Buy CL

Offcn Education Technology (002607.SZ)

An established player in a growing niche & potentially more; initiate at Buy, add to CL

002607.SZ	12m Price Target: **Rmb36.38**	Price: **Rmb28.59**	Upside: **27.2%**

Offcn Education is a unique company - positively exposed to the rising civil servant training market, having reached a largely dominant market share at 25% (next players at <7% mkt share) and with the optionality to deploy their strategy focused on product and branding, in new segments. Offcn focuses on providing training for civil servant admission - a market that we expect will more than double by 2025E to US$8bn, as China's understaffed public service system is a key source of job access, and graduates choose that job path for higher benefits and social status. Driven by its strong brand recognition, R&D/product design that yields higher exam passing rates, and the tripling of its in-depth sales network scale by 2025, we forecast Offcn **to reach a market share of 40%+ in 2025E**. We initiate at Buy and add it to our CL with a 12m TP of Rmb36.38 implying 27% upside.

We like **its superior and sustainable capital return**: We expect Offcn to sustain 60%+ ROE in the next few years based on its strong bargaining power, asset light business model, high and stable margin as well as strong free cash flow generation. We also believe we are potentially at the beginning of a **long-term expansion into new segments** in vocational education, given its strong past track record and the large market size.

We expect a 33% EPS CAGR in 2019-25E and see 2H20E revenue growth at 50%+ as a potential catalyst. We are up to 4% ahead of 2020-22E consensus EPS likely on operating leverage and new business expansion. To capture its longer-term growth, we value the stock on 30X 2025E EPS discounted back to 2021E with 7.5% COE. While its near term PE of 70x 20E looks high, we believe Offcn's competitive advantage can sustain long-term growth. Risks include uncertainties in education policy; intensifying competition; inability to run live classes in the event of further COVID-19 outbreaks.

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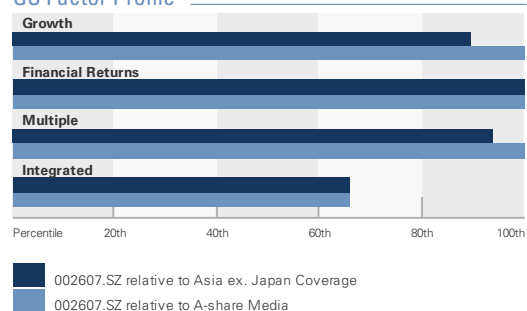Beijing Gao Hua Securities Company Limited

Key Data

Market cap:	Rmb176.3bn / $24.9bn
Enterprise value:	Rmb177.5bn / $25.1bn
3m ADTV:	Rmb289.1mn / $40.8mn
	China
	A-share Media
	M&A Rank: 3
Leases incl. in net debt & EV?:	No
	Asia ex. Japan Conviction List

GS Forecast

	12/19	12/20E	12/21E	12/22E
Revenue (Rmb mn)	9,176.1	11,830.5	15,570.4	19,953.4
EBITDA (Rmb mn)	2,191.2	2,798.7	3,890.3	5,300.2
EPS (Rmb)	0.29	0.40	0.55	0.75
P/E (X)	47.7	70.8	51.8	38.0
P/B (X)	25.1	42.2	31.8	23.8
Dividend yield (%)	1.7	1.0	1.2	1.6
N debt/EBITDA (ex lease,X)	0.1	0.4	0.4	0.3
CROCI (%)	44.8	42.7	42.9	42.6
FCF yield (%)	2.0	0.8	1.3	2.1

	3/20	6/20E	9/20E	12/20E
EPS (Rmb)	0.02	0.07	0.13	0.19

GS Factor Profile

Source: Company data, Goldman Sachs Research estimates.
See disclosures for details.

Offcn Education Technology (002607.SZ)

Buy CL

Rating since Jun 17, 2020

Ratios & Valuation

	12/19	12/20E	12/21E	12/22E
P/E (X)	47.7	70.8	51.8	38.0
P/B (X)	25.1	42.2	31.8	23.8
FCF yield (%)	2.0	0.8	1.3	2.1
EV/EBITDAR (X)	39.4	63.4	45.7	33.5
EV/EBITDA (excl. leases) (X)	39.4	63.4	45.7	33.5
CROCI (%)	44.8	42.7	42.9	42.6
ROE (%)	56.5	65.5	70.0	71.7
Net debt/equity (%)	4.2	27.6	28.0	19.7
Net debt/equity (excl. leases) (%)	4.2	27.6	28.0	19.7
Interest cover (X)	9.8	17.3	24.3	36.2
Days inventory outst, sales	0.0	–	–	–
Receivable days	6.9	9.1	9.0	9.1
Days payable outstanding	74.0	78.5	78.3	79.2
DuPont ROE (%)	52.6	59.6	61.4	62.7
Turnover (X)	0.9	1.0	1.2	1.2
Leverage (X)	2.9	2.8	2.4	2.2
Gross cash invested (ex cash) (Rmb)	5,668.1	7,531.2	10,062.6	13,641.5
Average capital employed (Rmb)	3,743.2	4,453.5	6,209.8	7,967.0
BVPS (Rmb)	0.56	0.68	0.90	1.20

Growth & Margins (%)

	12/19	12/20E	12/21E	12/22E
Total revenue growth	47.1	28.9	31.6	28.1
EBITDA growth	60.5	27.7	39.0	36.2
EPS growth	56.5	38.0	36.6	36.3
DPS growth	(3.0)	17.8	17.1	36.3
EBIT margin	22.1	22.0	23.4	25.1
EBITDA margin	23.9	23.7	25.0	26.6
Net income margin	19.7	21.1	21.8	23.2

Price Performance

002607.SZ (Rmb)   **Shanghai - Shenzhen 300**

	3m	6m	12m
Absolute	29.2%	59.3%	115.0%
Rel. to the Shanghai - Shenzhen 300	19.3%	60.2%	95.6%

Source: FactSet. Price as of 17 Jun 2020 close.

Income Statement (Rmb mn)

	12/19	12/20E	12/21E	12/22E
Total revenue	9,176.1	11,830.5	15,570.4	19,953.4
Cost of goods sold	(3,812.6)	(4,926.4)	(6,447.3)	(8,208.2)
SG&A	(2,638.1)	(3,460.4)	(4,445.4)	(5,517.1)
R&D	(697.9)	(840.7)	(1,028.6)	(1,218.4)
Other operating inc./(exp.)	1.4	–	–	–
EBITDA	**2,191.2**	**2,798.7**	**3,890.3**	**5,300.2**
Depreciation & amortization	(162.3)	(195.6)	(241.1)	(290.5)
EBIT	**2,028.8**	**2,603.0**	**3,649.2**	**5,009.7**
Net interest inc./(exp.)	(204.3)	(95.8)	(83.9)	(98.7)
Income/(loss) from associates	–	–	–	–
Pre-tax profit	**2,089.3**	**2,882.9**	**3,937.6**	**5,365.8**
Provision for taxes	(284.8)	(392.9)	(536.7)	(731.4)
Minority interest	0.0	1.0	1.1	1.1
Preferred dividends	–	–	–	–
Net inc. (pre-exceptionals)	**1,804.5**	**2,490.9**	**3,401.9**	**4,635.5**
Post-tax exceptionals	–	–	–	–
Net inc. (post-exceptionals)	**1,804.5**	**2,490.9**	**3,401.9**	**4,635.5**
EPS (basic, pre-except) (Rmb)	**0.29**	**0.40**	**0.55**	**0.75**
EPS (diluted, pre-except) (Rmb)	**0.29**	**0.40**	**0.55**	**0.75**
EPS (basic, post-except) (Rmb)	**0.29**	**0.40**	**0.55**	**0.75**
EPS (diluted, post-except) (Rmb)	**0.29**	**0.40**	**0.55**	**0.75**
DPS (Rmb)	0.24	0.28	0.33	0.45
Div. payout ratio (%)	82.0	70.0	60.0	60.0

Balance Sheet (Rmb mn)

	12/19	12/20E	12/21E	12/22E
Cash & cash equivalents	2,724.3	2,211.9	1,317.9	1,410.3
Accounts receivable	257.7	332.3	437.3	560.4
Inventory	–	–	–	–
Other current assets	1,854.2	2,854.2	3,854.2	5,354.2
Total current assets	**4,836.3**	**5,398.4**	**5,609.4**	**7,324.9**
Net PP&E	1,326.0	2,535.8	3,819.2	5,077.8
Net intangibles	297.4	340.5	387.4	438.8
Total investments	2,612.1	2,612.1	2,612.1	2,612.1
Other long-term assets	889.0	860.1	845.7	841.5
Total assets	**9,960.7**	**11,746.9**	**13,273.8**	**16,295.1**
Accounts payable	921.0	1,197.4	1,567.1	1,995.1
Short-term debt	2,867.0	3,367.0	2,867.0	2,867.0
Short-term lease liabilities	–	–	–	–
Other current liabilities	2,634.3	2,897.7	3,195.2	3,935.4
Total current liabilities	**6,422.2**	**7,462.2**	**7,629.3**	**8,797.5**
Long-term debt	–	–	–	–
Long-term lease liabilities	–	–	–	–
Other long-term liabilities	106.9	106.9	106.9	106.9
Total long-term liabilities	**106.9**	**106.9**	**106.9**	**106.9**
Total liabilities	**6,529.2**	**7,569.1**	**7,736.2**	**8,904.4**
Preferred shares	–	–	–	–
Total common equity	3,431.5	4,178.8	5,539.6	7,393.8
Minority interest	**(0.0)**	**(1.0)**	**(2.1)**	**(3.2)**
Total liabilities & equity	**9,960.7**	**11,746.9**	**13,273.8**	**16,295.1**
Net debt, adjusted	142.7	1,155.1	1,549.1	1,456.7

Cash Flow (Rmb mn)

	12/19	12/20E	12/21E	12/22E
Net income	1,804.5	2,490.9	3,401.9	4,635.5
D&A add-back	162.3	195.6	241.1	290.5
Minority interest add-back	(0.0)	(1.0)	(1.1)	(1.1)
Net (inc)/dec working capital	126.5	201.9	264.6	304.9
Other operating cash flow	380.6	–	–	–
Cash flow from operations	**2,474.0**	**2,887.4**	**3,906.6**	**5,229.8**
Capital expenditures	(719.9)	(1,419.7)	(1,557.0)	(1,596.3)
Acquisitions	–	–	–	–
Divestitures	–	–	–	–
Others	588.8	(1,000.0)	(1,000.0)	(1,500.0)
Cash flow from investing	**(131.1)**	**(2,419.7)**	**(2,557.0)**	**(3,096.3)**
Repayment of lease liabilities	–	–	–	–
Dividends paid (common & pref)	(1,525.8)	(1,480.2)	(1,743.6)	(2,041.1)
Inc/(dec) in debt	1,260.0	500.0	(500.0)	–
Other financing cash flows	(1.5)	0.0	0.0	0.0
Cash flow from financing	**(267.3)**	**(980.2)**	**(2,243.6)**	**(2,041.1)**
Total cash flow	**2,075.6**	**(512.4)**	**(894.1)**	**92.4**
Free cash flow	1,754.1	1,467.8	2,349.6	3,633.5

*Source: Company data, Goldman Sachs Research estimates.*

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Thesis in Charts

Exhibit 1: Summary of admission training industry and Offcn Education's admissions business

		2015A	2015-19 CAGR	2019A	2019-25E CAGR	2025E
Offcn Education admission category (Civil Servant/public institute/teachers)	Revenue (Rmb mn)	1,834	42%	7,505	22%	25,339
	Market share	15%	n.a.	26%	n.a.	45%
	Offline enrollment (k)	403	33%	1,252	15%	2,949
	ASP (Rmb)	4,556	7%	5,995	6%	8,591
	OP (Rmb mn)	167	83%	1,851	30%	9,045
Public service admission training industry	Total admission (k)	695	3%	790	14%	1,710
	Test takers (k)	9,020	10%	13,330	6%	18,985
	Training enrollment (k)	2,302	14%	3,946	7%	5,876
	HE enrolled students (k)	36,470	2%	39,595	2%	45,076
	Market size (Rmb mn)	12,549	23%	28,755	12%	56,772

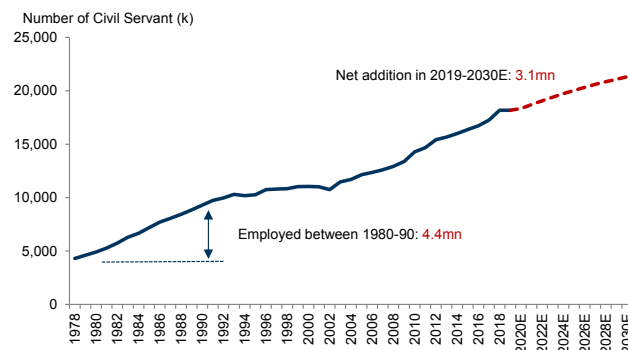Source: Company data, Gao Hua Securities Research

Exhibit 2: Revenue growth breakdown for Offcn Education
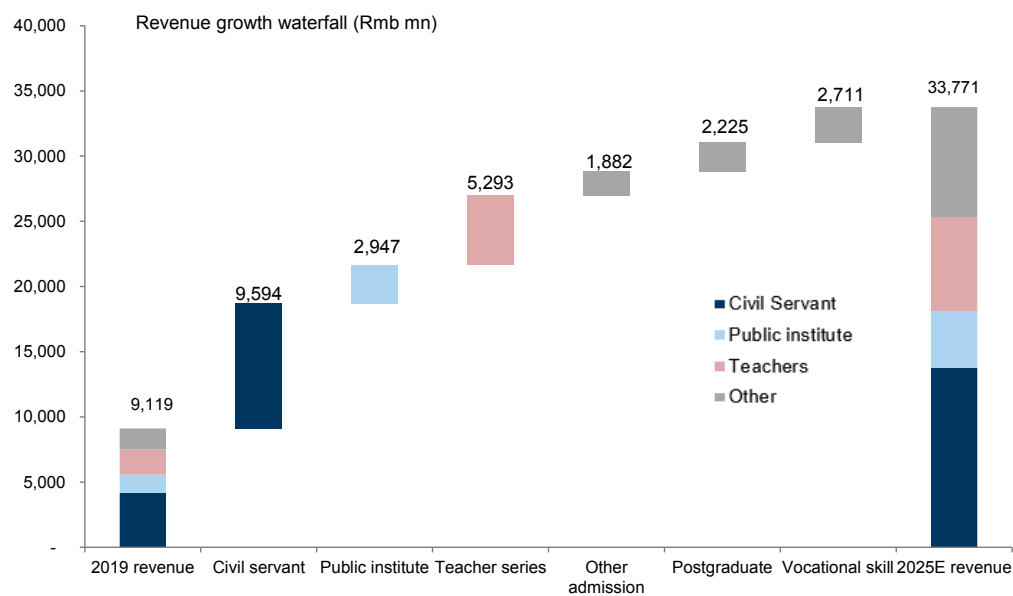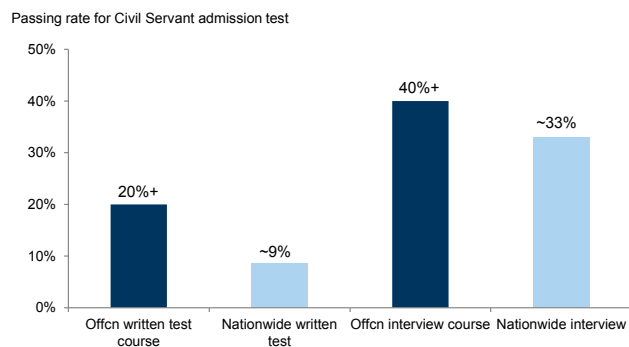

Source: Company data, Gao Hua Securities Research

Exhibit 3: We expect the market size of China's public service admission training to reach Rmb57bn in 2025E

Admission exam training market size (Rmb mn)
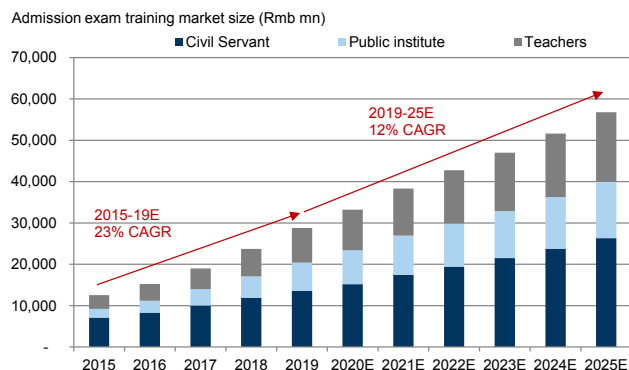
Source: Company data, Gao Hua Securities Research

Exhibit 4: We expect China's Civil Servant to increase 3.1mn in next 10 years

Number of Civil Servant (k)

Source: NBS, Gao Hua Securities Research

Exhibit 5: Students in Offcn Education's training courses have seen higher passing rates for the Civil Servant admission exam (data as of FY19)
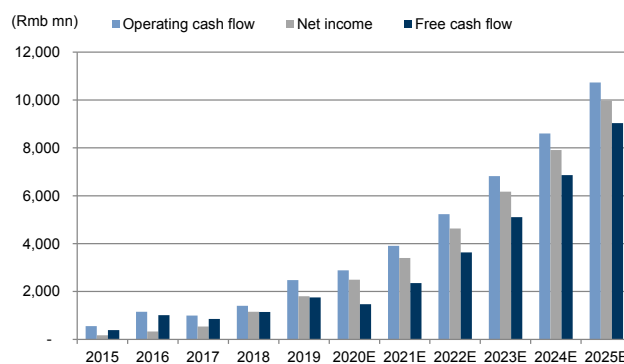
Passing rate for Civil Servant admission test

Source: Company data

Exhibit 6: We expect Offcn to expand number of sales branches by 3x in 5 years
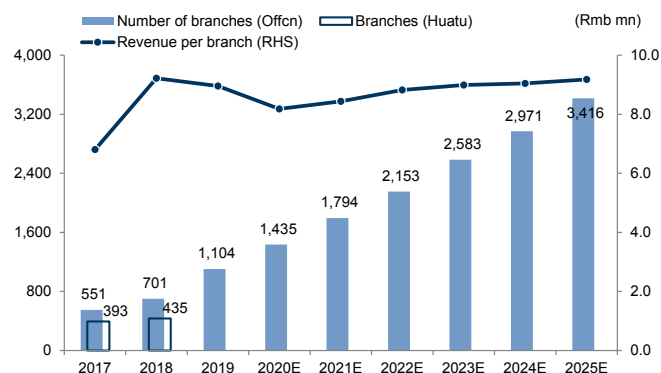
Source: Company data, Gao Hua Securities Research

Exhibit 7: We expect ROE and ROIC to remain high in next few years
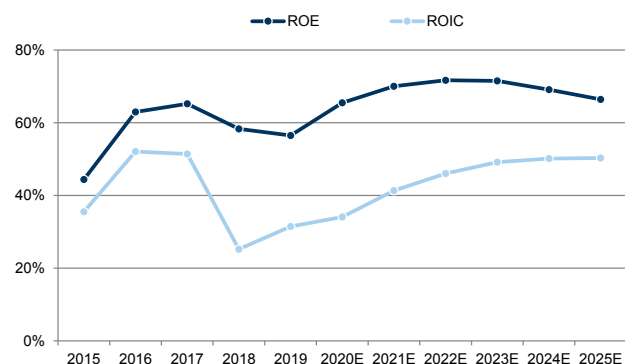
Source: Company data, Gao Hua Securities Research

**Exhibit 8: The company has strong cash flow**

Source: Company data, Gao Hua Securities Research

Company profile

Offcn Education is China's largest public service admission training company. It was founded in 2003 as a service provider in the civil servant admission training business, and the company's business lines now extend to training for public institutes, teachers, and various other programs for public service admissions, as well as postgraduate exam training and vocational skill training, etc. Three major admission training programs: civil servants, public institutes, and teachers account for 75%+ of revenue (as of FY19).

