A-Share Market

Transportation: 2H17 sector outlook; earnings visibility and growth potential two criteria for stock selection

In 2H17 we highlight industry leaders that might see continued re-rating and stocks with steady growth potential. Airlines’ operating profit should improve substantially HoH in 2H17 given more favorable fuel prices and exchange rates. As positivity in the airport subsector is now quite fully factored in, we believe the time horizon for investing in airport names has been lengthened and that investors will refocus on organic business growth as a share price driver. As industry growth slows, cost control and branding will become courier companies’ core competitiveness. Rebounding interest rates have put pressure on companies with higher debt ratios; companies diversifying into other business fields are worth watching as the return on new road construction projects continues to decline.

Wisdom Education (6068 HK, Buy): Acquisition of a school in Jieyang city, Guangdong; substantial room for increase in its capacity and profitability; raise TP to HK$3.55

We raise our adjusted net profit estimates for FY18/19 by 2%/3% to account for the acquisition of school in Jieyang city. We think the company can raise the school’s earnings substantially in FY18, as it 1) will raise its tuition fees for newly admitted students by at least 15% in the 2017/18 school year, 2) targets to increase student enrolment from 3,200 to 4,500 in 2017/18, and 3) can expand its revenue sources by providing ancillary services. We maintain our Buy rating and lift our target price from HK$3.32 to HK$3.55.
**Transportation: 2H17 sector outlook; earnings visibility and growth potential two criteria for stock selection**

We highlight two ideas for stock selection in 2H17: 1) continued re-rating in undervalued industry leaders, and 2) stocks with steady growth potential.

**Subsector outlook**

**Airlines** Amid tightening capacity at major hub airports, first-tier airlines’ pricing power is strengthening thanks to high entry barriers and high PLF. A mild demand recovery in 1H17 led to relatively strong business conditions in the airlines subsector. Airlines’ operating profit should improve substantially HoH in 2H17 given more favorable fuel prices and exchange rates. Considering flight supply growth of 15%-20%, domestic airline carriers might stick to a high pricing strategy in the international flight segment in the short term, while marginal improvements in the supply-demand balance should help airline companies mature more quickly. We suggest watching China Southern Airlines (600029 CH) and Juneyao Airlines (603885 CH).

**Airports** Share price strength in airport names in 1H17 was driven by steady business volume growth, the implementation of a fee reform on April 1, and the tendering of duty free shops which significantly enhanced airports’ non-flight profits. As subsector positivity is now quite fully factored in, we believe the time horizon for investing in airport names has been lengthened and that investors will refocus on organic business growth as a share price driver. We like Shenzhen Airport (000089 CH) and Guangzhou Baiyun International Airport (600004 CH) given sufficient capacity expansion potential and capex plans that can effectively match upcoming flight structures.

**Courier** Customer loyalty and the marginal benefits brought by price competition are declining; as industry growth slows, cost control and branding will become courier companies’ core competitiveness. We prefer Yunda (002120 CH) given strong cost control and rising market share.

**Toll roads** While the economic recovery and regulation targeting truck overload have resulted in traffic and earnings growth, rebounding interest rates have put pressure on companies with higher debt-to-asset ratios. Earnings growth and dividend yields remain key criteria for assessing toll road names' investment value. Companies diversifying into other business fields are worth watching as the return on new road construction projects continues to decline.

**Shipping** The shipping subsector has recovered after bottoming in 2016. However, the persistence of excess capacity continues to weigh on shipping rates, which might require a long process for overcapacity issues to be resolved.

**Wisdom Education (6068 HK, Buy): Acquisition of a school in Jieyang city, Guangdong; substantial room for increase in its capacity and profitability; raise TP to HK$3.55**

**What’s new?** Wisdom Education’s consolidated affiliated entity, Dongguan Huasheng, has agreed to acquire 1) 70% of the school sponsor’s interest in Huanan Shida Yuedong Preparatory School (华南师大粤东实验学校) for a consideration of Rmb91m from Mr Xu Chuangbo, and 2) a 70% interest in the school’s properties for Rmb133m from Mr Xu Chuangbo and Ms Xia Xiaowei, both independent third parties. Dongguan Huasheng is 92.86% and 7.14% owned by Wisdom Education and Ms Xia Xiaowei respectively, meaning Wisdom Education effectively holds a 65% interest in the school and its properties.

**School background** Huanan Shida Yuedong Preparatory School is a private school in Jieyang city, Jiedong district, Guangdong province, providing primary, middle and high school education. According to the school’s website, its students have had the best results in China’s Senior High School Entrance Exam of all schools in the Jiedong district for some time. The school has 3,200 students and targets to have around 4,500 in the 2017/18 school year. The acquisition is expected to be completed by Sept 1, 2017. After the acquisition, the company will rebrand the school and it will not have any relationship with Huanan Shida.

**School earnings to rise significantly in FY18** The school recorded net profit of Rmb7.125m in 2016. The acquisition valuation represents 48x historical P/E. However, we think the company can raise the school’s earnings substantially in FY18, as it 1) will raise its tuition fees for newly admitted
students by at least 15% in the 2017/18 school year, 2) targets to increase student enrolment from 3,200 to 4,500 in 2017/18, and 3) can expand its revenue sources by providing ancillary services.

**Local government supporting capacity expansion** The school’s current capacity is 5,000 students, but this could rise to 8,000 with the addition of more buildings. The Jiedong district government has agreed to support the company with land for further expansion to 18,000 students. At the current capacity of 5,000 students, the acquisition consideration equates to Rmb68,921 per student, around a 38% premium to the company’s self-built schools capex of Rmb50,000/student.

