

## China Oriental Culture Group

### Competitive solution to professional training

#### to summarize...

- COC to acquire the largest one-stop online education platform with over 800k registered users at HK\$199.5m with profit warranty of RMB40m until 2013F
- Established B2B online training platform with 3 main operating units to provide large scale group education entrusted by government and associations
- Platform of advanced IT solution, comprehensive education content and solid client base that enables it to capture significantly high market share
- Market potential of RMB2.8b for CHRT at 62m civil servants and professional with upside potential of cross-selling non-mandatory content in the future
- Close related market of pre-exam training services for public service and professional title qualification exams
- Active industrial education resources integrator in automotive industry
- The acquired business is planning to expand in traditional TV media as both distribution and promotion channels with primary focus on after-class supplementary tutoring service to middle and high school students

**To acquire the largest one-stop online education platform with over 800k registered users at HK\$199.5m.** China Oriental Culture (COC) announced a major acquisition of an online learning platform last month. Initial consideration was set at HK\$199.5m. COC plans to issue 950m preferred shares at HK\$0.21 per preferred share to the vendor, who is the third largest shareholder of COC. Table 1 shows current financial of the target group. Total equity as of end of Jun 2012 was RMB24.0m. Upon completion, shareholding of vendor Lu Xing would increase to 35.2% from 6.7% upon full conversion if the consideration is not adjusted. If the target group recognizes RMB40m net profit for period until end 2013F and number of registered users is 1m+, COC will issue additional 950m preferred shares to vendor that his shareholding goes to 50.5%.

**Table 1. Target group current financial**

RMBm	FY12/10A	FY12/11A	1H FY12/12A
Revenue	1.3	14.4	6.6
Gross profit	1.3	6.2	2.8
Net profit	0.1	(0.8)	(3.1)
Total assets	12.7	34.5	36.3
Total liabilities	0.2	12.6	12.3
Total equity	12.5	21.8	24.0

Source: Circular

**Table 2. China Oriental Culture shareholders**

	Prior to completion and CB conversion	Full conversion after completion without adjustment	Full conversion after completion with adjustment
Ho Wai Kong	20.8%	13.3%	10.2%
Lie Hai Quan	8.6%	5.5%	4.2%
Directors	2.0%	1.3%	1.0%
CBs holder	0%	4.9%	3.7%
Vendor Lu Xing	6.7%	35.2%	50.5%
Others and public	62.0%	39.8%	30.4%
Total	100%	100%	100%

Source: SBI E2-Capital

Ticker	2371 HK
Rating	Not Rated
Price (HK\$)	0.345
Target Price (HK\$)	-
12m Price Range (HK\$)	0.16-0.62
Market cap. (US\$m)	89.5
Daily t/o (US\$m)	0.2
Free float (%)	63.5

#### Financial summary

Year to Dec	08A	09A	10A	11A
Turnover (RMBm)	24	13	15	38
Net Profit (RMBm)	(33)	(9)	(105)	(147)
EPS (RMB)	(0)	(0)	(0)	(0)
P/E (x)	-	-	-	-
P/B (x) pre-CB	-	-	-	-
EV/EBITDA (x)	-	-	-	-
Yield (%)	-	-	-	-
ROE (%)	0.0	(2.2)	(24.5)	(21.6)
ROCE (%)	0.0	(2.2)	(24.5)	(21.6)
N. Gear. (%)	Net Cash	Net Cash	5%	6%

Source: SBI E2-Capital

	11F	12F	13F
Consensus EPS (HK\$)	-	-	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	15.8	74.1	(17.2)
Actual price changes (%)	52.8	98.9	0.0



Source: Bloomberg

#### Research Team

(852) 2533 3700  
sbie2research@sbie2capital.com

**Established B2B online training platform with 3 main operating units to provide large scale group education entrusted by government and associations.** The target has effective controlling interest in the one-stop comprehensive online learning system, where the remaining interest is held by Government body. The target platform has currently 3 main operating units at various subsidiaries, including 1) 51% of China National Personnel & Talent Training Network (中国国家人事人才培训网) through VIE structure; 2) Exammm.com (考仕网); and 3) China Automotive Human Resources Training Network (国汽车人才培训网). The platform also form partnership with leading international education institution Berlitz and domestic leading magazine EXAM magazine (光明日报) that aims to provide high standard of training to civil servants and industry professionals.