Offcn Education was founded by LI Yongxin, whose career in the education business began after graduating from Peking University in 1999. The company's major founding shareholders together own 75% of total shares.
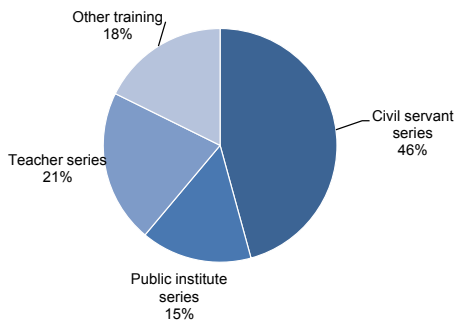
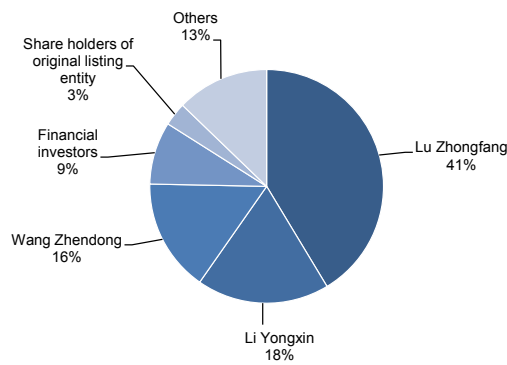**Exhibit 9: Business lines of Offcn Education**
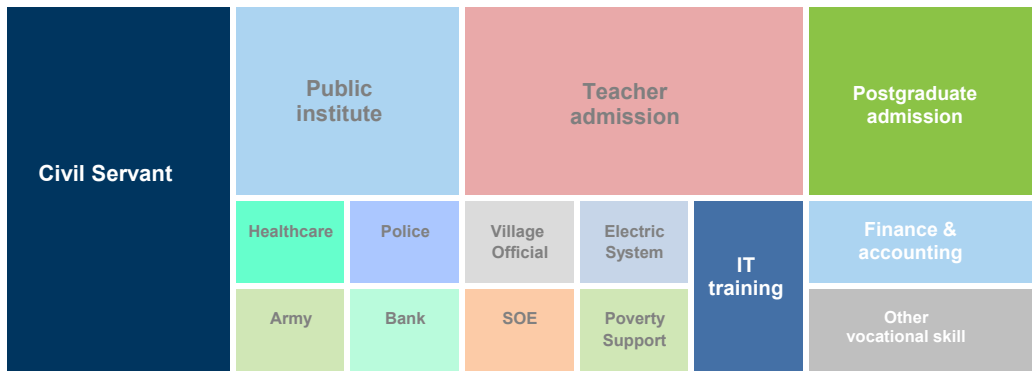
Source: Company data

Exhibit 10: Revenue breakdown

Revenue breakdown, 2019

Source: Company data

Exhibit 11: Founding team owns 75% of shares

Source: Company data

Exhibit 12: Management profile of Offcn Education

| Name	Title	Bio
LI Yongxin	Chairman	Began career in the education industry after graduating from Peking University in 1999. In 2001, started a civil servant training business and founded Offcn Education in 2003.
WANG Zhendong	President	Entered the education industry in 2001. Headed operations for Offcn Online from 2005-2010. Served as the president of Offcn's predecessor firm and has been president of Offcn Education since 2010.

Source: Company data

Industry landscape: Competitive exams lead to strong demand for training

### China's public service system: An introduction

Public service system jobs refer to occupations that serve society, in contrast with corporations or private institutes, including jobs in the civil service, education, public health, and public safety sectors, etc. In China, civil servant (administrative staff) refers to government officials and employees who have administrative power. A more general definition of civil servant includes public institute employees, who are also employed by government, but mainly take on supervisory functions, without administrative power. The general civil servant population totaled 18mn in 2018, according to the National Bureau of Statistics. The education system and public health system have 17mn and 9mn employees in total as of 2018. With other public service employees, the total public service employee population in China could have reached 50mn by 2015, according to estimates by China Economic Weekly.

Exhibit 13: Population structure of China's public service system
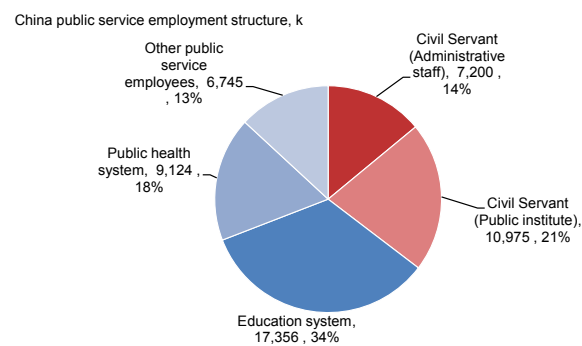
Source: NBS, Data compiled by Gao Hua Securities Research

Exhibit 14: China's public service employment has been growing slowly
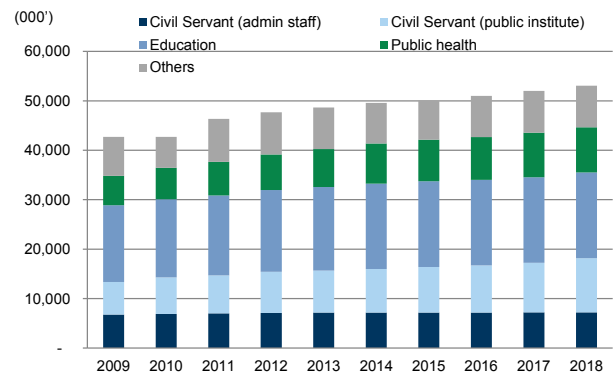
Source: NBS, Data compiled by Gao Hua Securities Research

Exhibit 15: China's Civil Servant (administrative staff) system

Type	General categories	Specific examples
Central Civil Servant	Central party office	Office of CPC central committee, Publicity Department of the CPC
	Central government administration	State council and direct administrations
	Direct agency of central administration	Local tax bureau, local customs
	Public institute subject to civil servant laws	National Bureau of Statistics, China Meteorological Administration
Provincial Civil Servant	Provincial party office	Provincial people's prosecutorial office, Provincial people's court
	Provincial government administrations	Provincial public security system, provincial education department
	Municipal/district government administrations	Municipal government agencies, Municipal Health Bureau, Municipal Education Bureau
	County/village agencies	County government agencies, County People's Court, County Public Security Bureau

Source: National Council, Offcn Education

Exhibit 16: China's Civil Servant (public institute) system

General categories	Specific examples
Administrative execution function	State Radio and Television Administration Bureau, Real Estate Management Bureau, Tourist Bureau
Administrative + Supervision function	Road Transportation Administration Bureau, Local Maritime Safety Administration
Law execution and supervision function	Environmental Supervision Institute, Public Health Supervision Institute, National Resource Supervision Institute

Source: National Council, Offcn Education

## China's public service system is relatively under-staffed

Over the past 20 years, China's general civil servant population increased from 11mn in 2000 to 18.2mn in 2019, representing a 2.7% CAGR. We find that the **growth of the civil service sector is highly correlated with urbanization**, and that the civil servant population has remained stable at 2.1% of urban population over the last 10 years. Rural areas are significantly understaffed in terms of civil servants, as villages are considered self-administrated groups in China. As the NDRC targets China's urbanization rate to reach 70% in 2030 from 60% in 2019, we see the general civil servant population reaching 21.3mn in 2030, implying 1.5% CAGR, or 284k net additions per year.

Contrary to stereotypes that suggest China's civil service sector size is too large, **China's civil service employees account for 1.3% of total population, lower than US (2.9%), Germany (2.9%), UK (2.3%), Japan (1.9%) and South Korea (1.4%),** but higher than India (0.5%). We think the size of China's civil service sector reflects different levels of urbanization, with developed countries having higher urbanization rates than China, while India has an urbanization rate at roughly 32% (as of 2014). Here, we use the same definition of civil servant for comparison, including admin staff and public institute employees, excluding education, public health, and postal service workers.

Moreover, we think **China's civil servants will enter a rapid retirement stage in the next ten years**, as 30%+ of civil servants are aged 50-60, according to data from the National Bureau of Statistics. In fact, 4.4mn civil servants employed in 1980-1990 are retiring now, or c. 400k each year. However, currently new admissions of 300-400k each year only account for around 2% of all civil servants, not even enough to make up for the number entering retirement, in our view. Hence, we expect civil servant admission numbers to increase in the next few years, at 724k per annum on average before 2025 as per our estimate, of which 440k would replenish retiring civil servants, while the average 284k net increase would be driven by urbanization, which should increase demand for public servants.

In 2020, China's central civil service sector and those in many provinces have expanded the admission of civil servants by an average of 50% yoy, not only on a low base last year, but also to support employment as the economy faces the challenges of COVID-19. In March 2020, the Publicity Department of the CPC Central Committee issued a document requiring that public institutes increase their university graduate recruiting efforts. Hence, we can expect civil service and public institute admission numbers to significantly increase this year.

Exhibit 17: China's Civil Servant population is relatively small

Civil Servant Employees as % of total population
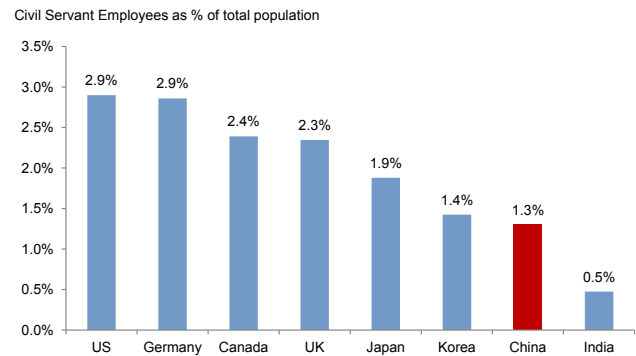
Source: NBS, US Census Bureau, Statistic Bureau of Japan, Official for National Statistics of UK, Data complied by Gao Hua Securities Research
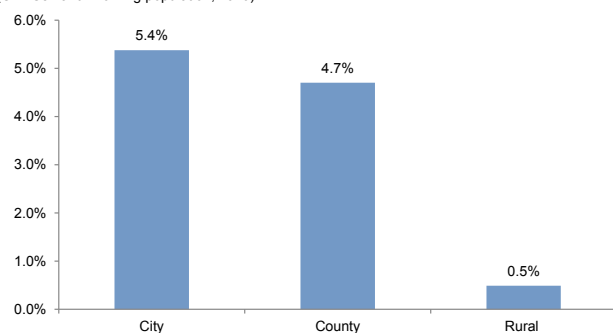
Exhibit 18: China's growing Civil Servant is highly correlated with urbanization
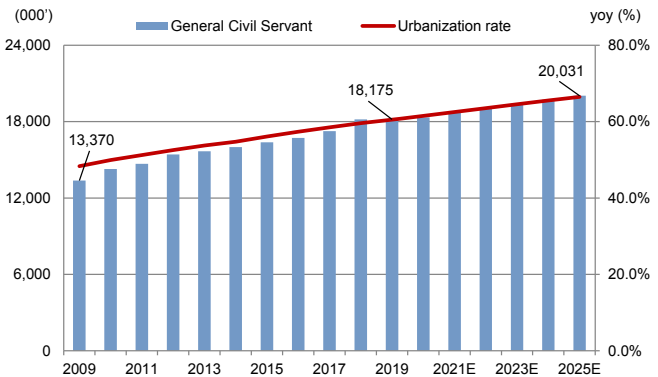
Source: NBS, Gao Hua Securities Research

Exhibit 19: ... as rural areas are significantly under-staffed with civil servants
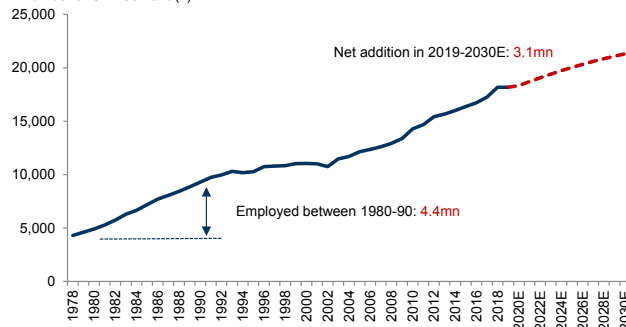
(Civil Servant / working population, 2010)

Source: NBS, Data complied by Gao Hua Securities Research

Exhibit 20: 4.4mn Civil Servants were employed in 1980-90, and many are approaching retirement

Number of Civil Servant (k)

Net addition in 2019-2030E: 3.1mn

Employed between 1980-90: 4.4mn

Source: NBS, Gao Hua Securities Research

Exhibit 21: A large percentage of Civil Servants will retire in the next 10 years

Civil Servant population age structure, 2010
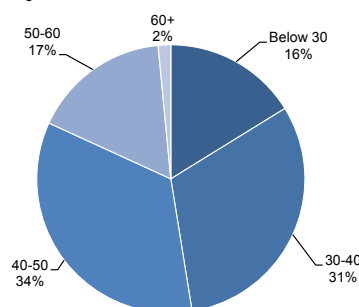
Source: NBS, Data complied by Gao Hua Securities Research

Exhibit 22: Public service admission numbers expected to increase in 2020

(Annual admission, k)
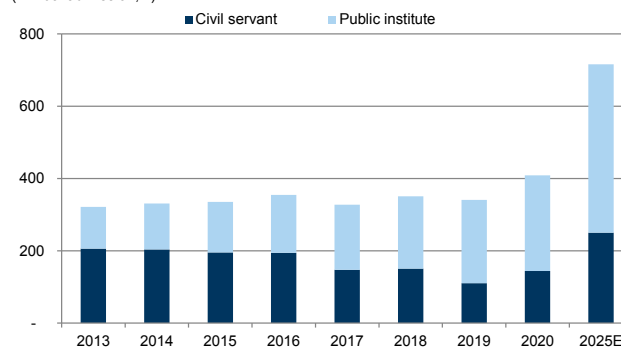
Source: Chinagwy.org, Data complied by Gao Hua Securities Research

Exhibit 23: The annual replenish rate for public service population is quite slow

New admission / existing number
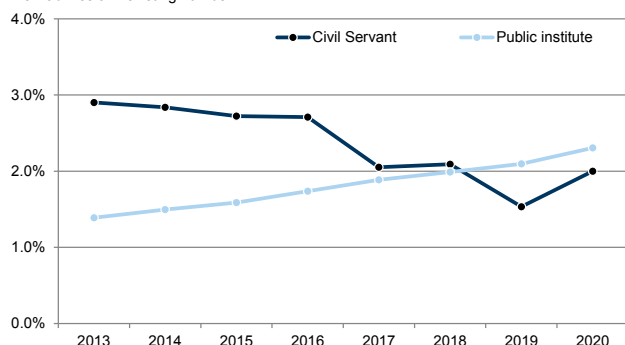
Source: NBS, Chinagwy.org, Data complied by Gao Hua Securities Research

Exhibit 24: National and provincial governments have increased Civil Servant admissions in 2020 to support employment

Admission expansion in 2020
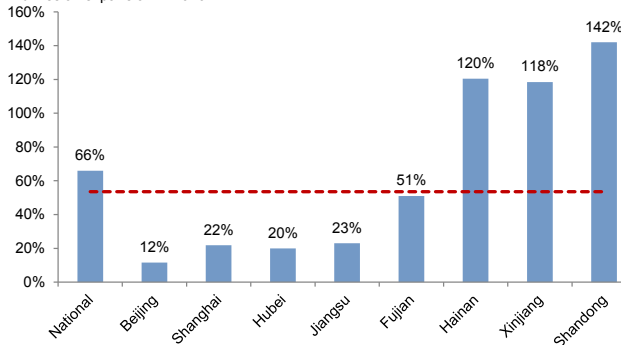
Source: Offcn Education, Gao Hua Securities Research

China's teacher population is also under-staffed, in our view. The country's student to teacher ratio for primary schools is 19:1, larger than most developed countries (15-17). China has 14mn kindergarten to high school teachers as of 2018, while new admissions are only 400-500k each year, accounting for c. 3% of the existing teacher base and only

enough to make up for those teachers entering retirement. In addition, the Chinese government is actively promoting the reduction of large class sizes (>50 students) and the reduction of the student to teacher ratio. Accordingly, we think teacher admission numbers will likely need to increase in the next few years.

Exhibit 25: China's teacher population is small compared with developed countries

Student to teacher ratio, primary school, 2017

Source: Ministry of Education, OECD.org, Data complied by Gao Hua Securities Research

Exhibit 26: China's teacher population by school grade

Number of teachers (k)
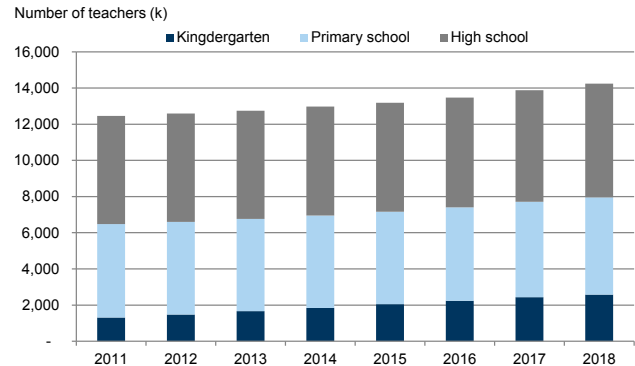
Source: Ministry of Education, Data complied by Gao Hua Securities Research

Exhibit 27: Teacher admission rates are still increasing slowly

Teacher admission number (k)
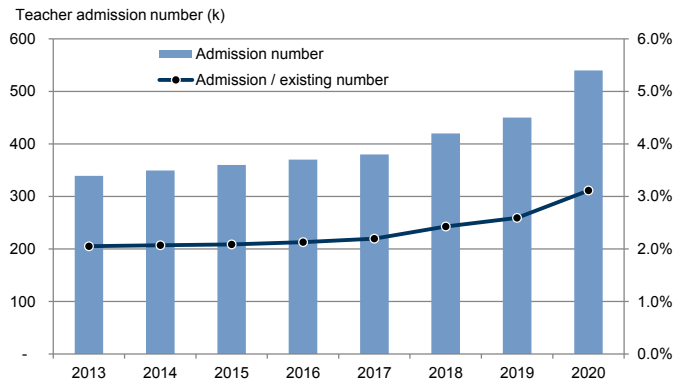
Source: Ministry of Education, Data complied by Gao Hua Securities Research

Relatively standardized admission exams, extremely competitive

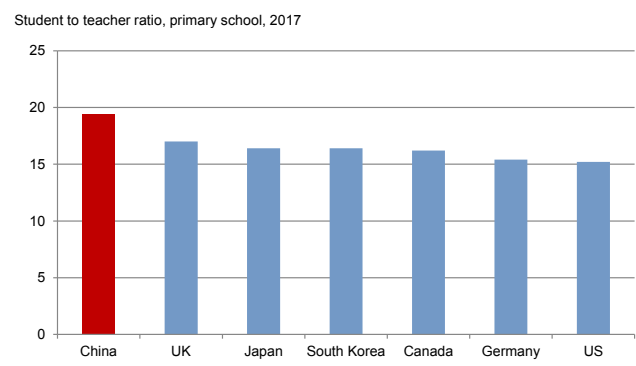Public service occupations have broad appeal and are actively sought after in China. In terms of salary, civil servants, teachers, and public health workers are better paid than the national average. In addition, public service jobs are generally more stable than jobs in the private sector, with less pressure and high social status. Teachers also have long summer and winter holidays.

