has one school campus in Woodlands (north of Singapore).
United World College of South East Asia (UWCSEA)	UWCSEA has two campuses in Singapore. The Dover campus (in south-west Singapore) has 3,000 students while the East Coast campus, opened in 2008, can take 2,200 students.
Dulwich College	Dulwich open a campus in Bukit Batok in Aug 2014. It enrolled 980 students in its first year of operations and increased this number to 1,270 this year.
“Second-tier” international schools	
Tanglin Trust School (TTS)	TTS has one campus in Portsdown Road (in south-west Singapore) with 2,700 students. TTS provides UK system education from nursery to the Sixth Form.
Canadian International School (CIS)	CIS has two campuses in Singapore, the Tanjong Katong campus (in eastern Singapore) and the new Lakeside campus (in western Singapore). The Lakeside campus sits on a 43,000 sq meter plot of land, with a maximum capacity of 3,300 students.
Australian International School (AIS)	AIS is owned by the Cognita School Group, a leading international independent school. It has one campus in Serangoon Gardens (in central Singapore) catering to 2,600 students and 220 teaching staff. 70% of its students are from Australia and New Zealand.
Stamford American International School (SAIS)	Stamford American International School also belongs to the Cognita School Group and can accommodate about 2,500 students in its new campus in Woodleigh Lane (in central Singapore). More than 50 nationalities are represented on their campus.
GEMS World Academy	GEMS, the world’s largest operator of private schools opened GEMS World Academy in Yishun in Sep 2014. It currently has about 200-300 students.

Source: Maybank

Top-tier international schools are Singapore American School, UWCSEA, and Dulwich College. They are the favourite among international schools in Singapore and differ from other schools by their strong curriculum and elitist culture. They already operate a full capacity and have closed to new applications for the 2015-16 academic year.

Other international schools still accept applications for this academy year. We note that, among “second-tier” schools, and apart from OEL, GEMS Academy is the only one struggling to enrol students. Its Dubai-based school does not appeal to expatriates of Singapore. It opened its campus last academic year, but currently only has 200 students vs. an initial target of 750.

Over-supply Risk

Some international schools have started expanding/upgrading their facilities, as they expect demand to increase in the next few years.

- The Australian International School is building an extension to its current campus to cater to demand for its early-years programme. The new facility is expected to open in 2017 and will be able to take in an additional 2,000 pupils aged between two and six.
- The German European School of Singapore plans to open a new campus in Bukit Timah in 2017.
- Tanglin Trust School is upgrading its facilities for Junior students in order to attract them.

Therefore, we see a risk of over-supply in the industry, especially as the global economic outlook remains weak, and the employment pass intake could stay flat or even decline. We note that these schools focus on early childhood and the primary level, as the expatriate demographics are changing; while the traditional expatriate was in their 40s or 50s, the “new” expatriate is younger, in their 30s. This implies that upcoming international students will be younger.

Figure 5: Foreign passes in Singapore

Overall, growth in foreign workers has slowed down among all categories

	Dec-09	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Jun-15
Employment Pass (EP)	114,300	143,300	175,400	173,800	175,100	178,900	180,800
EP addition		29,000	32,100	-1,600	1,300	3,800	1,900
Growth (%)		25.4%	22.4%	-0.9%	0.7%	2.2%	1.1%
S Pass	82,800	98,700	113,900	142,400	160,900	170,100	173,800
S Pass addition		15,900	15,200	28,500	18,500	9,200	3,700
Growth (%)		19.2%	15.4%	25.0%	13.0%	5.7%	2.2%
Work Permit	851,200	865,200	901,000	942,800	974,400	991,300	993,900
Work Permit addition		14,000	35,800	41,800	31,600	16,900	2,600
Growth (%)		1.6%	4.1%	4.6%	3.4%	1.7%	0.3%

Source: Ministry of Manpower

Valuation

Lacking positive catalysts, we downgrade the stock to HOLD from BUY with new TP of SGD0.72.

Change in Beta. We continue to use a DCF valuation, but we change our Beta to 1.2 from 0.7. We believe the Bloomberg Beta of 0.7 is unusually small because of the low liquidity of the stock. Our Beta of 1.2 is higher than industry peers, such as China Maple Leaf International (B=1.0), Tree House Educational & Accessories (B=0.9), and New Oriental Education (B=1.0), as we believe the risk premium for OEL should be higher given its current business outlook. Accordingly, our WACC is increased to 9.1% from 6.8%.

Target price. OEL currently trades at 16x FY16E P/E. Our DCF-valuation gives us a TP of SGD0.72, equivalent to 18x FY16E P/E and 13x FY17E P/E. Given the weak business outlook, lack of short-term catalysts, and moderate upside to our revised TP, we downgrade the shares to HOLD from BUY.