**Illustration 1. Hyper-link from Ministry of Human Resources and Social Security to target asset website - CHRT**



The screenshot shows the official website of the Ministry of Human Resources and Social Security of the People's Republic of China. The header features the national emblem and the ministry's name in Chinese and English. Below the header is a navigation menu with categories like '政务公开' (Government Openness), '新闻动态' (News), and '最新文件' (Latest Documents). A search bar and a '站内搜索' (Site Search) button are also present. The main content area includes a '相关链接' (Related Links) section with a dropdown menu for '--部属单位网站--' (Subordinate Unit Websites). This menu lists several websites, including '中国国家人才网' (China National Personnel & Talent Training Network), '中国劳动保障新闻网' (China Labor and Social Security News Network), and '中国社会保障网' (China Social Security Network). The '中国社会保障网' link is highlighted in red. Other links include '中国劳动保障科研网', '中国技工院校和职业培训教育网', '中国人事科学研究所', '中国博士后', '留学人员和专家服务中心', '人力资源和社会保障部教育培训中心', and '中国继续工程教育协会'. To the right of the '相关链接' section is a '网上办事大厅' (Online Service Hall) with icons for '办事指南' (Service Guide), '在线查询' (Online Query), '在线申报' (Online Application), and '表格下载' (Form Download). Below this are logos for '国家外国专家局' (State Administration of Foreign Experts), '国家公务员局' (State Administration of Civil Service), and '中国政府网' (China Government Network). At the bottom, there are logos for '中国社会保障网' (www.cnss.cn), '中国国家人才网' (www.newjobs.com.cn), '中国组织人事报' (www.zuzhirenshi.com), and '中国劳动保障新闻网' (www.clssn.com). The footer states '网站主办：中华人民共和国人力资源和社会保障部' (Website Host: Ministry of Human Resources and Social Security of the People's Republic of China).

Source: SBI E2-Capital

**Platform of advanced IT solution, comprehensive education content and solid client base that enables it to capture significantly high market share.** Through the target asset, COC directed its major business focus to provision of online and education services and extended its effort for a management platform for the purpose. To begin with, the target group is the first mover in providing large scale, general education and trainings and performance management systems to central and local government departments, various government agencies, enterprises and other social organizations. At the same time, the target group built up its core competence in three areas: (1) self-developed patented software and systems to provide large scale online education and trainings to various organizations with customized control, review and management functions; (2) comprehensive education material database – more than 1000 in-house developed courses (over 6,000 hours) lectured by senior government officers, industry experts and leading academic professors; (3) solid client base with strong customer relations at high switching cost. The target has developed dozens of central and local government clients and is now servicing more than half million government staff for education, trainings and performance reviews. As all the training systems for each client are customized with different requirements and functions, and all the end users' past and current records are kept at the target's servers, it's very hard for an existing client to switch to another provider, considering all the extra time, staff, money and learning curve need to be committed. In short, the platform offers comprehensive online education and training service with performance management system such that a client (i.e. a government department or agency) can entrust for education for civil servants, professionals, technicians, and enterprise managers; and there is no obvious commercialized competitor in this area.

## Business of target group

## a) China National Personnel &amp; Talent Training Network (CHRT)

**Government-established professional e-training network in 2005.** According to web information, in 2005, Ministry of Human Resources and Social Security of PRC authorized China Training Center of Senior Civil Servants (中国高级公务员培训中心) to setup CHRT for the purpose of professional e-training network. In 2007 and 2008, the government issued 《关于加强专业技术人员继续教育工作的意见》 and 《公务员培训规定 (试行)》 respectively on continual education / training matters. Early 2009, there was restructuring that Beijing Eduion Education effectively held 51% of the operating asset. In the latest transaction, COC acquired a holding company that has control over the e-training network. Since 2009, with working guidance from State Administration of Civil Service (国家公务员局) and management of Ministry of Human Resources and Social Security, China Training Center of Senior Civil Servants inputs various elements such as training organization and self-made courseware which facilitates operation of CHRT. Since then, the target has spent extra effort in developing and upgrading its IT software to grow the customer base. At the time of this report, the target is the largest commercial operator providing online continual education to civil servants, professionals and technical staff, and enterprise managers, with registered users over 800k, of which over 450k are fee-paying users. According to regulation, it is the government's duty to arrange continuing education on an annual basis for public servants, professionals and technicians. It represents the target's current market potential in the near future.