As a result, many college graduates compete for public service jobs. According to Offcn Education and Chinagwy.org, the total number of test takers for the civil servant admission exam increased from 4mn in 2015 to 5.3mn in 2019, partly due to the increasing number of college graduates, which grew from 5.7mn in 2009 to 8.2mn in 2019. Similar trends are also observed in public institute and teacher admissions.

Hence, admissions exams have become increasingly competitive. Admission rates

for the civil servant exam decreased from 5% in 2015 to 2% in 2019 (very low admissions in 2019 due to a staff restructuring in the civil servant system, e.g., the restructuring of local tax bureaus). In future years, while we expect admission rates for public service exams will increase, due to the expansion of admissions, we believe the exams will remain highly competitive, with 3-4% admission for civil servant admission exams, 6-8% for public institute exams, and 12-15% for teacher admission exams.

The exam formats for civil servant admissions is standardized, including a written test (administrative aptitude test + argumentative essay writing) and an interview. Public institute admission exams are more region and division specific but are also quite standardized. **The standardized exam format means transparency, hence reasonable exam prep and training is particularly important.**

The extreme competitiveness of public service exams and the material benefits after admission have led to demand for exam training. According to our estimates (based on data from the Ministry of Education), c.32% of civil servant admission exam takers enrolled for exam preparation training in 2019, increasing from around 27% in 2015, due to more competitive exams. In the future, we expect enrollment rates to remain largely stable, as the exams are likely to remain highly competitive.

Exhibit 28: Public institute employees have better pay than the national average
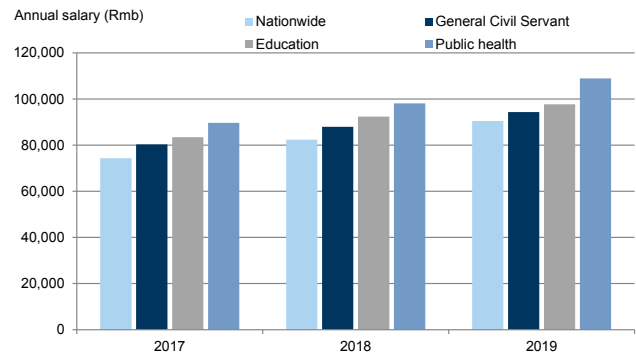
Source: NBS, Data complied by Gao Hua Securities Research

Exhibit 29: The admissions exams are very competitive, with 2-11% admission rates
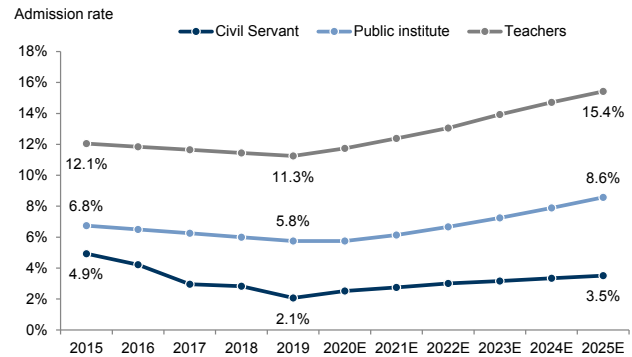
Source: Ministry of Education, Data complied by Gao Hua Securities Research

Exhibit 30: … with a growing number of test takers

Total test takers (k)
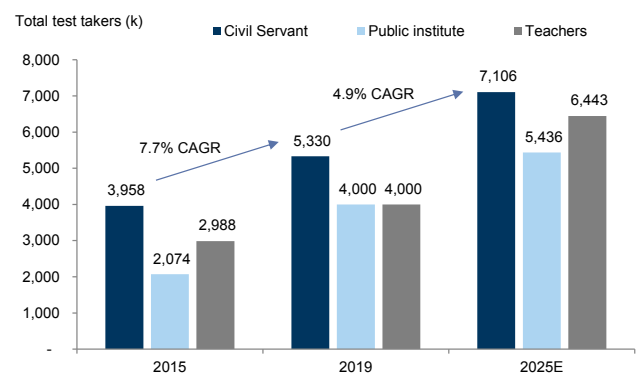
Source: Ministry of Education, Data complied by Gao Hua Securities Research

Exhibit 31: ... which is partly driven by an increasing number of college graduates

Higher education graduates (k)
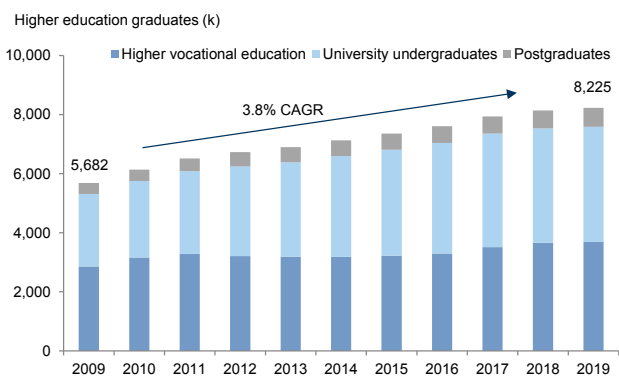
Source: Ministry of Education

Exhibit 32: We expect total higher-education enrolled students to continue growing at 2.2% CAGR in 2019-25E

Total students enrolled, higher education (000')
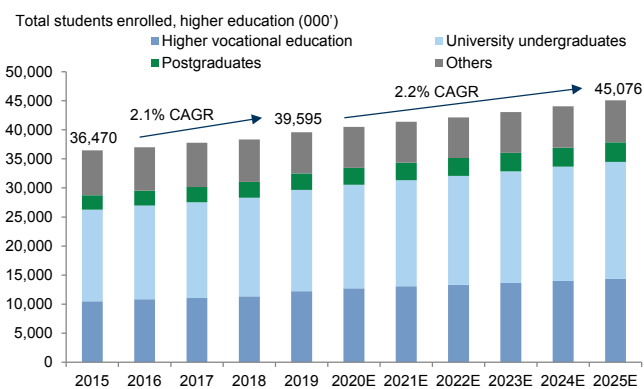
Source: Ministry of Education, Goldman Sachs Global Investment Research

Exhibit 33: Civil Servant exams have a standard test format

	Test format	Time	Grading
Administrative Aptitude Test	135 multiple choice questions, include 5 sections: language understanding, quantitative relationship, logic, material analysis and common sense judgement	120 min	Computer grading
Argumentative Essay Writing	5 essay writing questions, based on given background material	180 min	Manual grading
Interview	Presentation after reading material; leaderless group discussion, etc.	30-40 min	Manual grading

Source: Offcn Education

Exhibit 34: Public institute admissions exams are relatively standardized

	Test format	General institute	Education	Healthcare
Public basic knowledge	Laws and regulations, political and economic theories, policy, technology, provincial social situation analysis, etc	√	√	√
Education basic knowledge	Education theories, psychology, etc		√	
Healthcare basic knowledge	Healthcare professional knowledge			√
Interview	Q&A regarding organization ability, working attitude, understanding of specific institute issues, etc.	√	√	√

Source: Offcn Education

Exhibit 35: Hence the demand for exam training is quite strong
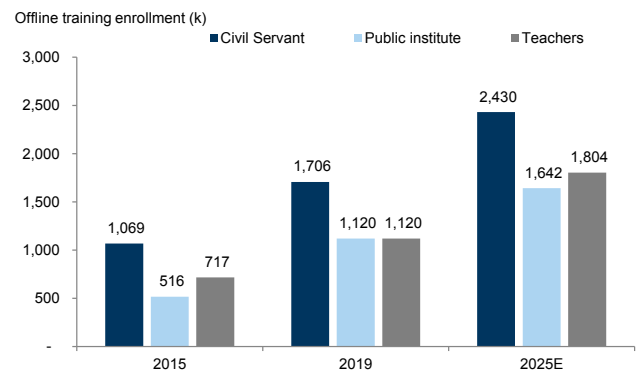
Source: Company data, Gao Hua Securities Research

Exhibit 36: Enrollment rates have slightly increased due to competitiveness of exams
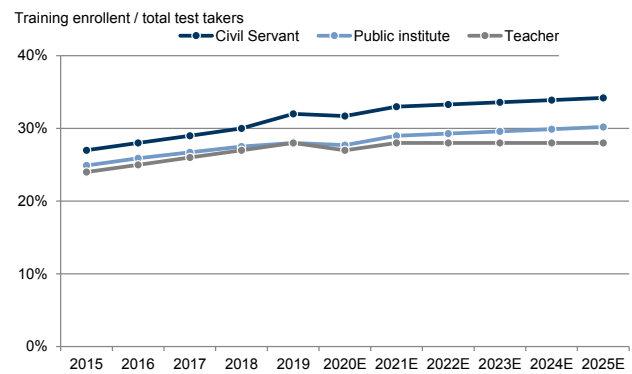
Source: Company data, Gao Hua Securities Research

Global comparison: Why civil servant admissions training is a large scale market in China

Compared with other countries, we find the scale of China's civil servant admissions training market to be much larger, with opportunities for growth that are well-suited to major national players given: **(1) China's civil servant population is much larger**, though the percentage of the total population is still smaller than most developed countries. In India, the general civil servant population is not small (6.4mn), but the core civil servant population totals only roughly 50k. For these government officials, admissions exams are extremely competitive with 500k people competing for 1,000 positions each year. The training enrollment is c.300k. But with much lower ASPs due to lower per capita GDP in India, the training market is as small as US$50mn, according to our estimates (based on data from The Hindu). **(2) High social status and benefits of civil service jobs**. As analyzed above, civil service occupations have broad appeal, with a higher salaries than average job and higher social status. This is also true in India and South Korea, while perhaps less so in Japan and western countries. Attractive jobs with many applicants make admissions exams extremely competitive and drive demand for training. **(3) Standardized exam format.** China's civil servant admission exams format are quite standardized, making it easier for training companies to provide services and expand scale. For India, apart from core civil servants, civil service entrance occurs through examinations at various recruiting agencies, hence the exam formats are

fragmented. For western countries, civil servants are admitted through applications and interviews while internal referrals tend to be very helpful, resulting in fewer services for training companies to provide.

Exhibit 37: Global comparison of civil service systems and admissions training markets

	China	India	Japan	Korea	US	Germany
General Civil Servant (k)	18,175	6,400	2,379	735	9,200	2,368
% of total population	1.3%	0.5%	1.9%	1.4%	2.9%	2.9%
Core Civil Servant (k)	7,200	50	n.a.	n.a.	n.a.	n.a.
Admission number (k)	340	n.a.	43	20	n.a.	200
replenish rate	1.9%	n.a.	1.8%	2.7%	n.a.	8.4%
Test takers (k)	9,330	1,000	532	440	n.a.	n.a.
Admission rate	2-6%	<1%	5-10%	1-5%	n.a.	n.a.
Training enrollment (k)	2,826	300	53	132	n.a.	n.a.
Enrollment rate	30%	30%	10%	30%	n.a.	n.a.
ASP (US$)	857	171	900	1,029	n.a.	n.a.
Market size (US$mn)	2,422	51	48	136	n.a.	n.a.
Civil Servant job	High social status, higher salary than average urben employee; stable job	Civil servants are government officials; they are well-paid and have high social status	Paid better than average job; but well known for heavy workload and long working hours	Stable job, better paid than average job	Civil servant salaries are lower than corporates, but are stable with attractive insurance coverage, and more holidays	Pay is lower than the average job
Admission exam	Written test + interview test, test format is largely standardized	For Civil Servant, test format is uniform; for other government employees, there are various 3rd party tests that gov follows	Three levels of exams for applicants with different background; for each level, test format is standardized	Level 7-9 Civil Servants are admitted through exams; the exam format is standardized, with many subjects	No standardized test; online application + background check + referral letter + interview	No admissions exam. Vacancies are filled online and applicants go through written tests and an interview process
Admission training market	Relatively more consolidated	Very fragmented	Small market size and fragmented	Small market size and fragmented	Training market barely exists	Training market barely exists

Source: Ministry of Education, The Hindu, US Census Bureau, CNTV, Gao Hua Securities Research

Offcn Education: Leader in a growing market

Based on the above drivers, we expect the total market size (in terms of revenue) of the public service admissions training industry to reach Rmb57bn in 2025E, 12% CAGR from Rmb28.8bn in 2019. For civil servant admission exam training, we forecast the market size to grow at an 11.6% CAGR from 2019 to Rmb26.3bn in 2025E, driven by enrollment volume growth (6% CAGR) and ASP growth (5% CAGR). The public institute and teacher admissions training markets also have similar growth profiles to the civil servant exam training market. We expect 5% ASP growth in the future, slightly below historical ASP growth of 6%. Companies in the industry have strong pricing power and ASPs tend to grow at a similar pace with income, as training and exam success are directly linked with employment and the potential for an increase in salary and other benefits.

We expect Offcn Education, the market share leader in China's public service admissions training market, to grow admission series revenue to Rmb25bn in 2025E, 22% CAGR from Rmb7.5bn in 2019. In this period, based on the demand drivers discussed above and the company's unique competitive advantages we analyze in subsequent sections of this report, we expect Offcn Education's market share in civil servant / public institute admissions training to increase from 31%/21% in 2019 to 52%/32% in 2025E, while market share in teacher admissions training should also

increase from 23% to 40%.

Exhibit 38: We expect the total market size of public service admissions training to reach Rmb57bn in 2025E

Admission exam training market size (Rmb mn)
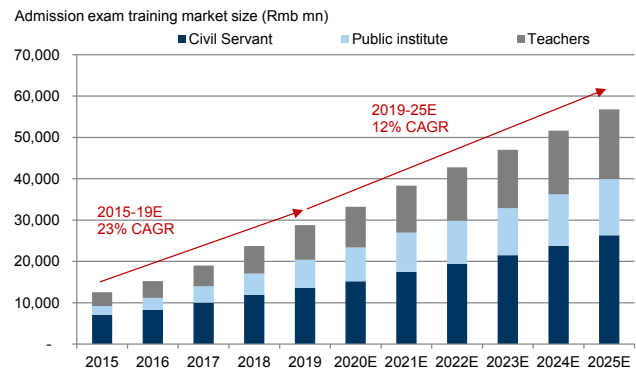
Source: Ministry of Education, Company data, Gao Hua Securities Research

Exhibit 39: We expect the civil servant admissions training market to reach Rmb26bn in 2025E

Civil Servant admission training market size (Rmb mn)
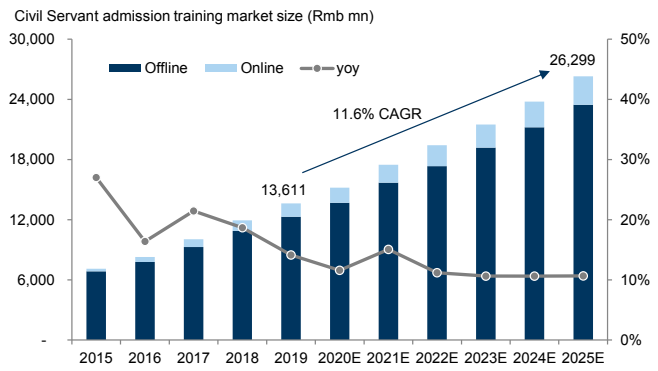
Source: Company data, Gao Hua Securities Research

Exhibit 40: We expect civil servant admissions training enrollment to grow at a 6% CAGR from 2019-25E
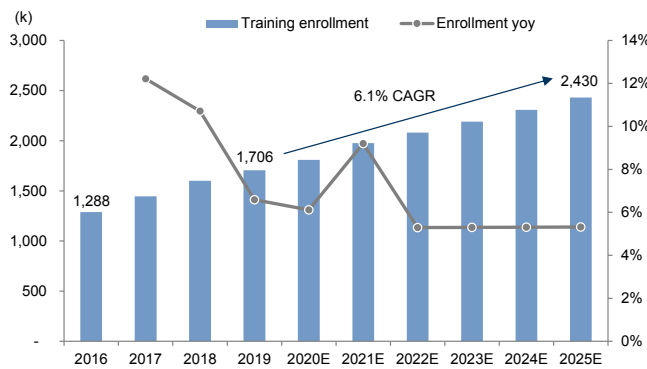
Source: Company data, Gao Hua Securities Research

Exhibit 41: … and ASPs to grow at a 5% CAGR in 2019-25E
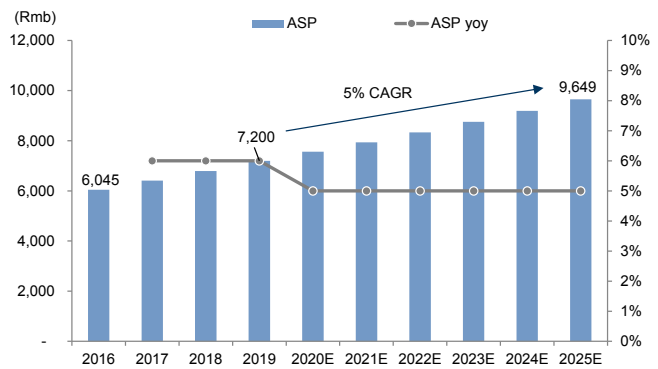
Source: Company data, Gao Hua Securities Research

Exhibit 42: We expect Offcn Education's revenue to grow at a 22.5% CAGR in 2019-25E

Revenue of Offcn Education (Rmb mn)
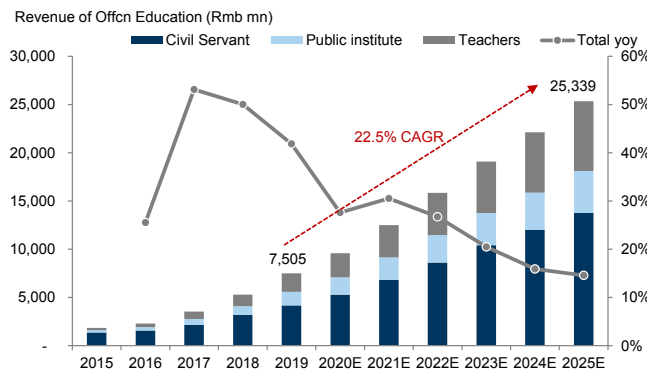
Source: Company data, Gao Hua Securities Research

Exhibit 43: … with increasing market share

Market share of Offcn Education
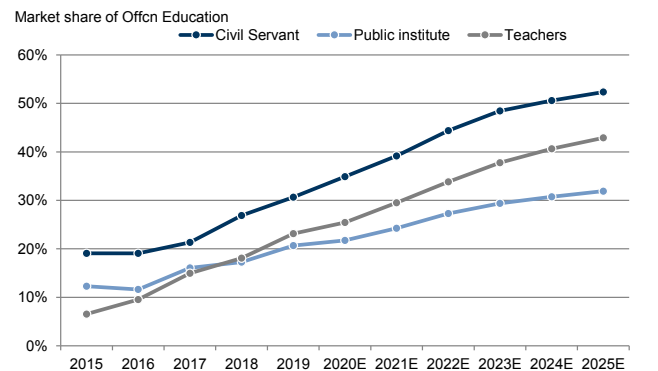
Source: Company data, Gao Hua Securities Research

Exhibit 44: Offcn Education is the dominant player in the public service admissions training industry

Market share in public service admission training
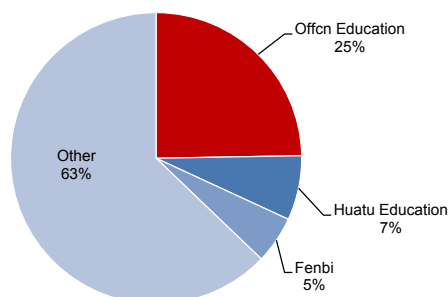
Source: Company data, Gao Hua Securities Research