**Maintain Buy and lift TP to HK3.55** Wisdom Education will finance the acquisition using internal resources (net cash balance of Rmb445m in 1HFY17). The acquisition is not cheap, in our view, but is justified by the room for the company to increase the school’s capacity and profitability in the future. We raise our adjusted net profit estimates for FY18/19 by 2%/3% to account for the acquisition. We lift our target price from HK$3.32 to HK$3.55, representing 20.5x FY18E P/E and based on 1.0x PEG (assuming 20.5% FY17-20 EPS CAGR). Potential catalysts: 1) student enrollment beats management’s target of 40,000 in Sept 2017; 2) possible inclusion in the Shenzhen-HK stock connect; 3) M&A.

**Risks:** 1) A surge in teacher costs; 2) policy risks; 3) an oversupply of private schools; 4) poor academic results; 5) the majority of the company’s income comes from just three schools in Dongguan.

(Albert Yip, CFA, Research Analyst, SFC CE No. ADT599, albertyip@gfgroup.com.hk +852 3719 1010)
Rating Definitions

Benchmark: Hong Kong Hang Seng Index
Time horizon: 12 months

<table>
<thead>
<tr>
<th>Company ratings</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy</td>
<td>Stock expected to outperform benchmark by more than 15%</td>
</tr>
<tr>
<td>Accumulate</td>
<td>Stock expected to outperform benchmark by more than 5% but not more than 15%</td>
</tr>
<tr>
<td>Hold</td>
<td>Expected stock relative performance ranges between -5% and 5%</td>
</tr>
<tr>
<td>Underperform</td>
<td>Stock expected to underperform benchmark by more than 5%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sector ratings</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive</td>
<td>Sector expected to outperform benchmark by more than 10%</td>
</tr>
<tr>
<td>Neutral</td>
<td>Expected sector relative performance ranges between -10% and 10%</td>
</tr>
<tr>
<td>Cautious</td>
<td>Sector expected to underperform benchmark by more than 10%</td>
</tr>
</tbody>
</table>

Analyst Certification

The research analyst(s) primarily responsible for the content of this research report, in whole or in part, certifies that with respect to the company or relevant securities that the analyst(s) covered in this report: (1) all of the views expressed accurately reflect his or her personal views on the company or relevant securities mentioned herein; and (2) no part of his or her remuneration was, is, or will be, directly or indirectly, in connection with his or her specific recommendations or views expressed in this research report.

Disclosure of Interests

(1) The proprietary trading division of GF Securities (Hong Kong) Brokerage Limited (“GF Securities (Hong Kong)”) and/or its affiliated or associated companies do not hold any shares of the securities mentioned in this research report.
(2) GF Securities (Hong Kong) and/or its affiliated or associated companies do not have any investment banking relationship with the companies mentioned in this research report in the past 12 months.
(3) Neither the analyst(s) preparing this report nor his/her associate(s) serves as an officer of the company mentioned in this report and has any financial interests or hold any shares of the securities mentioned in this report.

Disclaimer

This report is prepared by GF Securities (Hong Kong). It is published solely for information purpose and does not constitute an offer to buy or sell any securities or a solicitation of an offer to buy, or recommendation for investment in, any securities. The research report is intended solely for use of the clients of GF Securities (Hong Kong). The securities mentioned in the research report may not be allowed to be sold in certain jurisdictions. No action has been taken to permit the distribution of the research reports to any person in any jurisdiction that the circulation or distribution of such research report is unlawful. No representation or warranty, either express or implied, is made by GF Securities (Hong Kong) as to their accuracy or completeness of the information contained in the research report. GF Securities (Hong Kong) accepts no liability for all loss arising from the use of the materials presented in the research report, unless is excluded by applicable laws or regulations. Please be aware of the fact that investments involve risks and the price of securities may be fluctuated and therefore return may be varied, past results do not guarantee future performance. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. The report is not to be taken in substitution for the exercise of judgment by respective recipients of the report, where necessary, recipients should obtain professional advice before making investment decisions.

GF Securities (Hong Kong) may have issued, and may in the future issue, other communications that are inconsistent with, and reach different conclusions from, the information presented in the research report. The points of view, opinions and analytical methods adopted in the research report are solely expressed by the analysts but not that of GF Securities (Hong Kong) or its affiliates. The information, opinions and forecasts presented in the research report are the current opinions of the analysts as of the date appearing on this material only which may subject to change at any time without notice. The salesperson, dealer or other professionals of GF Securities (Hong Kong) may deliver opposite points of view to their clients and the proprietary trading division with respect to market commentary or dealing strategy either in writing or verbally. The proprietary trading division of GF Securities (Hong Kong) may have different investment decision which may be contrary to the opinions expressed in the research report. GF Securities (Hong Kong) or its affiliates or respective directors, officers, analysts and employees may have rights and interests in securities mentioned in the research report. Recipients should be aware of relevant disclosure of interest (if any) when reading the report.

Copyright © GF Securities (Hong Kong) Brokerage Limited.
Without the prior written consent obtained from GF Securities (Hong Kong) Brokerage Limited, any part of the materials contained herein should not (i) in any forms be copied or reproduced or (ii) be re-disseminated.

© GF Securities (Hong Kong) Brokerage Limited. All rights reserved.
29-30/F, Li Po Chun Chambers, 189 Des Voeux Road Central, Hong Kong
Tel: +852 3719 1111  Fax: +852 2907 6176  Website: http://www.gftgroup.com.hk