**Market potential of RMB2.8b for CHRT at 62m civil servants and professional.** CHRT inputs include software design, hardware support, system maintenance, promotion efforts, course research, other courseware, etc. Integrating courseware advantage and IT support, CHRT is currently providing e-training services to considerable amount of civil servants. Table 3 shows the partial list of government bodies subscribing CHRT services, which can be found on web page. The largest body current has 376k registered users and 265k fee-paying users. While CHRT only recognized RMB6.6m in 1H 2012A, management indicated that most clients are still in its trial period in large scale online training to the population they are managing. This a normal practice for government departments and agencies before they start to use services on very large scale basis. During this stage, the population engaged and courses hours taken are relatively small compared to the whole scale. With 7m civil servants and 55m professional staff in China, if market share of CHRT goes to 20% in the future, it would translate into RMB620m revenue a year base on ASP of RMB50 per fee-paying users. While gross profit margin in 2010A and 1H 2012A 40% to 45% and operating expenses were not significant, with increased scale in the future net margin may be between 40% and 60%. In short term, if fee-paying users is up to 1m with ASP at higher initial ASP at RMB100 at 40% net margin, 51%-owned CHRT itself can generate up to RMB40m net profit, compared to RMB40m profit warrant for the whole target asset until 2013F.

Table 3. Partial list of government bodies subscribing CHRT services

Institution	Number of registered users	Number of fee-paying users
重庆专业技术人员继续教育培训网	--	--
内蒙古专业技术平台	--	--
内蒙古自治区人事人才培训网	--	--
重庆市公务员在线培训	--	--
赤峰市专业技术人员在线培训	--	--
海南省行政机关公务员培训网	--	--
海口市专业人员继续网	--	--
海口市公务员在线学习中心	--	--
新华社教育培训网	--	--
四川省专业技术人员在线培平台	--	--
晋煤在线学习中心	--	--
Others	--	--
<b>Total</b>	<b>857,018</b>	<b>460,552</b>

Source: SBI E2-Capital

**Upside potential of cross-selling non-mandatory content in the future.** Under management's current plan, the target's strategy is to become the largest and one-stop shop for online education in China. In fact, it has already started to consolidate some of its various training platforms into one integrated system (version 4.0). Once the end users on this integrated platform reach a certain level and the consolidation of new education contents are ready, the target will start to promote more value-added online education services directly to these end users. Civil servants and professionals are a very large group of middle to high level income earners in China. With high-quality contents available on the platform at attractive price, the platform can essentially provide cross-selling opportunities addressing such massive registered users. Currently, some of leading online education content providers are already in the process of joining the platform cooperation with Eduion, including Berlitz, EXAM magazine and exammm.com. Once all these are consolidated successfully, the business will reach a new level with enormous potential.

**b) Exammm.com (考仕网)**

**Close related market of pre-exam training services for public service and professional title qualification exams.** Exammm is an online education platform for candidates who are preparing for i) national civil service exam ii) local civil service exam iii) professional title exam and iv) occupation qualification exam. The website provides any time study opportunity for student with reputation tutors at an affordable fee. It also provides instant Q&A chartroom with online tutors for immediate study enquiry. Exclusive cooperation with China senior civil servant training center not only ensures quality of courses materials but also the level of course recognition. Illustration 2 shows an example of online study interface:

**Illustration 2. User friendly interface - Exammm**



Source: Exammm.com, SBI E2-Capital

Exammm's available courses can be grouped into two categories.

- **Civil service series** are courses designed for candidates who are taking national civil service recruiting exams or local civil recruiting service exams. Available courses include general civil servants exam, public instruction exam, police recruiting exam, and public social worker exam. Exammm offers in depth analysis and focused study materials prep for the civil exam. Study materials are self-developed with working guidance from State Administration of Civil Services (SACS).
- **Cooperated series** are courses designed for candidates who are taking professional title exams or occupation qualification exams. Courses include occupation equalization exams that organize and supervise by Ministry of Human Resources & Social Security of the PRC (MOHRSS), such as bank profession qualification exam, securities profession qualification exam; and professional title exam that undertake by MOHRSS, such as constructor qualification exams and certified tax manager exams (CTMA). Study materials are provided by cooperated content providers. Ever green education & consulting, who is a professional financial training company with clients from most of the top financial organizations of China, is one of the content providers of Exammm.