Market sizing models for public service admission training

Exhibit 45: Market size of civil servant admissions exam training

Civil Servant admission	Unit	2015	2016	2017	2018	2019	2020E	2021E	2022E	2025E
Civil Servant number	k	7,167	7,190	7,200	7,200					
Central Civil Servant admission test										
Admission number	k	22	28	27	29	15	24	27	29	39
Test takers	k	900	930	984	1,134	920	1,035	1,080	1,095	1,140
yoy	%	-9%	3%	6%	15%	-19%	12%	4%	1%	1%
Admission rate	%	2.5%	3.0%	2.8%	2.5%	1.6%	2.3%	2.5%	2.7%	3.4%
Local Civil Servant admission test										
Admission number	k	173	167	120	122	96	120	138	159	211
Test takers	k	3,058	3,670	4,000	4,200	4,410	4,675	4,908	5,154	5,966
yoy	%	20%	20%	9%	5%	5%	6%	5%	5%	5%
Admission rate	%	5.7%	4.5%	3.0%	2.9%	2.2%	2.6%	2.8%	3.1%	3.5%
Total test takers	k	3,958	4,600	4,984	5,334	5,330	5,709	5,989	6,249	7,106
Total admission rate	%	4.9%	4.2%	3.0%	2.8%	2.1%	2.5%	2.7%	3.0%	3.5%
Civil Servant admission training market										
Market size	Rmb mn	7,112	8,277	10,051	11,928	13,611	15,186	17,470	19,423	26,299
yoy	%	27%	16%	21%	19%	14%	12%	15%	11%	11%
Offline	Rmb mn	6,849	7,786	9,262	10,869	12,280	13,682	15,688	17,344	23,448
Online	Rmb mn	264	491	789	1,058	1,331	1,504	1,782	2,078	2,851
Training enrollment	k									
Offline	k	1,069	1,288	1,445	1,600	1,706	1,810	1,976	2,081	2,430
Online	k	401	710	1,088	1,389	1,663	1,790	2,021	2,244	2,659
Enrollment yoy										
Offline	%			12%	11%	7%	6%	9%	5%	5%
Enrollment rate										
Offline	%	27%	28%	29%	30%	32%	32%	33%	33%	34%
Online	%	10%	16%	22%	27%	30%	32%	34%	36%	38%
ASP										
Offline	Rmb	6,408	6,045	6,408	6,792	7,200	7,560	7,938	8,335	9,649
Online	Rmb	658	691	726	762	800	840	882	926	1,072
Offcn revenue	Rmb mn	1,357	1,579	2,144	3,205	4,171	5,299	6,844	8,624	13,765
Market share	%	19%	19%	21%	27%	31%	35%	39%	44%	52%
Offline enrollment of Offcn	k	259	318	373	460	560	672	819	975	1,309
Market share	%	28%	29%	27%	29%	33%	37%	41%	47%	54%

Source: Ministry of Education, Company data, Gao Hua Securities Research

Exhibit 46: Market size of public institute admission exam training

Public institute admission	Unit	2015	2016	2017	2018	2019	2020E	2021E	2022E	2025E
General Civil Servant (public institute)	k	9,211	9,536	10,056	10,975	10,975				
Admission number	k	140	160	180	200	230	265	296	332	466
yoy	%		14%	13%	11%	15%	15%	12%	12%	12%
Total test takers	k	2,074	2,462	2,880	3,333	4,000	4,600	4,830	4,975	5,436
yoy	%		19%	17%	16%	20%	15%	5%	3%	3%
Admission rate	%	7%	7%	6%	6%	6%	6%	6%	7%	9%
Public institute training market size	**Rmb mn**	**2,119**	**2,909**	**3,934**	**5,129**	**6,784**	**8,194**	**9,479**	**10,433**	**13,626**
yoy	%		37%	35%	30%	32%	21%	16%	10%	9%
Market size breakdown										
Offline	Rmb mn	1,984	2,645	3,473	4,448	5,824	6,957	8,030	8,775	11,440
Online	Rmb mn	135	264	461	681	960	1,236	1,448	1,659	2,186
Training enrollment number										
Offline	k	516	638	769	917	1,120	1,274	1,401	1,458	1,642
Online	k	205	383	635	893	1,200	1,472	1,642	1,791	2,039
Enrollment yoy										
Offline	%		23%	21%	19%	22%	14%	10%	4%	4%
Online	%		86%	66%	41%	34%	23%	12%	9%	4%
Enrollment rate										
Offline	%	25%	26%	27%	28%	28%	28%	29%	29%	30%
Online	%	10%	16%	22%	27%	30%	32%	34%	36%	38%
ASP										
Offline	Rmb/cap	3,841	4,149	4,516	4,853	5,200	5,460	5,733	6,020	6,968
Online	Rmb/cap	658	691	726	762	800	840	882	926	1,072
ASP yoy	%		5%	5%	5%	5%	5%	5%	5%	5%
Offcn revenue	Rmb mn	260	338	632	884	1,401	1,780	2,299	2,849	4,348
Market share	%	12%	12%	16%	17%	21%	22%	24%	27%	32%
Offcn offline enrollment	000'	73	98	147	197	236	281	340	394	491
Market share	%	14%	15%	19%	22%	21%	22%	24%	27%	30%

Source: Ministry of Education, Company data, Gao Hua Securities Research

Exhibit 47: Market size for teacher exam training

Teacher training	Unit	2015	2016	2017	2018	2019	2020E	2021E	2022E	2025E
Total teacher exam trainig market size	**Rmb mn**	**3,318**	**4,040**	**5,016**	**6,642**	**8,360**	**9,817**	**11,369**	**12,918**	**16,847**
yoy	%	*0%*	*22%*	*24%*	*32%*	*26%*	*17%*	*16%*	*14%*	*9%*
Total number of teachers	k	12,749	12,880	13,115	13,366	13,434	13,590	13,828	14,160	15,619
Retire	k	363	364	368	375	382	384	388	395	430
Admission number	k	360	370	380	420	450	540	626	727	994
yoy	%	*3%*	*3%*	*3%*	*11%*	*7%*	*20%*	*16%*	*16%*	*10%*
Teacher admission training market size	**Rmb mn**	**3,027**	**3,603**	**4,286**	**5,414**	**6,560**	**7,757**	**9,328**	**10,876**	**14,679**
yoy	%	*0%*	*19%*	*19%*	*26%*	*21%*	*18%*	*20%*	*17%*	*11%*
Total test takers	k	2,988	3,122	3,262	3,668	4,000	4,600	5,060	5,566	6,443
yoy	%	*0%*	*5%*	*4%*	*12%*	*9%*	*15%*	*10%*	*10%*	*5%*
Admission rate	%	12.1%	11.9%	11.7%	11.5%	11.3%	11.7%	12.4%	13.1%	15.4%
Market size breakdown										
Offline	Rmb mn	2,840	3,277	3,774	4,672	5,600	6,521	7,810	9,021	12,089
Online	Rmb mn	187	326	512	742	960	1,236	1,517	1,856	2,590
Training enrollment number										
Offline	k	717	781	848	990	1,120	1,242	1,417	1,558	1,804
Online	k	296	485	720	983	1,200	1,472	1,720	2,004	2,416
Enrollment rate										
Offline	%	24%	25%	26%	27%	28%	27%	28%	28%	28%
Online	%	10%	16%	22%	27%	30%	32%	34%	36%	38%
ASP										
Offline	Rmb/cap	3,960	4,198	4,450	4,717	5,000	5,250	5,513	5,788	6,700
Online	Rmb/cap	634	672	712	755	800	840	882	926	1,072
ASP yoy	%		*6%*	*6%*	*6%*	*6%*	*5%*	*5%*	*5%*	*5%*
Teacher certificate training market size	**Rmb mn**	**291**	**437**	**730**	**1,228**	**1,800**	**2,060**	**2,042**	**2,042**	**2,168**
yoy	%	*0%*	*50%*	*67%*	*68%*	*47%*	*14%*	*-1%*	*0%*	*3%*
Teacher certificate test takers	k		2,600	4,100	6,510	9,000	10,000	9,622	9,344	9,078
yoy	%			*58%*	*59%*	*38%*	*11%*	*-4%*	*-3%*	*0%*
New teachers	k		1,500	1,800	2,160	2,592	3,110	3,421	3,764	5,009
Existing teachers	k		1,100	2,300	4,350	6,408	6,890	6,201	5,581	4,068
Enrollment	k		260	410	651	900	1,000	962	934	908
Enrollment rate	%		10%	10%	10%	10%	10%	10%	10%	10%
ASP	Rmb/cap		1,679	1,780	1,887	2,000	2,060	2,122	2,185	2,388
yoy	%			*6%*	*6%*	*6%*	*3%*	*3%*	*3%*	*3%*
Revenue of Offcn Education	Rmb mn	217	385	750	1,202	1,933	2,496	3,355	4,368	7,226
Market share	%	7%	10%	15%	18%	23%	25%	30%	34%	43%

Source: Ministry of Education, Company data, Gao Hua Securities Research

Core competitive advantage: Product, branding and channel

Product and branding: Well recognized, market-share leader in the public service admissions exam training market

Public service admissions tests in China have several characteristics: (1) high competitiveness, with 2-15% admission rates; (2) material benefits after admission, as analyzed in the previous section; (3) short user cycle, customers typically pay for one or several exam training courses and will not need to make subsequent purchases if they are admitted. The first two points determine that product quality, i.e., the likelihood of higher passing rates after attending a training course, is a key differentiating factor in the industry. Meanwhile, short user cycles determine that branding is very important, as customers typically enter the market a limited number of times leading to fewer opportunities for products to distinguish themselves among in the market. In our view, Offcn Education is able to provide course offerings that are among the industry's highest quality based on the company's continuous investment in product R&D. These R&D efforts (discussed below) have helped the company's customers achieve passing rates that are much higher than average levels. Hence, Offcn has developed significant brand equity (spread mainly through word of mouth) and become a leading civil servant admission test training company.

Pricing: The company promotes a pricing with refund policy to attract customers, called "contract classes." For example, the civil servant national written + interview test course is priced at Rmb35,800, and if the customers cannot pass the national civil servant final exam, they will be refunded Rmb16,000. In 2017, revenue from contract classes accounted for 73% of total revenue, vs. 59% in 2015, and has increasingly become the main revenue contributor for the company.

Exhibit 48: Nature of the public institute admission test underscores importance of product and branding
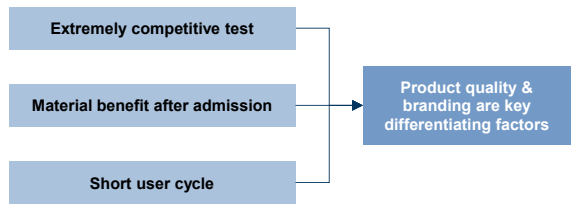
Source: Gao Hua Securities Research

Exhibit 49: Offcn Education students have achieved higher passing rates for civil servant admissions tests

Passing rate for Civil Servant admission test
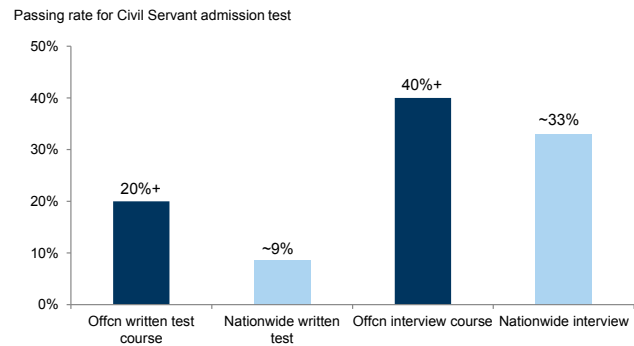
Source: Company data

Exhibit 50: Product features: Expensive pricing with refund policy
Sample product pricing for contract classes

Contract classes	Price (Rmb)	Refund	Refund rate	Content
Civil Servant admission test				
National test written+interview	52,800	30,000	57%	80 days offline training+12 days live broadcast
	40,800	16,000	39%	61 days offline training+12 days live broadcast
	35,800	16,000	45%	58 days offline training
National test 1 on 1	105,800	66,000	62%	written 126 hours,interview 18 hours
National test interview VIP	45,800	45,800	100%	10 days
Provincial test written+interview	52,800	52,800	100%	46 days
	41,800	39,000	93%	50 days
	26,800	10,000	37%	45 days
Public institute admission test				
Written + interview OAO package	29,800	16,000	54%	6 stage live broadcasting + offline training
Interview OAO course	12,800	12,800	100%	49hr online + 6 days offline
Interview VIP course	15,800	13,000	82%	8 days offline training
Teacher admission test				
Written + interview OAO course	35,800	35,800	100%	24 live broadcasting + 35days offline training
Interview small class	12,800	12,800	100%	9 days online + 3 days offlne training

Source: Company data, compiled by Gao Hua Securities Research

Focus on product R&D

The cornerstone of Offcn Education's product quality is R&D. The company places great importance on product R&D, and has established **a headquarters + provincial level R&D system**. The headquarters R&D center is responsible for research into various national level tests, including the civil servant admission test, public institute admission test, etc. The majority of the R&D force is in provincial R&D centers, which the company started building ten years ago to provide better research into local public service admissions tests. Over the last several years, the company's R&D spending has accounted for a stable 7-8% of revenue. R&D personnel are well-paid, with annual salaries averaging roughly Rmb400k.

Offcn Education's headquarters R&D provides research content and prep material on common subjects, such as administrative aptitude tests and argumentative essay writing for the civil servant admission test. Provincial R&D centers provide on-the-ground research into local public institute tests. Moreover, we expect **Offcn Education's R&D to achieve economies of scale as it expands.** On one hand, R&D efforts will likely see better monetization with a larger customer base. On the other, R&D content can be internally shared as the company expands its product categories. For example, research into subjects such as IT as well as finance and accounting for post-graduate exam training can be coupled with research in the same or similar subject areas for professional technique training.

The R&D scale for competitors such as Huatu Education, the second largest national player by market share in the industry, or smaller local players does not match that of Offcn Education. Therefore, we think the company's focus on R&D and its unique R&D systems represent key competitive advantages that have driven Offcn's high product-quality standards.
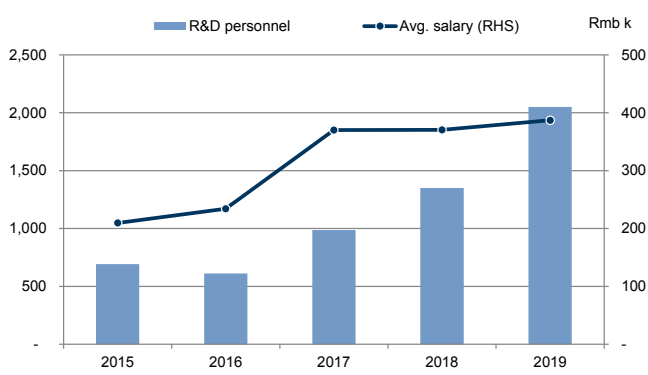
Exhibit 51: Offcn Education's R&D system
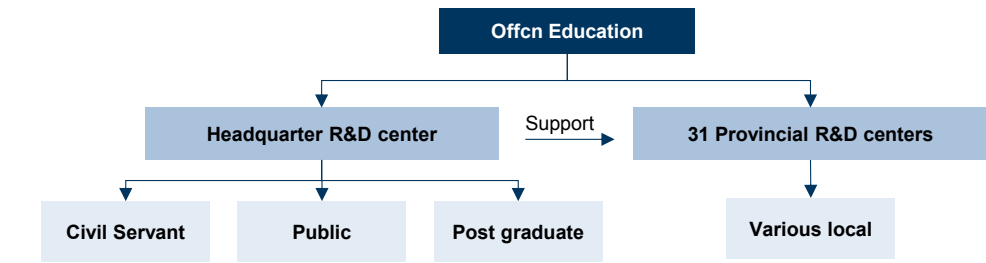
Source: Company data

Exhibit 52: Offcn Education spends more on R&D than peers
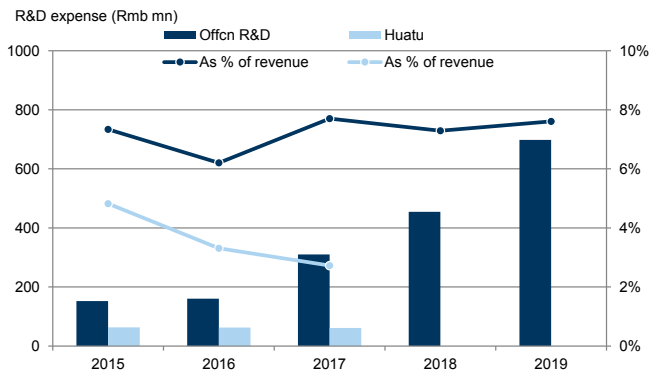
Source: Company data

Exhibit 53: ... with expanding and well paid R&D team

Source: Company data

Deepening sales network

Offcn Education operates a direct owned branch network which is crucial to its expansion. As of 2019, the company has 1,104 branches in China, covering most of the 300 prefecture cities throughout the nation. Offcn's sales network is the market leader in terms of scale and depth. For example, Huatu Education, the second largest public institute education company, had 393 branches as of 2017, vs. 551 for Offcn Education (also as of 2017). There are several unique features of the company's sales network model:

Deepening sales channels: According to management, there is still the potential for two to three times the number of branches. The company plans to mainly expand in: (1) western China, and lower tier cities where there are 1,500 more counties to penetrate; and (2) Universities, with the company having penetrated 100-200 universities and the opportunity to expand into 1,500 more. We believe the expansion of points of sale in universities will facilitate the development of the company's postgraduate admissions exam training and professional skills education businesses.

Asset light model: Offcn Education's sales branches are only responsible for sales, while the actual courses are taught in hotels or teaching centers. When expanding a new branch office, the company typically rents a 200-300m2 office site, which does not have to be on the ground floor in core areas of cities, and hires a few salespeople. Fixed investment is therefore very limited and asset light and thus the company's expansion

can be fast and flexible.

Cross-selling: As the company expands its subject matter categories, the same branch can cross-sell products from multiple categories, thus increasing resource efficiency. For example, branches in universities can sell training courses for civil service and public institute admissions exams, postgraduate programs, as well as courses in vocational skill training.

Exhibit 54: We expect the number of branches to triple in five years
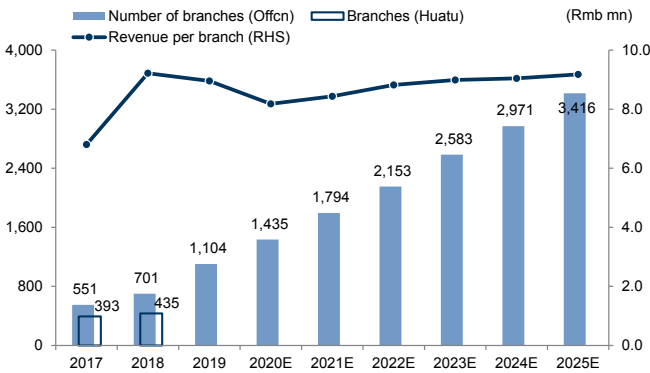
Source: Company data, Gao Hua Securities Research

Exhibit 55: Offcn's branches are spread throughout the nation

Offcn's number of branches, 2017
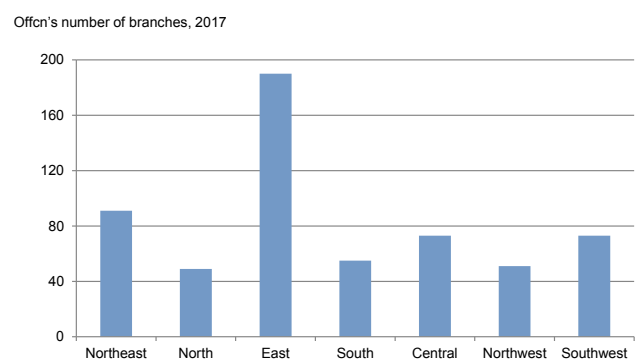
Source: Company data

Exhibit 56: Sample branch office of Offcn Education

Source: Company data

"Quick-response" organization and culture

Offcn Education operates a vertically integrated organizational structure. Quick response and feedback is facilitated by its organizational structure and embedded in its culture. When the company launches a teaching project for a certain exam, sales are made and teaching is carried out on a rolling basis, while teaching feedback is shared with headquarters and the company's R&D division through an internal software system. This ensures that information flows smoothly throughout the company, while headquarters management receives timely feedback on front-line progress and can give suggestions. **We think Offcn's organizational structure is well-suited to maximize local resources, while at the same time providing headquarters support, which allows the entire company to act seamlessly**. We think this organizational and management structure is unique in the market and affords Offcn a competitive advantage versus

other nationwide or local players.