Figure 6: DCF-valuation

	FY15E	FY16E	FY17E	FY18E	FY19E	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E
Free Cash Flow	(40)	31	38	43	43	44	47	49	48	46	47
PV of FCF		28	32	33	30	29	28	27	24	21	20
Total PV of FCF	271										
Terminal value	244										
PV of terminal value	102										
Firm value	373										
Add cash	75										
Less debt	(150)										
Equity value	298										
Number of shares (in million)	415										
Intrinsic value/share	0.72										
Rf	3.5%										
Rm - Rf	8.5%										
Beta	1.2										
Cost of equity	13.7%										
Cost of debt	5.2%										
Tax rate	17.0%										
E	51.2%										
D	48.8%										
WACC	9.1%										
Terminal growth rate	1.0%										

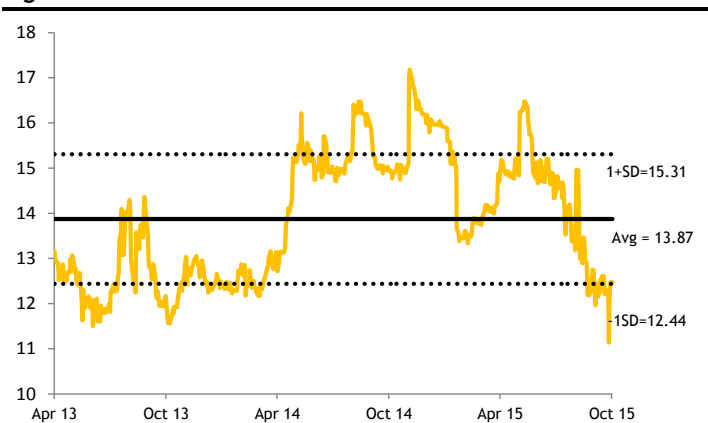
Source: Maybank

Figure 7: Peers comparison

Company	Country	Last price	Mkt cap (USDm)	P/E (x)			P/B (x)			EV/EBITDA			Dividend yield (%)			Net margin	ROE (%)	3-year EPS CAGR (%)
				FY15	FY16	FY17	FY15	FY16	FY17	FY15	FY16	FY17	FY15	FY16	FY17			
Overseas Education	Singapore	0.64	191	12.4	13.8	12.0	1.6	1.5	1.4	9.2	8.0	7.4	4.0	3.6	4.2	20.6	14.5	0.2
Average				18.3	16.4	14.0	2.4	2.0	1.8	11.9	8.3	6.3	1.8	1.7	1.9	16.7	13.9	23.7
Meiko Network Japan	Japan	1,445	332	16.5	17.8	17.5	2.7	2.5	2.3	n.a.	n.a.	n.a.	2.4	2.5	2.7	14.1	17.6	3.0
China Maple Leaf Educational Systems	Hong Kong	2.71	475	18.8	16.6	14.0	1.7	1.4	1.3	8.7	6.2	4.6	2.4	2.7	3.1	7.4	9.0	19.3
Tree House Education & Accessories	India	283	184	n.a.	15.4	11.2	n.a.	1.6	1.4	n.a.	7.4	5.6	n.a.	0.9	1.1	29.6	11.6	44.5
New Oriental Educatio-Sp Adr	China	26	4,111	19.6	16.0	13.4	2.9	2.5	2.1	15.1	11.3	8.6	0.5	0.6	0.8	15.5	17.2	28.2

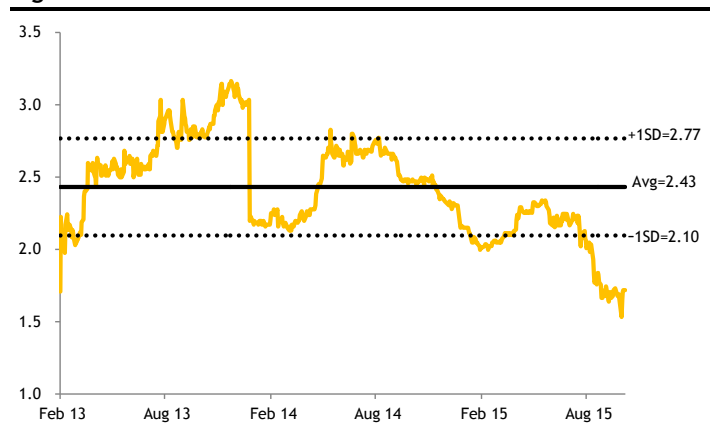
Source: Maybank

Figure 8: P/E band



Source: Maybank

Figure 9: P/B band



Source: Maybank

FYE 31 Dec	FY13A	FY14A	FY15E	FY16E	FY17E
Key Metrics					
P/E (reported) (x)	11.2	12.0	14.0	16.0	13.2
Core P/E (x)	11.2	12.0	14.0	16.0	13.2
P/BV (x)	1.7	1.7	1.6	1.5	1.4
P/NTA (x)	nm	nm	nm	nm	nm
Net dividend yield (%)	4.5	4.2	3.6	3.1	3.8
FCF yield (%)	nm	nm	nm	11.5	14.2
EV/EBITDA (x)	6.6	12.7	10.1	8.3	7.1
EV/EBIT (x)	7.6	14.5	13.1	11.9	9.7

INCOME STATEMENT (SGD m)

