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Investors increasingly interest in China

Private equity and venture capital have been showing increasing interest in China's private education market over the last couple of years and seeing huge potential. Recently, the Huiou (Chongqing) Education Equity Investment Fund (Huiou), the first of its kind in China, was launched in Chongqing on December 27, 2009, to seek out education-related firms engaged in the cultural and media sectors as its main investment targets.

The fund plans to raise a total of RMB 5 billion (US\$735 million), with RMB 200-500 million (US\$29-74 million) for the first phase and RMB 2 million (US\$0.3 million) as a fund unit, with an operating period of 5+2 years. Huiou investment director Roger Wang says that the fund currently focuses on mature educational organizations at pre-IPO stage with good business models and management teams.

Wang said the fund has set its eye on early education for children from 1 to 6 years old. There are numerous private kindergartens in China, and Huiou's selection criteria is whether the kindergarten has successfully built and managed its brand and then duplicated its successful business model in another city or region.

China's education sector has become attractive to domestic and overseas investors in recent years, especially after the outbreak of the financial crisis, thanks to the country's large population base and rapid economic development, as well as the stable cash flow and counter-cyclical business nature of educational organizations.

Statistics from China Venture, a leading research and consulting institute focusing on China's VC/PE investment industry, show that during the 12 months from December 18, 2007, there were 30 investments in the education sector, valued at US\$474 million, a leap from 18 and US\$284 million during the same period 2006/2007.

The student population in China, from primary school through university level, makes up 17% of the world's total, but China's current educational market share, in value terms, makes up a mere 2%, according to the World Bank's 2007 report entitled "Enhancing China's Competitiveness through Lifelong Learning." Chinese households' educational expenditures have ample room to grow. Compared to Japan, where spending on education accounted for 34.1% of total household income during 2007-2008, it equaled only 17.8% of the total service expenditures in Beijing.

The swift development and structural change in China's economy motivate professionals and fresh college graduates to continue to acquire new knowledge to meet career challenges, Wang says. "Millions of Chinese college graduates every year can not find jobs. They need more professional training to be qualified and employed. This market alone already shows enormous potential."

The urbanization process is also pushing rural workers to equip themselves with new skills. "Preparing the huge rural population flowing into the cities by providing them vocational education is also a huge market," says Wang.

The Chinese education sector is traditionally controlled by the government. Most students receive their education at public schools and universities, which does not always equip students with professional skills meeting the needs of prospective employers. Private schools are playing an increasingly important role in filling the gap and are proliferating at the rate of 20% to 30% annually, and attracting private equity and venture capital from home and abroad.

The education industry's counter-cyclical nature and stable cash flow especially beckons investors during an economic down-turn.

That World Bank report shows that the education sector often outperforms other sectors during a recession as people have more spare time and a stronger need to prepare for further career development when the economy turns around.

Prepaid tuition fees provide stable cash flows, different from other business sectors that often face payment risks and long cash conversion cycles. What really interests private equity investors, however, are education organizations with light assets and high earnings growth, such as online education, rather than traditional schools, which often reinvest and lock up profits in new fixed assets, such as new facilities, classrooms and buildings. Wang says, "The light asset business model generates higher returns and faster growth of profits, which can be fostered by a public company in a short-timeframe, though this kind of organization accounts for only around 10% of the education sector in China."

Given the traditional mindset of government-run education that prevails in China, bringing together educational organizations and capital markets remains a challenge. So far there is not one real educational organization with an A-share listing in China. Those that have gone public have chosen overseas listing, such as the New Oriental Education & Technology Group and Noah Education Holdings, Ltd., on the NYSE.

This is set to change. Chongqing's municipal government has expressed a special interest in the start-up Huiou Fund. At a higher level, education, as part of domestic consumption needed to drive China's economic development, will continue to gain government support in 2010 and beyond.

ChiNext, the growth enterprise board launched last October, has established a good circular model of private equity placement, investment and successful exit at maturity. "There will be private educational organizations listed on ChiNext in the future," said Wang.

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