Exhibit 57: Organization structure of Offcn Education
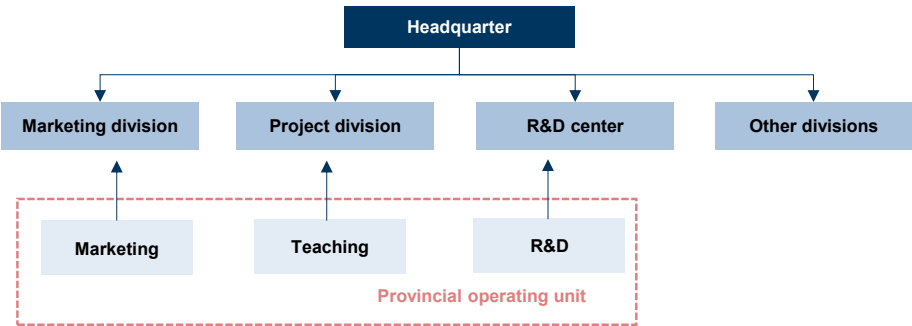
Source: Company data

Growth drivers: Admissions training for near term, other training for longer-term growth

Public service admissions training: Growth drivers for near term

Civil servant admissions training: Based on the market's size and Offcn's competitive advantages, we expect revenue for the company's civil servant series to increase from Rmb4.2bn in 2019 to Rmb13.8bn in 2025E, and its market share to increase from 31% in 2019 to 52% in 2025E. As discussed above, we are positive on the company's potential to gain market share from small local players, by leveraging its significant product and branding advantages as well as its deepening sales channel. The civil servant admissions training market is and will likely continue to be the most consolidated among the three public service admissions training markets, as the relatively standard exam format across the country tends to magnify the advantage of national leaders, whose R&D investments are more scalable.

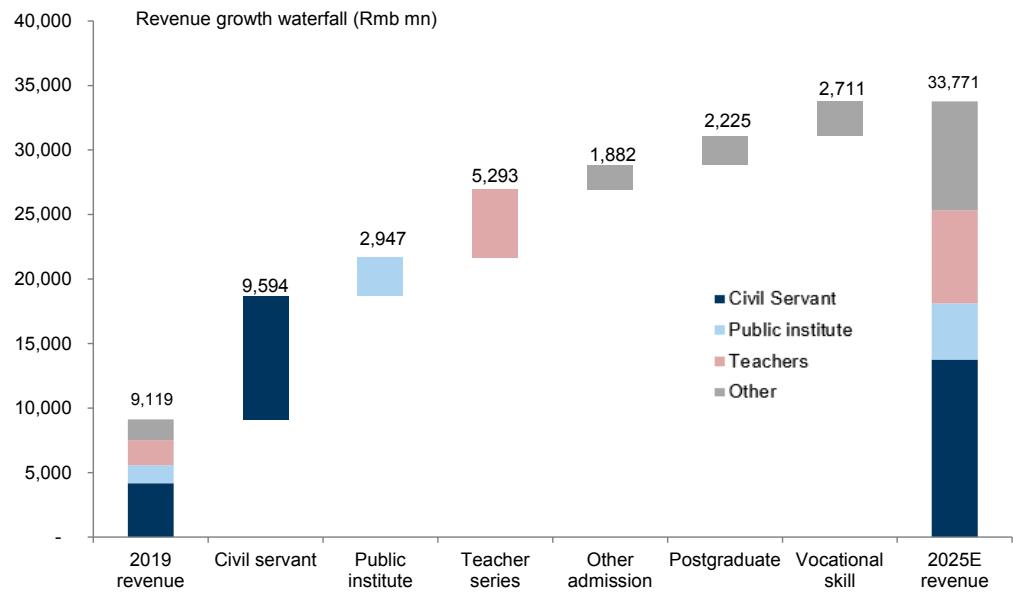The company's revenue growth is mostly driven by volume, i.e., enrollment growth. For ASPs, historically the company's ASP saw average annual growth of 11% in 2016-19, while in the future we expect annual ASP growth of 5-6%, similar to the level of China's sustainable disposable income growth, as we believe the company's pricing power is very strong.

Public institute admission training: We expect revenues for the company's public institute series to increase from Rmb1.4bn in 2019 to Rmb4.3bn in 2025E, and market share to increase from 21% to 32%. Public institute admission exams are less standardized than civil servant admission exams, i.e. exam formats vary by institution and region. Hence, the market is less consolidated with many small local players. Yet we still expect Offcn Education to expand market share with its competitive advantage and deepening sales channels.

Teacher training: Offcn Education's teacher training revenue grew at a 73% CAGR from 2015-19, and its market share reached around 23% in 2019 from 7% in 2015 per our estimates. Of its Rmb1.9bn in teacher training revenue in 2019, teacher certificate exam training only accounted for about Rmb100mn, per management, while the majority came from training for the typically more challenging teacher admission exam. The industry is still quite fragmented as exam formats vary in different subjects and regions, but Offcn Education has managed to gain market share as the company enhanced its R&D in teacher training courses from 2015, and optimized its management team in 2018. We expect the company's competitive advantages to drive teacher training series revenue to Rmb7.2bn in 2025E, accounting for 43% market share.

Exhibit 58: Revenue growth breakdown for Offcn Education

Revenue growth waterfall (Rmb mn)

Civil Servant
Public institute
Teachers
Other

9,119 | 9,594 | 2,947 | 5,293 | 1,882 | 2,225 | 2,711 | 33,771

2019 revenue | Civil servant | Public institute | Teacher series | Other admission | Postgraduate | Vocational skill | 2025E revenue

Source: Company data, Gao Hua Securities Research

Exhibit 59: Civil Servant series revenue forecast

Offcn Edu's Civil Servant series (Rmb mn)
Offline revenue | Online revenue
Total revenue yoy | Market share
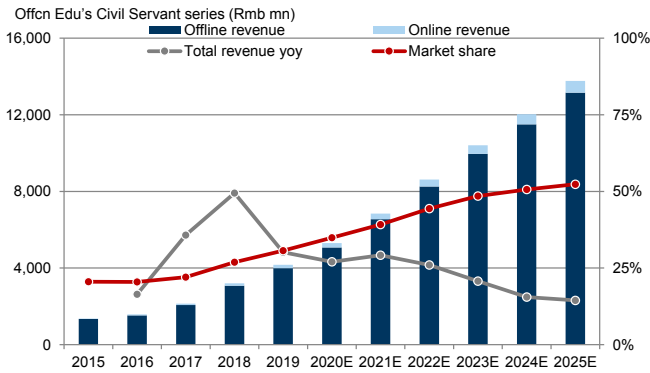
Source: Company data, Gao Hua Securities Research

Exhibit 60: Revenue growth is mostly driven by volume, with steadily increasing ASP

Civil Servant growth drivers
Offline volume yoy | Offline ASP yoy
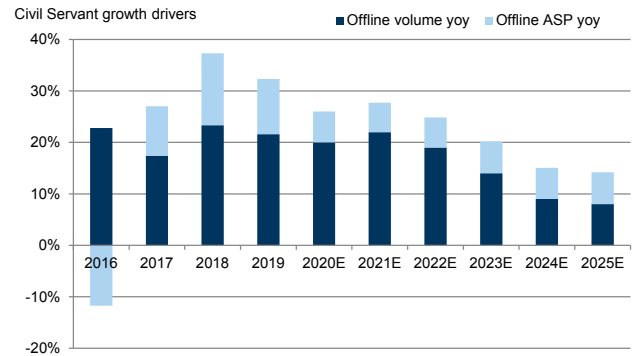
Source: Company data, Gao Hua Securities Research

Exhibit 61: Public institute series revenue of Offcn Education

Offcn Edu's Public institute series (Rmb mn)

Legend: Offline revenue | Online revenue | Total revenue yoy | Market share
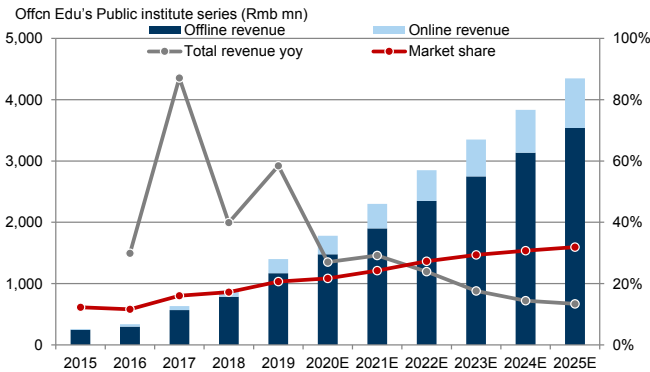
Source: Company data, Gao Hua Securities Research

Exhibit 62: Revenue growth driver breakdown for public institute series

Public institute growth drivers

Legend: Offline volume yoy | Offline ASP yoy
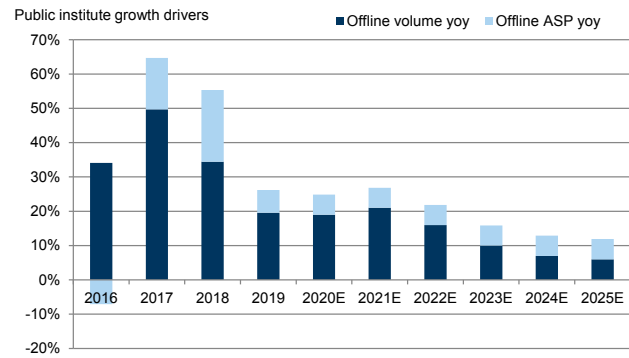
Source: Company data, Gao Hua Securities Research

Exhibit 63: Revenue forecast for teacher series

Offcn Edu's teacher series (Rmb mn)

Legend: Offline revenue | Online revenue | Total revenue yoy | Market share
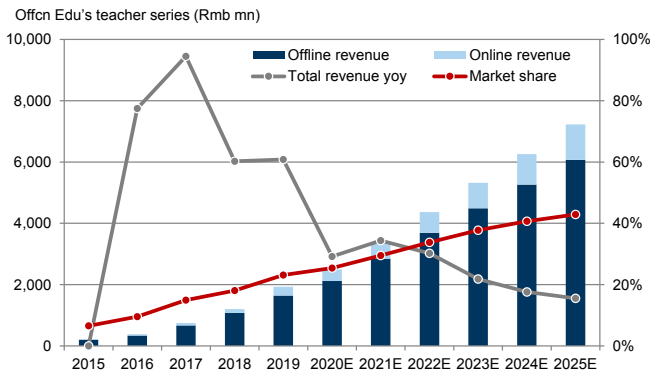
Source: Company data, Gao Hua Securities Research

Exhibit 64: Revenue growth drivers for teacher series

Teacher series revenue growth drivers

Legend: Offline volume yoy | Offline ASP yoy
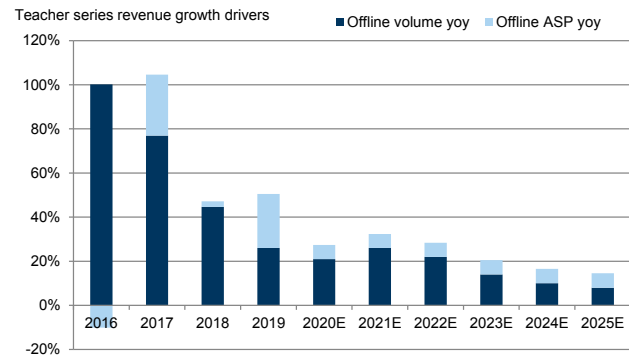
Source: Company data, Gao Hua Securities Research

Other training: A long-term growth driver

In 2019, other training revenue was Rmb1.6bn, accounting for 17% of total revenue. Of this revenue, other public service admission training accounted for c. Rmb850mn, and postgraduate admission exam training accounted for c. Rmb700mn.

Other public service admission training: This includes admission in other public services like auxiliary police, public health, army, etc. According to management, these are relatively small admission exams. The relevant training market is under penetrated, without many local players. We think potential market share gains for **Offcn Education in these areas should be relatively less challenging** versus other series given: (1) strong R&D with a dedicated R&D team. Local players generally do not have a dedicated R&D team, product design is carried out by teachers. In our view, specialized R&D affords Offcn Education a level of product quality that helps its students achieve higher passing rates. (2) Organizational advantage. Offcn Education operates a vertical organization structure, and promotes quick and frequent communication between front-line teaching staff and headquarters, to ensure that headquarters and R&D centers get the latest feedback on teaching and learning, so they can provide timely adjustments. We believe such product and organizational structures are a clear advantages relative to other nationwide or local competitors and should help Offcn Education gain market share in these new admission training markets.

Postgraduate admission exam training: Offcn Education's revenue from postgraduate admission training increased from Rmb400mn in 2018 to Rmb700mn in 2019, partly due to the growing number of test takers (2.9mn in 2019, up 22% yoy), and increasing market share as R&D investment started to payoff. We expect Offcn Education to increase its market share from 16% in 2019 to 29% in 2025E, as the company is investing significant resources into product R&D. Together with R&D, we think the company's postgraduate teacher team (the largest in the industry at 1,000+ teachers), should help drive product quality leading market share gains. More details are outlined in the next section.

Vocational skill training: This area includes finance and accounting training, healthcare training, IT training, etc. Currently the revenue contribution of this segment is only 1%, but this will be an important growth driver in the longer run, according to management. The company has already proved its ability to replicate success from public service admission training to postgraduate exam training. We think with increasing focus in this segment, we could see higher revenue contribution in the long run.

Exhibit 65: Other revenue breakdown for Offcn Education

Revenue breakdown, 2019
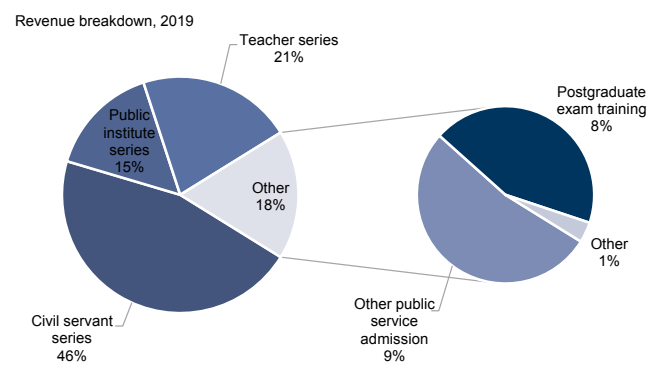
Source: Company data

Exhibit 66: We expect other revenue to maintain rapid growth in 2020-25E
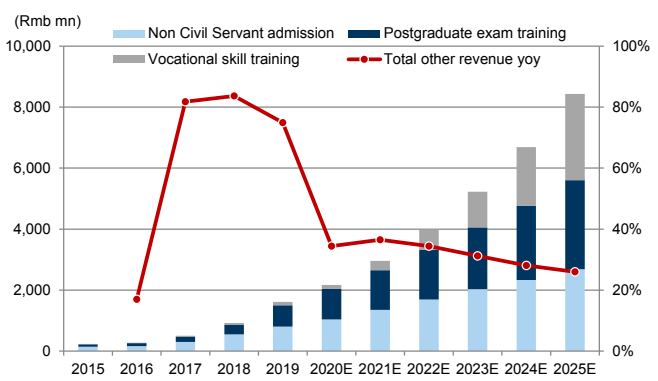
Source: Company data, Gao Hua Securities Research

Postgraduate admission training

The postgraduate admission training market has existed for 20 years, yet there has not been a large-scale player, likely due to the small training market size (less than Rmb2bn in 2015) given a limited number of test takers (1.7mn). The largest competitor is Koolearn (1797.HK, covered by Christine Cho), with Rmb339mn revenue in 2019 (8% market share). Other competitors like Wendu.com and Haiwen.com are relatively small. Wendu disclosed revenue of Rmb45mn in 2015, accounting for 2.5% market share. **The overall market is fragmented as there are many majors, while exam requirements at different universities may vary widely.** However, in recent years, the number of test takers for postgraduate admission exams has rapidly increased, from 1.6mn in 2015 to 3.4mn in 2020. The admission training market size is expanding, opening room for companies to grow market share.

Offcn entered the industry five years ago, and has quickly grown its revenue to Rmb700mn in 2019, already the largest player. We think Offcn Education has enjoyed faster growth than peers due to: (1) **a much larger full-time teaching team**, offering more comprehensive training services; and (2) **focus on product R&D**. The company has established an R&D team for postgraduate admissions exams and will soon have the leading R&D resources in the industry, according to management.

In the future, we expect Offcn Education to continue to gain market share in the postgraduate space, with strong product R&D and a deepening sales network, especially with its increasing focus on universities. As the potential customer bases for postgraduate exam training and public service admission training largely overlap, we do not expect the company would need to increase its sales expense significantly to acquire new customers.