**Asset light business levered on market potential.** Civil service and professional qualification is a mass market with potential. Exclusive cooperation arrangement with reputation professional training as well as related governmental bodies are the 2 key elements to be build a successful platform for civil service exam and professional title exam. Pursuant to company management, the civil service exam series have a potential market size of 4m people, whereas the cooperated series have a potential market size of 10m people. If paid subscribers are up to 0.1m at ASP RMB500, cash income could be as much as RMB50m.

**Illustration 3. Current available courses on Exammm**



Source: Exammm.com, SBI E2-Capital

**c) China Automotive Human Resources Training Network (CAHRT)**

**Active industrial education resources integrator in automotive industry.** In 2011, the target company launched CAHRT under the witness of Mr. Shao Qihui, the former minister of ministry of machinery industry and Mr. Xu Songtao, the former minister of personnel ministry. CAHRT provides online courses under two business strategies, i) B2B and ii) B2C. B2B courses are specifically tailored for auto enterprises that provide continuous professional training courses to their existing staffs. B2C courses are decided for candidates/ existing professional pursuing higher qualification. Online courses include professional knowledge and skills training and occupation qualification ranging from manufacture, maintenance to sales and marketing in different certification level in the auto industry. Illustration 4 shows the lists of cooperation partners' member companies and target courses on CAHRT:

**Illustration 4. Lists of cooperation partners' member companies and target courses on CAHRT**

Source: CAHRT.com, SBI E2-Capital

**Exclusive cooperation with authoritative organizations.** Alike previous business models, CAHRT entered into exclusive cooperation with authoritative industry bodies, SAE-China and China Auto Talents Society, that cooperators acts as content providers and sourcing partners, while CAHRT inputs software design, system maintenance, promotion efforts etc. Background information of two major cooperators of CAHRT:

- **Society of Automotive Engineers of China (SAE- China)** is a professional automotive engineer professional qualification certification institute authorized by the China Association for Science and Technology. Established in 1963, SAE-China is the leading national and academic body corporate and a non-profit organization composed voluntarily by the industry and one of the initiators in organizing International Pacific Conference (IPC) on automotive engineering.
- **China Auto Talents Society (CATS)**, founded in 2005, is one of the major national non-profit organizations in Chinese automotive industry. The board members of CATS composed by automotive leaders from government, enterprise, universities and institutions. CATS offers comprehensive platform including integrating research, training, exchange and services for the industry professional.

**Fast growing industry with shortage of right talents.** Automotive industry is one of the fastest growing industry in the country with double digit growth rate annually. The number of the trained employees failed to catch up with the rapid growth of the industry leading to widened talent gap. The increasing standard requirement of the automotive sectors is the catalyst for the need of CAHRT's service. According to company management, there are currently more than 40m employees. If the number of paid users is up to 0.4m at ASP RMB150, CAHRT can generate up to RMB60m cash revenue.

**d) Up-coming exclusive cooperation with recognized organization to establish a comprehensive online platform.** Target company management saw the massive market potential in both language and national examination for high school students. Target Company entered into MOU to secure exclusive cooperation arrangement with leading enterprises in the industry. Details of cooperators:

- **Language - Berlitz** is a global leading language school with over 130 years of experience. Berlitz training courses cover 52 different languages.
- **National examination - EXAM magazine (光明日报)**, founded in 1983, is the sole leading magazine on course supplements and exams issued by the central government level agency under Guangming Newspaper group. EXAM magazine provides exams update, recent trend and exam focus for middle school and high school students and teachers with over 600,000 monthly subscribers.

**Illustration 5. Exclusive cooperation with EXAM magazine and Berlitz**



Source: CAHRT.com, SBI E2-Capital

The acquired business is planning to expand in traditional TV media as both distribution and promotion channels with primary focus on after-class supplementary tutoring service to middle and high school students. According to management, a much more aggressive strategy has been carried out to integrate traditional media (i.e. TV, broadcasting) with Eduion's online education platform. The logic of this move is that TV media is still the largest content distribution channel in China, which will be a new income stream for Eduion's education contents and at the same time, will serve as a great promotion channel back to Eduion's online service.