Revenue	102.5	101.4	101.7	99.8	103.0
Gross profit	41.2	39.5	38.2	35.4	39.9
EBITDA	30.8	29.4	33.6	38.9	43.1
Depreciation	(3.3)	(3.7)	(7.6)	(11.8)	(11.9)
Amortisation	(0.7)	0.0	0.0	0.0	0.0
EBIT	26.8	25.7	26.0	27.1	31.2
Net interest income / (exp)	0.4	0.6	(3.4)	(7.3)	(7.3)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.1	0.1	0.1	0.1	0.1
Pretax profit	27.3	26.4	22.6	19.9	24.0
Income tax	(4.7)	(4.5)	(3.8)	(3.4)	(4.1)
Minorities	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	22.6	22.0	18.8	16.5	19.9
Core net profit	22.6	22.0	18.8	16.5	19.9

BALANCE SHEET (SGD m)

Cash & Short Term Investments	124.7	125.5	74.8	89.6	109.8
Accounts receivable	1.5	5.2	3.4	3.0	2.8
Inventory	0.6	0.5	0.6	0.6	0.6
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	58.8	214.3	270.0	262.3	254.4
Intangible assets	3.2	2.9	3.0	3.0	3.0
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	5.3	3.4	5.4	5.4	5.4
Total assets	194.1	351.9	357.2	364.0	376.0
ST interest bearing debt	0.0	0.0	0.0	0.0	0.0
Accounts payable	0.9	1.0	1.1	1.2	1.3
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	0.0	150.0	150.0	150.0	150.0
Other liabilities	47.0	44.0	39.0	37.0	39.0
Total Liabilities	47.4	194.7	190.1	188.6	190.7
Shareholders Equity	146.7	157.2	167.0	175.3	185.3
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholder equity	146.7	157.2	167.0	175.3	185.3
Total liabilities and equity	194.1	351.9	357.2	364.0	376.0

CASH FLOW (SGD m)

Pretax profit	27.3	26.4	22.6	19.9	24.0
Depreciation & amortisation	4.0	3.7	7.6	11.8	11.9
Adj net interest (income)/exp	(0.4)	(0.6)	3.4	7.3	7.3
Change in working capital	(0.2)	(3.8)	(3.2)	(1.2)	2.3
Cash taxes paid	(4.0)	(5.0)	(3.8)	(3.4)	(4.1)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	26.7	20.8	26.6	34.4	41.4
Capex	(53.2)	(152.7)	(67.0)	(4.0)	(4.0)
Free cash flow	(26.5)	(132.0)	(40.4)	30.4	37.4
Dividends paid	(11.4)	(11.4)	(9.4)	(8.3)	(10.0)
Equity raised / (purchased)	68.0	0.0	0.0	0.0	0.0
Change in Debt	0.0	150.0	0.0	0.0	0.0
Other invest/financing cash flow	(0.4)	(6.4)	(1.4)	(7.8)	(7.8)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	29.7	0.2	(51.2)	14.4	19.6

FYE 31 Dec	FY13A	FY14A	FY15E	FY16E	FY17E
Key Ratios					
Growth ratios (%)					
Revenue growth	6.8	(1.1)	0.3	(1.9)	3.2
EBITDA growth	8.2	(4.5)	14.2	15.9	10.8
EBIT growth	11.1	(4.0)	1.0	4.5	15.0
Pretax growth	11.7	(3.2)	(14.3)	(12.1)	20.5
Reported net profit growth	9.5	(2.8)	(14.5)	(12.1)	20.5
Core net profit growth	9.5	(2.8)	(14.5)	(12.1)	20.5
Profitability ratios (%)					
EBITDA margin	30.0	29.0	33.0	39.0	41.8
EBIT margin	26.1	25.4	25.5	27.2	30.3
Pretax profit margin	26.6	26.1	22.3	19.9	23.3
Payout ratio	50.5	50.0	50.0	50.0	50.0
DuPont analysis					
Net profit margin (%)	22.1	21.7	18.5	16.6	19.3
Revenue/Assets (x)	0.5	0.3	0.3	0.3	0.3
Assets/Equity (x)	1.3	2.2	2.1	2.1	2.0
ROAE (%)	21.1	14.5	11.6	9.7	11.0
ROAA (%)	14.6	8.1	5.3	4.6	5.4
Liquidity & Efficiency					
Cash conversion cycle	3.3	9.6	12.1	8.0	5.9
Days receivable outstanding	5.3	11.9	15.2	11.5	10.2
Days inventory outstanding	3.7	3.4	3.6	4.1	4.2
Days payables outstanding	5.7	5.8	6.6	7.6	8.6
Dividend cover (x)	2.0	2.0	2.0	2.0	2.0
Current ratio (x)	2.8	3.0	2.1	2.5	2.9
Leverage & Expense Analysis					
Asset/Liability (x)	4.1	1.8	1.9	1.9	2.0
Net debt/equity (%)	net cash	15.6	45.0	34.4	21.7
Net interest cover (x)	na	na	7.6	3.7	4.3
Debt/EBITDA (x)	0.0	5.1	4.5	3.9	3.5
Capex/revenue (%)	51.9	150.6	65.9	4.0	3.9
Net debt/ (net cash)	(124.7)	24.5	75.2	60.4	40.2

Source: Company; Maybank

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