Exhibit 67: Postgraduate exams are getting more competitive

Postgraduate admission exam (k)
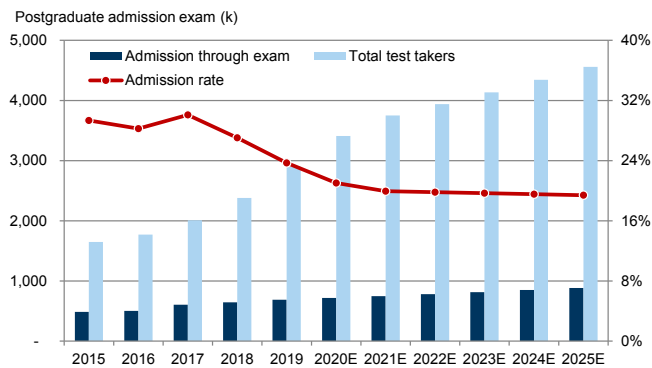
Source: Ministry of Education, Gao Hua Securities Research

Exhibit 68: ... leading to increasing training enrollment

Postgraduate exam training (k)
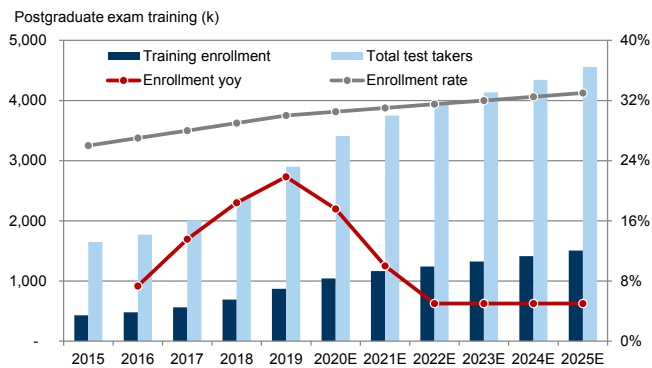
Source: Ministry of Education, Gao Hua Securities Research

Exhibit 69: We expect the postgraduate training market size would grow at 15% CAGR in 2019-25E

Postgraduate exam training market size (Rmb mn)
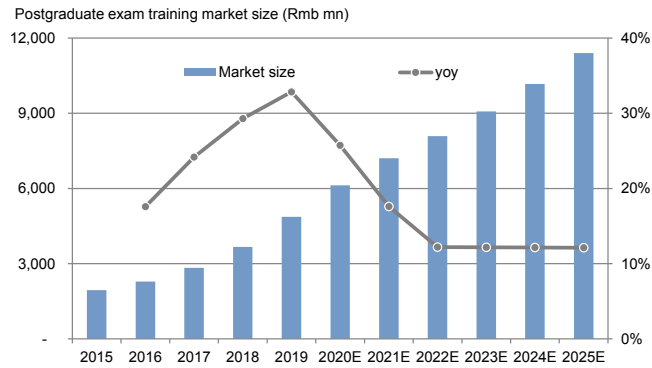
Source: Company data, Gao Hua Securities Research

Exhibit 70: Offcn Education is the largest player in postgraduate exam training

Market share in postgraduate exam training, 2019

Offcn education 14%
Koolearn 7%
Wendu 2%
Others 77%
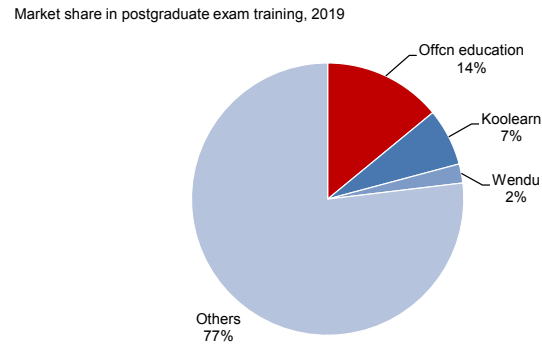
Source: Company data

Exhibit 71: Offcn Education had faster revenue growth than Koolearn

(Rmb mn)
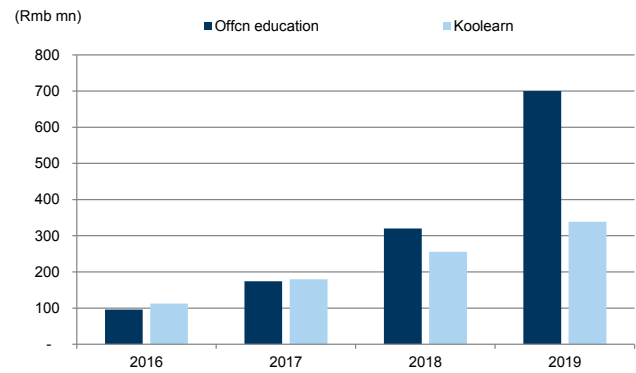
Source: Company data

Exhibit 72: Offcn Education has a much larger team of full-time teachers than peers

Number of teachers
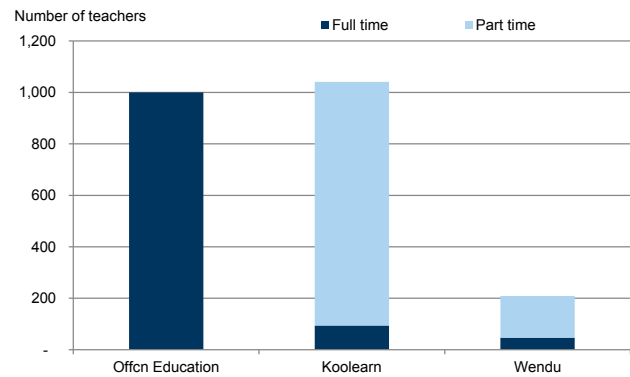
Source: Company data

Exhibit 73: We expect Offcn Education's market share to increase from 14% to 26% in 2019-25E

(Rmb mn)
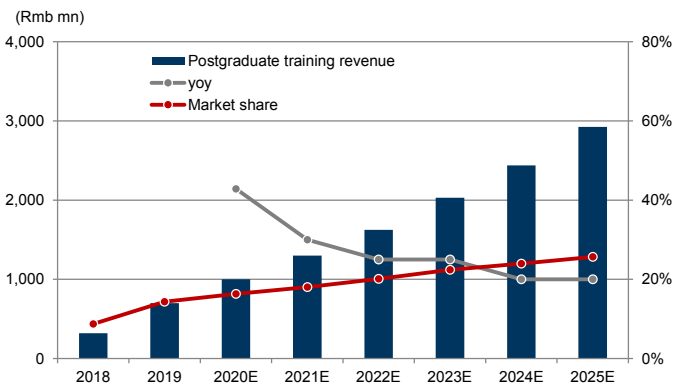
Source: Company data, Gao Hua Securities Research

Exhibit 74: Market sizing of postgraduate entrance exam

Postgraduate exam training	Unit	2015	2016	2017	2018	2019	2020E	2021E	2022E	2025E
Total test takers	k	1,649	1,770	2,010	2,380	2,900	3,410	3,751	3,939	4,559
yoy	%	-4%	7%	14%	18%	22%	18%	10%	5%	5%
Admission number	k	645	667	806	858	917	962	1,010	1,061	1,228
yoy	%	4%	3%	21%	6%	7%	5%	5%	5%	5%
% Recommended	%	25%	25%	25%	25%	25%	26%	26%	27%	28%
Admission through exam	k	484	500	605	643	687	717	748	780	884
Admission rate	%	29%	28%	30%	27%	24%	21%	20%	20%	19%
Market size of postgraduate exam training	**Rmb mn**	**1,943**	**2,284**	**2,837**	**3,667**	**4,872**	**6,126**	**7,204**	**8,084**	**11,401**
yoy	%	0%	18%	24%	29%	33%	26%	18%	12%	12%
Offline	Rmb mn	1,764	2,064	2,552	3,287	4,350	5,460	6,410	7,181	10,081
Online	Rmb mn	179	220	284	381	522	666	794	903	1,320
Training enrollment										
Offline	k	429	478	563	690	870	1,040	1,163	1,241	1,505
Online	k	363	425	523	666	870	1,057	1,200	1,300	1,641
Enrollment rate										
Offline	%	26%	27%	28%	29%	30%	31%	31%	32%	33%
Online	%	22%	24%	26%	28%	30%	31%	32%	33%	36%
ASP										
Offline	Rmb/cap	4,114	4,319	4,535	4,762	5,000	5,250	5,513	5,788	6,700
Online	Rmb/cap	494	518	544	571	600	630	662	695	804
ASP yoy	%		5%	5%	5%	5%	5%	5%	5%	5%
Revenue of Offcn	Rmb mn		96	174	320	700	1,000	1,300	1,625	2,925
Market share	%		4%	6%	9%	14%	16%	18%	20%	26%

Source: Ministry of Education, Gao Hua Securities Research

Vocational skill training: Tapping into a large and fragmented market

Offcn Education has also entered the vocation skill training industry and saw its IT training revenue increase 100%+ in 2019, though the contribution to overall revenue is still less than 1%. **The overall vocational skill training industry is very large, with a market size totaling roughly Rmb90bn in 2019, according to our estimates**. Among this, IT training is the largest with an estimated market size of Rmb40bn.

The market size of the IT training industry grew at 25-30% CAGR in 2015-19 (according to our estimates), driven by an expanding IT industry, attractive salaries, and a mismatch between talent supply and demand. Though large in size and growing quickly, China's IT training industry has many different categories and is therefore very fragmented, while market demand and courses are not standard. Tarena Education (TEDU, Not Covered) is the largest player with 5% market share. **We think the advantage of Offcn Education is its sales network, which we believe can enable the company to acquire incremental new customers without making significant investments in advertising.**

The finance and accounting training industry has a smaller market size (Rmb15bn as of 2019 based on our estimates) than IT training, and is also fragmented. We think Offcn Education has a competitive advantage in this industry, as its product R&D has synergies with its postgraduate admission training business. The potential customers overlap with the company's current customer profile as well (college students and graduates). **We believe the sales network advantage can help the company gain a small share in the industry, without spending a lot on marketing.**

Implications for sales expense: Competitors in vocational skills training generally have higher sales expense ratios than K-12 or public service admission training companies, as customers are mainly entry level white-collar workers who have had their graduate degrees for a few years. This market is quite fragmented and new customers tend to be inefficient to acquire. For example, Tarena Education (TEDU, Not Covered) spent c. 30% of revenue on sales & marketing in 2019, and the company's management has noted that online advertising can be particularly expensive with sales expense per enrollment going as high as Rmb2,500. We think Offcn Education would not need to spend as much on sales and marketing, as the potential customers of the company's vocational skill training would overlap, to a certain extent, with its core customer profile, namely college graduates. The advantage of Offcn Education is its large and deep-rooted sales network, which can enable the company to acquire incremental new customers without making significant investments in advertising. **Hence, we do not expect it would be very difficult for Offcn Education to capture a small market share (<3%) in this growing market.**

Exhibit 75: Market size of vocational skill training

(Rmb mn)
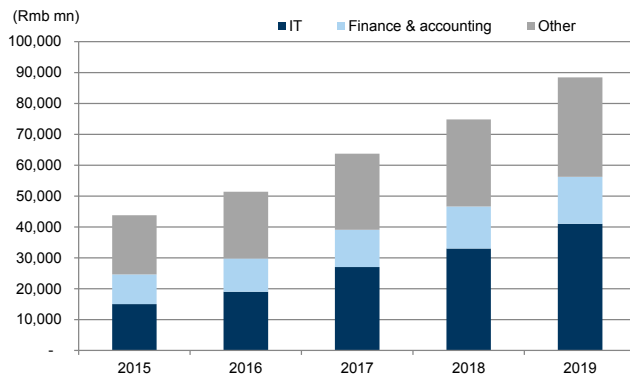
Source: chyxx.com, Gao Hua Securities Research

Exhibit 76: IT training industry is very fragmented with Tarena being the leader

Market share in IT training, 2019
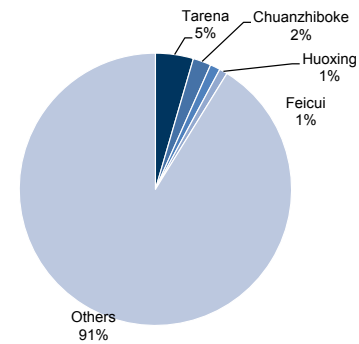
Source: Company data

Exhibit 77: Finance & Accounting training industry is also fragmented

Market share in finance & accounting training, 2019
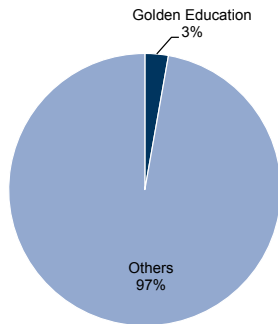
Source: Company data

Exhibit 78: We expect vocational skills training to have a lower op margin

(Op margin comparison)
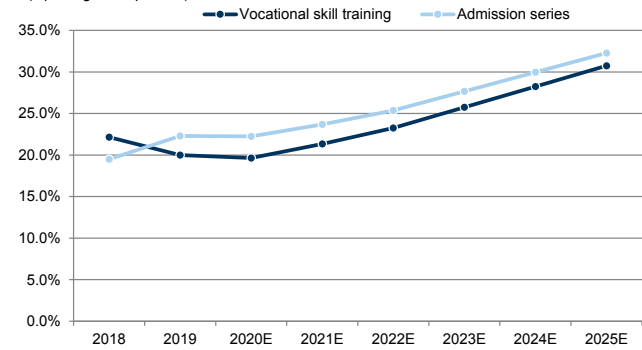
Source: Company data, Gao Hua Securities Research

Exhibit 79: ... with higher sales expense

(Sales expense ratio comparison)
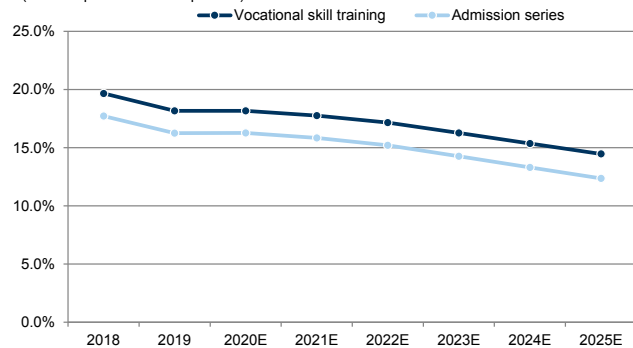
Source: Company data, Gao Hua Securities Research

Exhibit 80: The impact on overall sales expense is very limited

Sales expense (Rmb mn)
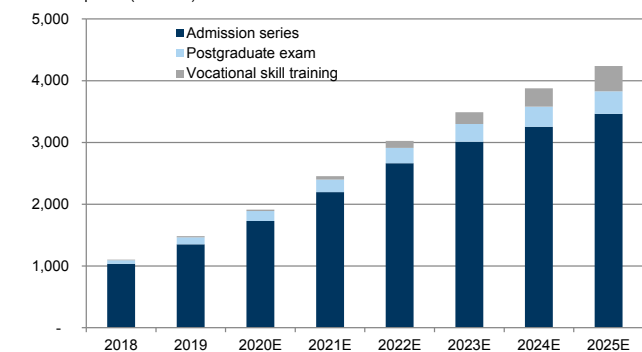
Source: Company data, Gao Hua Securities Research

Financial analysis: Solid margin and return profile

As we forecast the company to have a 24% revenue CAGR In 2019-25E driven by expanding market size and market share gains, we expect a 33% EPS CAGR over the same period, driven by operating leverage and margin expansion. As we expect an increase in operating efficiency for its sales network and scalable R&D, the company's sales and administrative expense ratio should decline from 36% in 2019 to 27% in 2025E, driving net margin expansion from 20% to 29% in the same period.

For 2020-22E EPS, we are 0 to 4% ahead of Wind consensus likely on: (i) our positive view on sustainable returns thanks to competitive advantages; and (ii) our assessment of Offcn's potential success in other vocational training areas.

Operating leverage to drive margin improvement

As the company grows in scale, we expect operating leverage to drive margin improvement. For sales expense, we expect the near term sales expense ratio to be largely stable as the company continues to invest in deepening its sales network. But in outer years, we expect cross selling various categories would improve the efficiency of the sales network and reduce the company's sales expense ratio. The admin expense ratio has declined from 28% in 2015 to 20% in 2019, and we expect the admin expense ratio to decline to 15% in 2025E. The R&D expense ratio should remain largely stable at 8% of revenue in the near term due to the company's focus on R&D, while salaries and other admin expense ratio should decline, thanks to operating leverage. Therefore, we expect net margin to increase from 20% in 2019 to 29% in 2025E.

Exhibit 81: We expect sales expense ratio to gradually decline
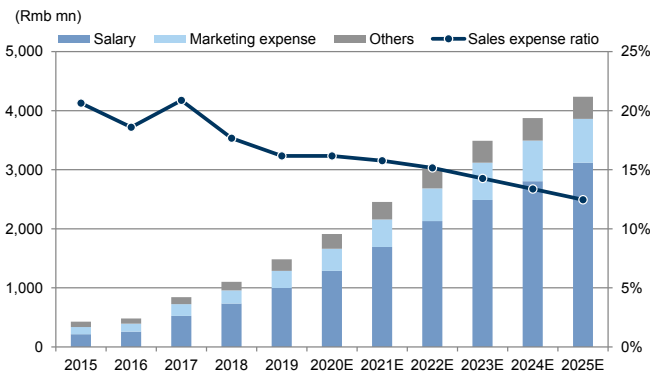
Source: Company data, Gao Hua Securities Research

Exhibit 82: ... with the admin expense ratio declining as well
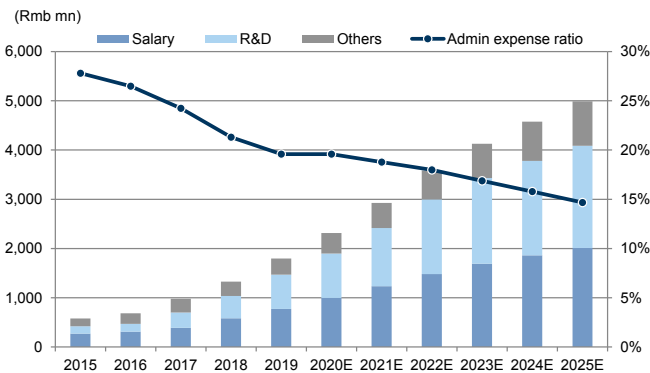
Source: Company data, Gao Hua Securities Research

Exhibit 83: We expect net margin to expand in the next few years
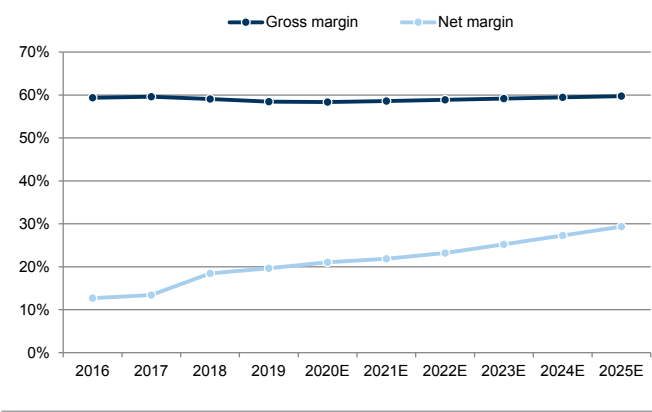
Source: Company data, Gao Hua Securities Research

Strong cash position and investment income

Offcn Education's operating cash flow is generally larger than net income, thanks to deferred revenue which grows proportionately with revenue scale each year. Prepayment of tuition is a common practice in the education industry. Per the company's refund policy, students would prepay the full amount of tuition when enrolling in a contract class, and will be refunded a predetermined amount if they do not pass the exam, which is usually three to four months after their enrollment. The company invests its cash into wealth management products and bond investments, which can earn 3.5%-5.5% interest/investment income, contributing to sizable income each year.