**Table 4. Profit and loss summary**

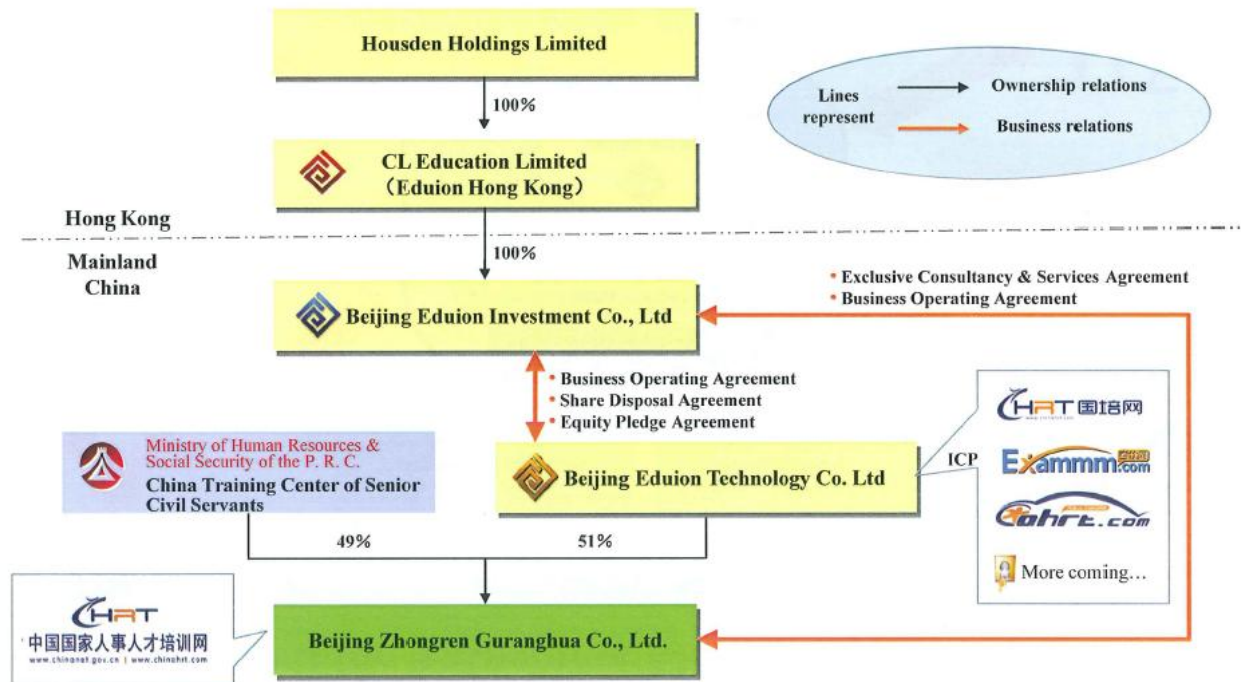
RMB m	FY12/09A	FY12/10A	FY12/11A	1H FY12/12A
Revenue	13	15	38	13
Cost of goods sold	(13)	(48)	(82)	(38)
Gross profit	0	(33)	(44)	(25)
Operating expenses	(38)	(40)	(68)	(24)
Other expenses	28	(32)	(35)	(2)
Profit before tax	(9)	(106)	(147)	(51)
Income tax expenses	(2)	0	0	0
Total net profit	(9)	(105)	(147)	(51)

**Table 5. Balance sheet summary at period end**

RMB m	FY12/09A	FY12/10A	FY12/11A	1H FY12/12A
Non-current assets				
Property, plant and equipment	4	10	11	11
Intangible asset	0	646	653	634
Other non-current assets	30	18	20	20
Current assets				
Trade and other receivables	8	23	38	37
Bank balances and cash	85	42	18	6
Other current assets	56	46	11	9
Non-current liabilities				
Convertible loan notes	0	73	38	33
Current liabilities				
Trade and bills payables	12	20	10	24
Other current liabilities	2	6	30	29
Equity				
Total equity	170	686	674	631

Source: COC

Illustration 6. Target company structure illustration upon completion



Source: COC, SBI E2-Capital

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