Exhibit 84: Offcn Education has strong cash flow
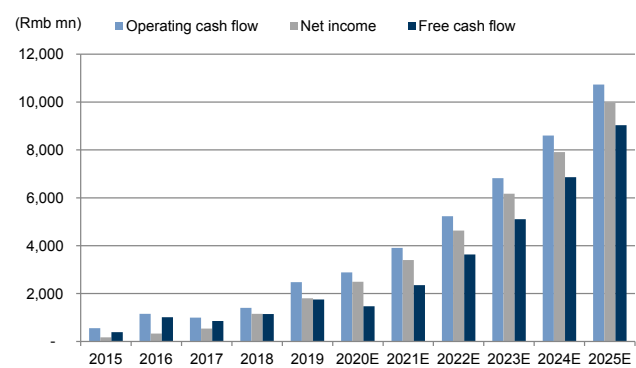
Source: Company data, Gao Hua Securities Research

Exhibit 85: ... and a strong net cash position
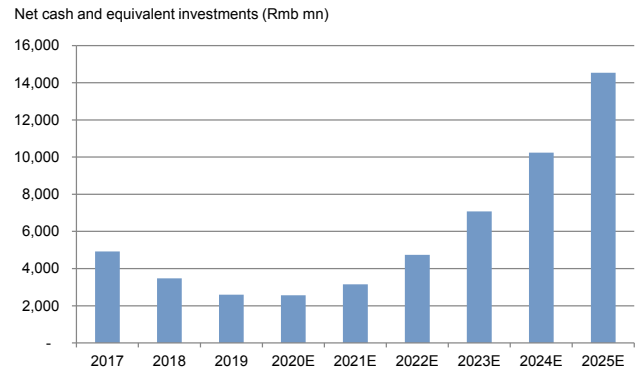
Source: Company data, Gao Hua Securities Research

Exhibit 86: ... partly due to sizable deferred revenue
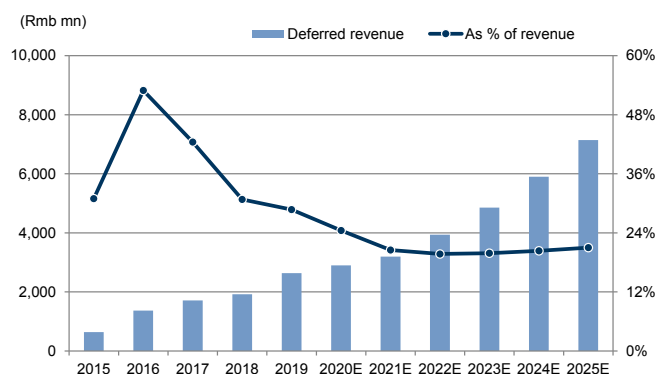
Source: Company data, Gao Hua Securities Research

Exhibit 87: Interest and investment income increases due to increasing cash position
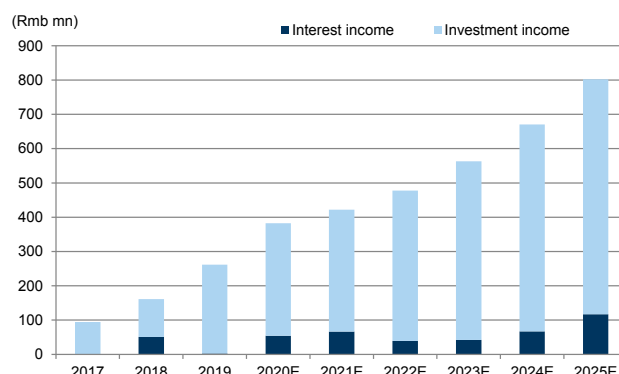
Source: Company data, Gao Hua Securities Research

Light asset model driving high return profile

Gradually increasing self-owned learning centers: As analyzed in previous sections, Offcn Education operates a light asset model, teaching takes place in hotels and other similar venues without fixed investment. CAPEX was Rmb140-260mn in 2016-18, less than 5% of revenue. In 2019, the company started to build three office buildings with teaching centers and spent Rmb720mn on CAPEX. It also spent Rmb383mn to acquire a building in Xi'an as learning center, with capacity for 3,000 people and annual enrollment capacity of about 24,000. In the future, the company aims to build c.20 more learning centers to facilitate centralized teaching. Management views self-owned learning centers as more cost efficient compared with the current model of renting hotel meeting rooms. Hence we expect CAPEX would be in the range of Rmb1.0-1.5bn in the next few years, less than 6% of revenue. Overall, the company's asset base is still light We expect asset turnover to be 1.1-1.5X in future years.

Profitability of learning centers and impact on margin: According to management, for enclosed training courses, students currently needed to spend as much on hotel and food as tuition fees. After moving to learning centers, part of the hotel and food expense can be saved and built into product ASP, benefiting both the company and its students. According to our estimates, for a learning center with a fixed investment of c.Rmb350mn, an 80% utilization rate can create 73% gross margin (higher than current 60%) with a 3.4 year payback period. We estimate that 20 learning centers with similar scale can accommodate c.380k offline training enrollments, accounting for 10% of 2025E total offline enrollment for Offcn Education. Hence, we think the gradual increase of self-owned learning centers can boost overall gross margin by c.1ppt in the next five years.

Exhibit 88: We expect CAPEX to be less than 6% of revenue in the future
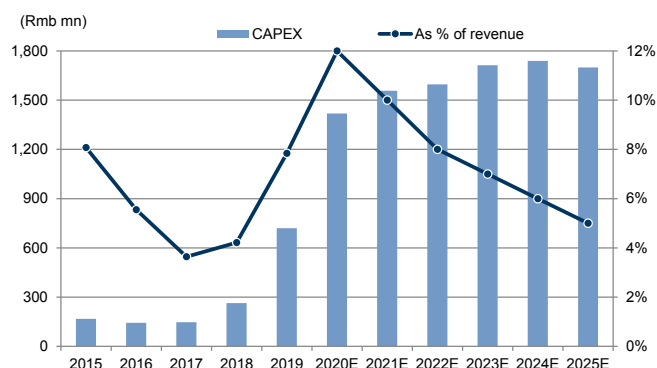
Source: Company data, Gao Hua Securities Research

Exhibit 89: COGS breakdown
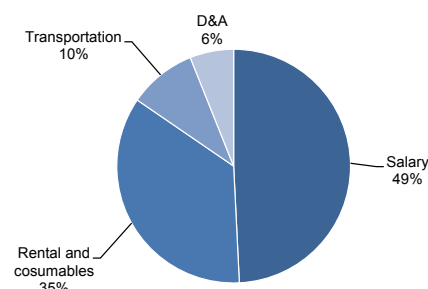
Source: Company data

Exhibit 90: We expect asset turnover to increase to 1.5 in 2022E
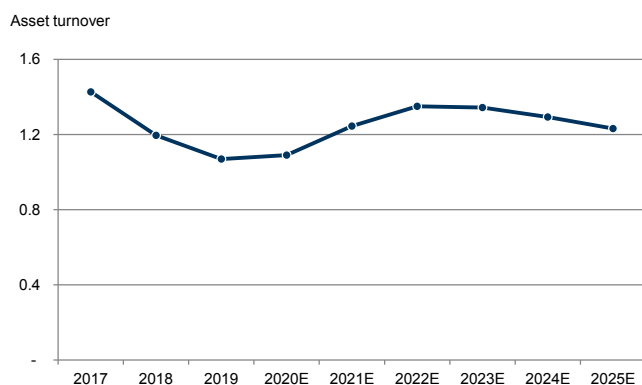
Source: Company data, Gao Hua Securities Research

Exhibit 91: Learning center model

Learning center model					
Fixed investment (Rmb mn)	350	**Revenue (Rmb mn)**	**192**	Sales & admin expense	47
Depreciating years	15	COGS		As % of ASP pre-hike	36%
Capacity (k)	24	Salary	14		
		Operating expense	12	**Net income (Rmb mn)**	**81**
Utilization rate	80%	Depreciation	23	Net margin	42%
Enrollment (k)	24.0	Travel	3		
Current ASP	5.4	**Gross profit**	**141**	**Free cash flow**	**104**
ASP post price hike (k)	8.0	Gross margin	73%	Payback period	3.4
Op exp / enrollment	0.5				

Source: Company data, Gao Hua Securities Research

Dividend and return profile: In 2018-19, the company paid 80-130% of net income as dividend. We expect the dividend payout ratio to remain 60% in future years, as the company has abundant cash, which would keep assets light and drive ROE from 57% in 2019 to 66% in 2025E, and ROIC from 31% in 2019 to 50% in 2025E.

Exhibit 92: We expect dividend payout ratio to be around 60% in future years
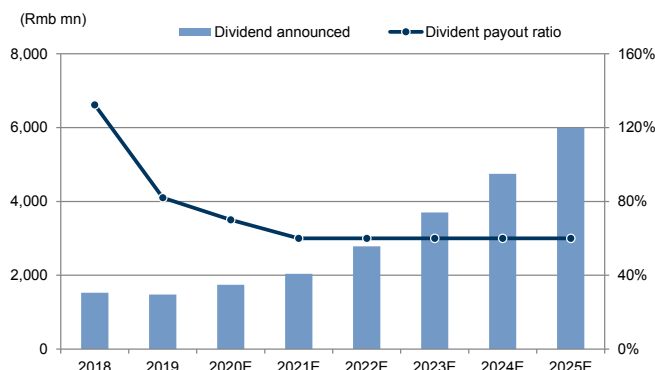
Source: Company data, Gao Hua Securities Research

Exhibit 93: We expect high ROE/ROIC to continue in future years
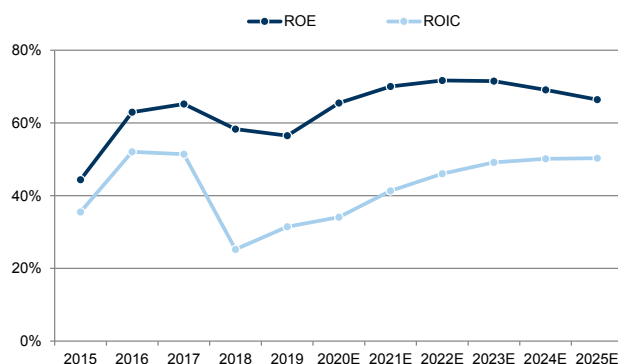
Source: Company data, Gao Hua Securities Research

Earnings forecast and financial statements

Exhibit 94: Key drivers and income statement forecast

Rmb mn	2015	2016	2017	2018	2019	2020E	2021E	2022E	2023E	2024E	2025E
Total revenue	**2,076**	**2,584**	**4,031**	**6,237**	**9,176**	**11,831**	**15,570**	**19,953**	**24,467**	**29,001**	**34,001**
Civil servant series	1,357	1,579	2,144	3,205	4,171	5,299	6,844	8,624	10,413	12,027	13,765
Public institute series	260	338	632	884	1,401	1,780	2,299	2,849	3,350	3,834	4,348
Teacher series	217	385	750	1,202	1,933	2,496	3,355	4,368	5,320	6,256	7,226
Other training	236	276	502	923	1,614	2,170	2,961	3,980	5,224	6,692	8,432
Revenue yoy		*24%*	*56%*	*55%*	*47%*	*29%*	*32%*	*28%*	*23%*	*19%*	*17%*
Civil servant series		*16%*	*36%*	*49%*	*30%*	*27%*	*29%*	*26%*	*21%*	*16%*	*14%*
Public institute series		*30%*	*87%*	*40%*	*58%*	*27%*	*29%*	*24%*	*18%*	*14%*	*13%*
Teacher series		*77%*	*94%*	*60%*	*61%*	*29%*	*34%*	*30%*	*22%*	*18%*	*16%*
Other training		*17%*	*82%*	*84%*	*75%*	*34%*	*37%*	*34%*	*31%*	*28%*	*26%*
COGS	(827)	(1,051)	(1,630)	(2,552)	(3,813)	(4,926)	(6,447)	(8,208)	(9,994)	(11,765)	(13,694)
Gross profit	**1,249**	**1,534**	**2,402**	**3,685**	**5,364**	**6,904**	**9,123**	**11,745**	**14,473**	**17,236**	**20,307**
Gross margin	**60%**	**59%**	**60%**	**59%**	**58%**	**58%**	**59%**	**59%**	**59%**	**59%**	**60%**
Business tax and add-ons	(67)	(30)	(19)	(27)	(57)	(73)	(96)	(123)	(151)	(179)	(210)
As % of sales	*3%*	*1%*	*0%*	*0%*	*1%*	*1%*	*1%*	*1%*	*1%*	*1%*	*1%*
Sales expense	(428)	(481)	(841)	(1,102)	(1,483)	(1,912)	(2,454)	(3,025)	(3,489)	(3,875)	(4,237)
As % of sales	*21%*	*19%*	*21%*	*18%*	*16%*	*16%*	*16%*	*15%*	*14%*	*13%*	*12%*
Administrative expense	(577)	(684)	(977)	(1,328)	(1,796)	(2,316)	(2,924)	(3,587)	(4,129)	(4,576)	(4,990)
As % of sales	*28%*	*26%*	*24%*	*21%*	*20%*	*20%*	*19%*	*18%*	*17%*	*16%*	*15%*
EBIT (operating profit)	**177**	**338**	**564**	**1,227**	**2,029**	**2,603**	**3,649**	**5,010**	**6,703**	**8,606**	**10,870**
yoy		*92%*	*67%*	*118%*	*65%*	*28%*	*40%*	*37%*	*34%*	*28%*	*26%*
EBIT margin	9%	13%	14%	20%	22%	22%	23%	25%	27%	30%	32%
Interest income	(2)	(20)	(28)	3	(204)	(96)	(84)	(99)	(96)	(71)	(21)
Investment gains	21	71	95	110	259	328	356	438	521	603	686
Profit before tax	200	391	642	1,340	2,089	2,883	3,938	5,366	7,145	9,155	11,551
Income tax	(31)	(63)	(100)	(187)	(285)	(393)	(537)	(731)	(974)	(1,248)	(1,574)
Minority interest	0	-	-	-	0	1	1	1	1	1	1
Net income to shareholders	**169**	**328**	**542**	**1,153**	**1,805**	**2,491**	**3,402**	**4,636**	**6,172**	**7,908**	**9,977**
yoy		94%	65%	113%	57%	38%	37%	36%	33%	28%	26%
EPS (Rmb)	n.m.	n.m.	n.m.	0.19	0.29	0.40	0.55	0.75	1.00	1.28	1.62

Source: Company data, Gao Hua Securities Research

Exhibit 95: Income statement

Rmb mn

Income statements	2017	2018	2019	2020E	2021E	2022E	2023E	2024E	2025E
Total sales/revenues	**4,031**	**6,237**	**9,176**	**11,831**	**15,570**	**19,953**	**24,467**	**29,001**	**34,001**
yoy %	*56%*	*55%*	*47%*	*29%*	*32%*	*28%*	*23%*	*19%*	*17%*
Total COGS	(1,630)	(2,552)	(3,813)	(4,926)	(6,447)	(8,208)	(9,994)	(11,765)	(13,694)
Gross profit	**2,402**	**3,685**	**5,364**	**6,904**	**9,123**	**11,745**	**14,473**	**17,236**	**20,307**
yoy %	*57%*	*53%*	*46%*	*29%*	*32%*	*29%*	*23%*	*19%*	*18%*
SG&A	(1,838)	(2,457)	(3,336)	(4,301)	(5,474)	(6,736)	(7,770)	(8,630)	(9,437)
Sales tax and add-on	(19)	(27)	(57)	(73)	(96)	(123)	(151)	(179)	(210)
Sales expense	(841)	(1,102)	(1,483)	(1,912)	(2,454)	(3,025)	(3,489)	(3,875)	(4,237)
Administrative expense	(977)	(1,328)	(1,796)	(2,316)	(2,924)	(3,587)	(4,129)	(4,576)	(4,990)
Other operating expense	(0)	(0)	1	-	-	-	-	-	-
Impairment losses on asset	(0)	(0)	(0)	-	-	-	-	-	-
net gains/loss of fair value	-	-	2	-	-	-	-	-	-
EBITDA	**743**	**1,365**	**2,191**	**2,799**	**3,890**	**5,300**	**7,049**	**8,995**	**11,297**
Adjusted EBITDA	746	1,366	2,198	2,849	3,910	5,321	7,071	9,018	11,321
Depreciation		(46)	(72)	(110)	(164)	(217)	(272)	(313)	(347)
Amortization		(92)	(90)	(86)	(77)	(74)	(74)	(74)	(81)
EBIT (operating profit)	**564**	**1,227**	**2,029**	**2,603**	**3,649**	**5,010**	**6,703**	**8,606**	**10,870**
yoy %	*67%*	*118%*	*65%*	*28%*	*40%*	*37%*	*34%*	*28%*	*26%*
EBIT margin	14.0%	19.7%	22.1%	22.0%	23.4%	25.1%	27.4%	29.7%	32.0%
Net financial expenses	**(28)**	**3**	**(204)**	**(96)**	**(84)**	**(99)**	**(96)**	**(71)**	**(21)**
Interest income		51	2	54	66	40	42	67	117
Interest expense	(28)	(13)	(108)	(150)	(150)	(138)	(138)	(138)	(138)
Foreign exchange gain/(loss)		-	-	-	-	-	-	-	-
Other finanical costs		(36)	(99)	-	-	-	-	-	-
Investment gains/loss	**95**	**110**	**259**	**328**	**356**	**438**	**521**	**603**	**686**
Net income from associates or jointly controlled entities		-	-	-	-	-	-	-	-
Other investment gains/loss		110	259	328	356	438	521	603	686
Other non-operating income/expense	**11**	**(0)**	**6**	**48**	**17**	**17**	**17**	**17**	**17**
Other non-operating income	2	1	7	50	20	21	22	23	24
Other non-operating expense	9	(1)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Pre-tax profit (income before tax)	**642**	**1,340**	**2,089**	**2,883**	**3,938**	**5,366**	**7,145**	**9,155**	**11,551**
yoy %	*64%*	*109%*	*56%*	*38%*	*37%*	*36%*	*33%*	*28%*	*26%*
Income taxes	(100)	(187)	(285)	(393)	(537)	(731)	(974)	(1,248)	(1,574)
Minority interest	-	-	0	1	1	1	1	1	1
Preferred dividends	-	-	-	-	-	-	-	-	-
Extraordinary gain/(loss)	-	-	-	-	-	-	-	-	-
Net income	**542**	**1,153**	**1,805**	**2,491**	**3,402**	**4,636**	**6,172**	**7,908**	**9,977**
yoy %	*65%*	*113%*	*57%*	*38%*	*37%*	*36%*	*33%*	*28%*	*26%*
		-	-			*37%*			
EPS - basic	**0.66**	**0.19**	**0.29**	**0.40**	**0.55**	**0.75**	**1.00**	**1.28**	**1.62**

Source: Company data, Gao Hua Securities Research

Exhibit 96: Balance sheet

Rmb mn

Balance sheets	2017	2018	2019	2020E	2021E	2022E	2023E	2024E	2025E
Cash and equivalents	190	649	2,724	2,212	1,318	1,410	2,240	3,897	6,686
Net receivables	40	88	258	332	437	560	687	815	955
Inventory/stocks	-	0	-	-	-	-	-	-	-
Other current assets	2,171	2,334	1,854	2,854	3,854	5,354	6,854	8,354	9,854
Current assets	**2,401**	**3,070**	**4,836**	**5,398**	**5,609**	**7,325**	**9,781**	**13,066**	**17,495**
Gross PP&E/Fixed assets	280	988	1,579	2,899	4,346	5,821	7,400	8,993	10,530
Less accumulated depreciation		(197)	(253)	(363)	(526)	(743)	(1,015)	(1,327)	(1,674)
Less fixed asset impairment		(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Net PP&E/Fixed assets	**280**	**790**	**1,326**	**2,536**	**3,819**	**5,078**	**6,386**	**7,666**	**8,856**
Gross intangibles	240	320	320	370	425	485	552	625	706
Accumulated amortization		(16)	(23)	(30)	(38)	(47)	(57)	(69)	(83)
Net intangibles	**240**	**304**	**297**	**340**	**387**	**439**	**495**	**556**	**623**
Total investments	52	936	2,612	2,612	2,612	2,612	2,612	2,612	2,612
Other long-term assets	2,663	2,101	889	860	846	842	845	854	867
Total assets	**3,235**	**7,202**	**9,961**	**11,747**	**13,274**	**16,295**	**20,119**	**24,753**	**30,453**
Accounts payable	383	624	921	1,197	1,567	1,995	2,429	2,860	3,328
Short-term debt and current portion of long-term debt	100	1,607	2,867	3,367	2,867	2,867	2,867	2,867	2,867
Other current liabilities	1,712	1,920	2,634	2,898	3,195	3,935	4,857	5,899	7,141
Current liabilities	**2,195**	**4,151**	**6,422**	**7,462**	**7,629**	**8,798**	**10,153**	**11,626**	**13,336**
Long-term debt	-	-	-	-	-	-	-	-	-
Other long-term liabilities/creditors	39	97	107	107	107	107	107	107	107
Total long-term liabilities	**39**	**97**	**107**	**107**	**107**	**107**	**107**	**107**	**107**
Total liabilities	**2,234**	**4,248**	**6,529**	**7,569**	**7,736**	**8,904**	**10,260**	**11,733**	**13,443**
Preferred shares	-	-	-	-	-	-	-	-	-
Common stock	90	104	104	104	104	104	104	104	104
Treasury stock	-	-	-	-	-	-	-	-	-
Retained earnings	552	1,705	2,092	2,839	4,200	6,054	8,523	11,686	15,677
Other common equity	358	1,145	1,236	1,236	1,236	1,236	1,236	1,236	1,236
Total common equity	**1,000**	**2,954**	**3,432**	**4,179**	**5,540**	**7,394**	**9,863**	**13,026**	**17,017**
Minority interest (balance sheet)	-	-	(0)	(1)	(2)	(3)	(4)	(6)	(7)
Total shareholders funds/equity	**1,000**	**2,954**	**3,432**	**4,178**	**5,538**	**7,391**	**9,858**	**13,020**	**17,010**
Total liabilities and equity	**3,235**	**7,202**	**9,961**	**11,747**	**13,274**	**16,295**	**20,119**	**24,753**	**30,453**

Source: Company data, Gao Hua Securities Research

Exhibit 97: Cash flow statement

Rmb mn

Cash flow statements	2017	2018	2019	2020E	2021E	2022E	2023E	2024E	2025E
Income pre-preferred share dividends	**542**	**1,153**	**1,805**	**2,491**	**3,402**	**4,636**	**6,172**	**7,908**	**9,977**
Minority interest add-back	-	-	(0)	(1)	(1)	(1)	(1)	(1)	(1)
Depreciation and amortization add-back	-	138	162	196	241	290	345	389	428
Net income from associates and jointly controlled entiti	-	-	-	-	-	-	-	-	-
Net loss/(gain) on asset sales		(110)	(259)	-	-	-	-	1	2
(Increase)/decrease in working capital :	43	193	127	202	265	305	307	303	328
Accounts receivable	4	(47)	(170)	(75)	(105)	(123)	(127)	(127)	(140)
Inventory	-	(0)	0	-	-	-	-	-	-
Accounts payable	39	241	297	276	370	428	434	431	469
Other operating cash flow items	415	34	640	-	-	-	-	-	-
Cash flow from operations	**999**	**1,408**	**2,474**	**2,887**	**3,907**	**5,230**	**6,824**	**8,600**	**10,734**
Capital expenditure	(147)	(263)	(720)	(1,420)	(1,557)	(1,596)	(1,713)	(1,740)	(1,700)
(Acquisitions)/divestitures	56	(260)	-	-	-	-	-	-	-
Investments	(1,504)	(1,942)	392	-	-	-	-	-	-
Other investment cash flow items	26	105	197	(1,000)	(1,000)	(1,500)	(1,500)	(1,500)	(1,500)
Cash flow from investing	**(1,569)**	**(2,360)**	**(131)**	**(2,420)**	**(2,557)**	**(3,096)**	**(3,213)**	**(3,240)**	**(3,200)**
Dividends paid (common and preferred)	(74)	(9)	(1,526)	(1,480)	(1,744)	(2,041)	(2,781)	(3,703)	(4,745)
Share repurchase/issue (change In common stock)		-	-	-	-	-	-	-	-
Increase/(decrease) in short-term debt		-	-	500	(500)	-	-	-	-
Increase/(decrease) in long-term debt	100	1,507	1,260	-	-	-	-	-	-
Increase/(decrease) in preferred shares		-	-	-	-	-	-	-	-
Change in minority interest		-	-	-	-	-	-	-	-
Other financing cash flow items	(172)	(87)	(2)	-	-	-	-	-	-
Cash flow from financing	**(146)**	**1,411**	**(267)**	**(980)**	**(2,244)**	**(2,041)**	**(2,781)**	**(3,703)**	**(4,745)**
Effect of foreign exchange rate changes	-	-	-	-	-	-	-	-	-
Total cash flow	**(715)**	**459**	**2,076**	**(512)**	**(894)**	**92**	**830**	**1,657**	**2,789**

Source: Company data, Gao Hua Securities Research

Seasonality of earnings and impact of COVID-19

Offcn Education's earnings have seasonality patterns, due to the timing of exams and the recognition of revenue. For contract classes with refund policies, the revenue of non-refundable course fees is recognized when the education service is completed, while the refundable part is recognized when test result is released and conditions are met. Generally, 1Q is a slow revenue season for the company and most revenue is spread over 2Q-4Q, as major public administration exams end in 2Q/3Q and their results are announced in 2Q-4Q, when the company can recognize the refundable part of its product pricing as revenue.

In 1Q20, revenue declined 6% yoy given the impact of offline course suspensions in February and March due to COVID-19. According to management, most offline teaching had resumed as of late March and is operating normally as of now, though overall activity is still less than pre-COVID levels. Revenues from provincial civil servant admission training are generally recognized in 2Q, but this year there will be a delay as the provincial exams have been postponed to late June and early July. Revenue from the refundable part would need to be recognized in 3Q. Hence, we expect an 8% revenue decline in 2Q20 and 55% revenue growth in 3Q20. **We think 2020 will see a strong rebound in admission numbers for central and provincial civil servants, along with public institute workers and teachers, hence we expect revenue growth for 2020 would remain robust despite the COVID-19 impact.**

Exhibit 98: Time window of major public institute exams

	Sign up	Written exam	Interview
National Civil Servant Admission Exam	Oct	Nov	Jan-Feb next year
Provincial Civil Servant Admission Exam	Mar	Apr	Jun
Public Institution Admission Exam	Apr	May	Jun
Teacher Certificate Exam	Jan / Sep	Mar / Nov	May / Jan
Teacher Admission Exam		Jul-Aug	

Source: Offcn Education

Exhibit 99: Quarterly income statement of Offcn Education

YTD analysis		1Q19	1H19	9M19	2019	1Q20	1H20E	9M20E	2020E
Revenue		1,312	3,637	6,159	9,176	1,230	3,370	7,278	11,831
	YoY				47.1%	(6.2%)	(7.4%)	18.2%	28.9%
COGS		548	1,545	2,611	3,813	521	1,420	3,061	4,926
Gross profit		**764**	**2,092**	**3,548**	**5,364**	**709**	**1,950**	**4,217**	**6,904**
	YoY				46%	(7%)	(7%)	19%	29%
Gross margin		58%	58%	58%	58%	58%	58%	58%	58%
Sales tax and other		7	32	43	57	3	16	41	73
	% of revenue	0.54%	0.88%	0.70%	0.62%	0.27%	0.49%	0.56%	0.62%
Sales expense		289	675	1,081	1,483	273	658	1,323	1,912
	% of revenue	22%	19%	18%	16%	22%	20%	18%	16%
Administrative expense		331	804	1,340	1,796	315	743	1,486	2,316
	% of revenue	25%	22%	22%	20%	26%	22%	20%	20%
	SG&A ratio	48%	42%	40%	36%	48%	42%	39%	36%
Other operating expenses		-	-	-	(0)	-	-	-	-
EBIT		**137**	**581**	**1,084**	**2,028**	**118**	**533**	**1,368**	**2,603**
	YoY				21%	(14%)	(8%)	26%	28%
	EBIT Margin	10%	16%	18%	22%	10%	16%	19%	22%
Finance expense		38	43	65	204	55	70	85	96
Investment gains		32	54	127	259	49	119	209	328
Non-operating revenue		0	2	4	7	37	37	37	50
Non-operating expense		0	0	0	1	0	0	0	2
Earnings before tax		132	595	1,148	2,089	149	618	1,529	2,883
Tax		25	102	190	285	32	96	220	393
Net income		**106**	**493**	**959**	**1,805**	**116**	**522**	**1,309**	**2,490**
	% of revenue	8%	14%	16%	20%	9%	15%	18%	21%
Minority interest		-	-	(0)	(0)	(0)	(0)	(0)	(1)
Net income attributable to majority shareholders		**106**	**493**	**959**	**1,805**	**116**	**522**	**1,309**	**2,491**
	YoY				57%	10%	6%	36%	38%
	Net margin	8%	14%	16%	20%	9%	15%	18%	21%
Basic EPS		0.02	0.08	0.16	0.29	0.02	0.08	0.21	0.40

QoQ analysis		1Q19	2Q19	3Q19	4Q19	1Q20	2Q20E	3Q20E	4Q20E
Revenue		1,312	2,326	2,522	3,017	1,230	2,140	3,909	4,552
	YoY	62%	42%	46%	46%	(6%)	(8%)	55%	51%
	QoQ	(37%)	77%	8%	20%	(59%)	74%	83%	16%
COGS		548	998	1,066	1,202	521	899	1,642	1,865
Gross profit		**764**	**1,328**	**1,456**	**1,815**	**709**	**1,241**	**2,267**	**2,687**
	YoY					(7%)	(7%)	56%	48%
	Gross margin	58.3%	57%	58%	60%	57.7%	58%	58%	59%
Sales tax and other		7	25	11	13	3	13	24	32
	% of revenue	1%	1%	0%	0%	0%	1%	1%	1%
Sales expense		289	386	406	402	273	385	664	589
	% of revenue	22%	17%	16%	13%	22%	18%	17%	13%
Administrative expense		331	473	537	456	315	428	743	831
	% of revenue	25%	20%	21%	15%	26%	20%	19%	18%
	SG&A ratio	48%	38%	38%	29%	48%	39%	37%	32%
Other operating expenses		-	-	-	(0)	-	-	-	-
EBIT		**137**	**445**	**502**	**944**	**118**	**415**	**836**	**1,235**
	EBIT					(14%)	(7%)	66%	31%
	EBIT Margin	10%	19%	20%	31%	10%	19%	21%	27%
Finance expense		38	5	23	139	55	15	15	11
Investment gains		32	22	73	132	49	70	90	119
Non-operating revenue		0	2	2	3	37	-	-	13
Non-operating expense		0	0	0	1	0	-	-	2
Earnings before tax		132	463	554	941	149	470	911	1,354
Tax		25	76	88	95	32	64	124	173
Net income		**106**	**387**	**466**	**846**	**116**	**406**	**787**	**1,181**
	% of revenue	8%	17%	18%	28%	9%	19%	20%	26%
Minority interest		-	-	(0)	(0)	(0)	-	-	(1)
Net income attributable to majority shareholders		**106**	**387**	**466**	**846**	**116**	**406**	**787**	**1,182**
	NI	(305%)	46%	42%	38%	10%	5%	69%	40%
	QoQ	(83%)	264%	20%	82%	(86%)	249%	94%	50%
	Net margin	8%	17%	18%	28%	9%	19%	20%	26%
Basic EPS		0.02	0.06	0.08	0.14	0.02	0.07	0.13	0.19

Source: Company data, Gao Hua Securities Research

Valuation and key risks

We value the stock using 30X 2025E PE which we discount back to 2021E with 7.5% COE. We believe a discounted PE approach is appropriate for Offcn given clear growth visibility into the mid to long term, particularly for growth drivers in both its core admission training business as well as its postgraduate exam training and vocational skill training businesses. Our target multiple is based on the average 5-year PE of 32.4X for TAL and EDU (appropriate valuation reference points given similar business models) with a 10% discount, as we expect the net profit growth of Offcn Education after 2025E to be 20-25%, lower than the average NP growth of TAL and EDU in 2015-19 (35%).

The stock is trading at 51X 2021E PE, higher than EDU (32X) but lower than TAL (63X). These multiples are arrayed consistently with the relative earnings growth outlook for the three companies, as we forecast a 36% earnings CAGR for Offcn Education in 2019-23E, vs. 40% for TAL and 30% for EDU. The relatively high valuation multiples of education stocks reflect their strong pricing power, high margin and returns, as well as their strong cash positions. We highlight that Offcn Education has higher ROE/ROIC than TAL and EDU, due to its light asset model and higher dividend payout ratio. Thus, we think our valuation methodology and approach for Offcn Education is reasonable.

Exhibit 100: We value Offcn Education using 30X 2025E PE discounted back to 2021E with 7.5% COE

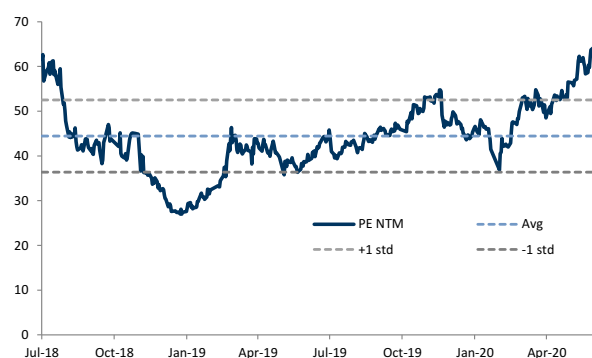| Discounted PE valuation	2020E	2021E	2022E	2023E	2024E	2025E
EPS	0.40	0.55	0.75	1.00	1.28	1.62
Exit PE						30x
2025E equity value						48.53
COE						7.5%
12-m TP (Rmb/sh)		**36.38**				
Implied PE	90X	66X	48X	36X		

Source: Gao Hua Securities Research

Exhibit 101: Average historic PE of TAL/EDU

Source: Bloomberg, Data compiled by Gao Hua Securities Research

Exhibit 102: Historic PE of Offcn Education

Source: Bloomberg, Data compiled by Gao Hua Securities Research

Exhibit 103: Net profit and forecast comparison

| Net profit	Unit	2015	2016	2017	2018	2019	2020E	2021E	2022E	2023E	2015-19 CAGR	2019-23E CAGR
Offcn Edu	Rmb mn	169	328	542	1,153	1,805	2,491	3,402	4,636	6,172	81%	36%
TAL	Rmb mn	530	815	1,024	1,641	2,554	2,644	4,458	6,843	9,925	48%	40%
EDU	Rmb mn	1,292	1,549	2,002	2,309	2,809	3,505	4,505	6,271	7,982	21%	30%
NP yoy												
Offcn Edu	%		94%	65%	113%	57%	38%	37%	36%	33%		
TAL	%		54%	26%	60%	56%	4%	69%	53%	45%		
EDU	%		20%	29%	15%	22%	25%	29%	39%	27%		

For TAL 2020E NP is still different from our published numbers as we adjust for other income to make it comparable with Offcn Education

Source: Company data, Gao Hua Securities Research, Goldman Sachs Global Investment Research

Exhibit 104: Valuation comparison with TAL/EDU

Ticker	Company	Ccy	Price	12-m TP	Current P/E(X)				TP implied PE			
			6/15/2020		2020E	2021E	2022E	2023E	2020E	2021E	2022E	2023E
002607.SZ	Offcn Education	Rmb	28.51	36.38	71X	52X	38X	28X	90X	66X	48X	36X
TAL	TAL	US$	64.8	64.0	99X	62X	41X	29X	98X	61X	41X	28X
EDU	New Oriental	US$	127.0	145.0	41X	32X	23X	18X	46X	37X	26X	21X

Source: FactSet, Gao Hua Securities Research, Goldman Sachs Global Investment Research

Exhibit 105: Offcn Education has higher ROE than TAL/EDU
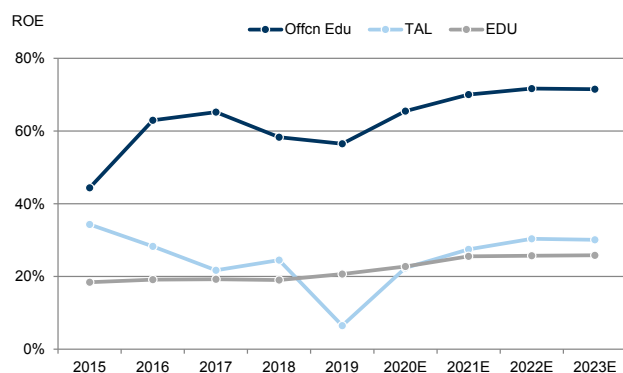
Source: Company data, Gao Hua Securities Research

Exhibit 106: ... and higher ROIC
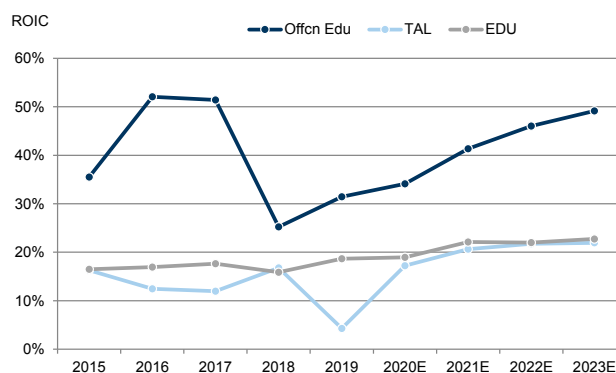
Source: Company data, Gao Hua Securities Research

Key risks

1. Civil servant admission numbers below expectation. We expect China's Civil Servant population to increase by 3.3mn in the next ten years, based on increasing urbanization rates. However, if the country's national and provincial governments adopt a leaner Civil Servant administration than we expect, leading to lower admissions per year, admissions exams would likely become more competitive, leading to higher refund rates for the company's contract classes, with a corresponding impact on ASPs and margins.

2. More intense competition leading to lower margins and higher sales expenses. Offcn Education is the dominant player in the public service admissions training market, and its leadership against the market's number-two operator has actually widened in recent years. However, we are also seeing new entrants like Fenbi Education, which is a pure online player that caters to the needs of online learning. If competitive environment intensifies and becomes characterized by lower pricing, it could impact the company's profitability or revenue growth. Moreover, Offcn Education is entering the vocational education market, where it is generally more difficult for the company to acquire students, compared with K12 or public service admissions training. While Offcn Education could leverage its large and deep-rooted sales network to acquire a small market share without spending too much on sales and marketing, if competition intensifies in this very fragmented market, Offcn Education may need to spend more on sales expense, hence impacting margin.

3. Policy uncertainty. The education industry is generally sensitive to policy. Though government policies have been supportive of the vocational education industry, any material change of policy could be a headwind to industry demand and development. In addition, Offcn Education's business is spread throughout the country and is therefore subject to potential education and training policy changes at the provincial level.

M&A rank

Across our global coverage, we examine stocks using an M&A framework, considering both qualitative factors and quantitative factors (which may vary across sectors and regions) to incorporate the potential that certain companies could be acquired. We then assign an M&A rank as a means of scoring companies under our rated coverage from 1 to 3, with 1 representing high probability (30%-50%) of the company becoming an acquisition target, 2 representing medium probability (15%-30%) and 3 representing low probability (0%-15%). For companies ranked 1 or 2, in line with our standard departmental guidelines, we incorporate an M&A component into our target price. An M&A rank of 3 is considered immaterial and therefore does not factor into our target price, and may or may not be discussed in research.

"Can": Our "Can" assessment measures the possibility of executing an acquisition if there is a bidder. Offcn Education is a large cap stock, with a founding team owning 75% of total shares, hence it would be very difficult for a potential buyer to acquire. Thus, we assign a score of 3 for this category.

"Should": Our "Should" assessment takes a fundamental view in justifying whether a company is an attractive M&A target for potential bidders. Offcn Education is in an attractive industry with promising growth and has market leading position. But the stock's high valuation likely makes it less attractive for a potential acquirer. Hence, we assign an M&A rank of 3 for this category.

"Would": In our "Would" assessment, we measure the strategic attractiveness of the assets as well as management's stance on being acquired. Management has not expressed any intention to be acquired, and we think the inclination to sell would be relatively low given the Chairman who started the business 20 years ago has clearly stated his plans to drive the company's growth. Hence, we assign an M&A rank of 3 for this category.

Accordingly, we assign an overall M&A rank of 3 to Offcn Education.

Exhibit 107: We give an M&A score of 3 to Offcn Education

Can					
Size (mkt cap $mn)	% Free Float	Comment	Mgmt voting power	Regulatory risk	Overall Score
25,370	13%	Founding team own 75%	75.0%	Low	3

Should				
Growth (NI 19-22E CAGR)	Industry positioning	Cost synergies	Valuation 2020E PE	Overall Score
37%	Leader	Low	69X	3

Would				Final Score
Strategic Appeal	Mgmt Stance	Overall Score		Rank (1-3)
Medium	Low	3		3

Source: Gao Hua Securities Research

Disclosure Appendix

Reg AC

We, Xufa Liao, CFA and Brian Dai, CFA, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Goldman Sachs Investment Research global Equity coverage universe

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