“Asia Education” Investments chat with Geoffroy Wallier, Managing Partner of Hong-Kong based Orfi Capital

Could you give us a bit of background about your firm and the Asia Education Certificate?

Our firm was created five years ago to leverage our long and good knowledge of the Asian market. The partners have each worked more than 10 years in the financial markets in Asia and have learned to understand a vast array of Asian companies, we have also developed very good contacts with firms as well as market players over the years.

With RJ Management, we have identified a few themes which are paramount to the future of China and fundamental for most Asian countries. Themes which both drive strong government interest and high individual spending. Education is essential for every Chinese family, particularly with the one child policy until very recently. All Asian families invest heavily within their means to make sure their children can have a better future. This is not only economic but also cultural. In China only, 18M students graduate from university every year and numbers are growing. English education is one of the fastest growing segment. According to the Social Survey Institute of China, in 2017, China's English training market totalled 489.7 billion yuan ($72bn), growing 296 percent year-on-year. The market is estimated to reach 947.2 billion yuan in 2019 ($140bn).

The certificate has been experiencing a very hard S2-2018 due to “China’s private Education promotion Law”. What is the impact of this new law on the portfolio’s companies?

The new law, which is still not enacted, would forbid most schools K-12 (compulsary education) to grow through M&A. This had an impact on valuation as the market panicked and thought that growth was over for Chinese Education companies and thus sold their stocks. The top 5 Chinese Education stocks by market capitalisation went down of 38% in average in the second half of 2018, while the certificate went down of 28.6%.

The implementation of the new law should benefit the larger players. We see the new law as a confirmation of the Government’s strong interest for the sector, which is a long-term commitment. Beyond the education theme, the Chinese stock market is known for its high volatility (the CSI 3000 Chinese equity index was down 27% in 2018 and up 22% YTD) and it is important to understand how to ride the cycles. Furthermore, as two of the main education stocks are listed in the US (Tal Education Group and New Oriental Education), they are particularly sensitive to swings from US operators who trade during US hours and look for Chinese stocks they can trade. The impact works both on the negative and the positive side.

As of the the 19th of June, the 2019 performance is up +23.8%? How can you explain such a positive reversal?

The market started to realize two things:

1/ China had been heavily oversold by panicked international funds who thought that the trade war with the US would destroy the Chinese economy. Although the trade war has and will continue to have an impact, China net export position is less than 2% of GDP (down from 7% in 2006) and gross exports to the US represent only 4.5% of GDP. China's biggest market is by far its internal market. The market is still sensitive, though, to the trade negotiations between the US and China and particularly to surprise announcements. It is important to keep a clear mind when those events occur.

2/ Education companies particularyl in China showed revenue increases despite the new law, mostly organic growth thanks to higher enrolment, as the demand for better education is pressing and constant. As an example, among our largest positions, Tal Education revenues grew 49.4% yoy in 2018, New Oriental revenues grew 36% in 2018, Yuhua's revenues grew 41.2%. When the market went into nose dive in 2018, we understood that the market was over reacting. We decided to focus on some of the larger caps which are more difficult to move and also on tutoring activities which are less sensitive to new laws. This enabled us to lessen the negative performance and over perform the market by 10% in 2018 and allowed us to pick up the upturn in 2019 and perform well again.

Photo: New Oriental Education Group, Beijing HQ

More than 75% of the geographical exposure is in China, while Australia, Japan and Korea count for 24%. Why keep these "small" positions vs. focusing solely on Chinese companies?

"The Education theme is here to stay and large companies will continue to grow, particularly in China."

The certificate is an "Asian certificate" rather than a "Chinese certificate". China is a volatile market and other investments allow us to own stocks with a more classic behaviour. The education theme is very valid for all of Asia where competition is fierce and parents push their children hard to succeed. We have invested in companies with great potential. As an example we invested in IDP, a very successful Australian company specialised in students placement all over Asia which is up 60% YTD.

Do you consider this investment as an opportunistic approach or long-term conviction-based investment?

There will be a lot of ups and downs as there has been in the last years in the Chinese market. The key is to do two things:
1/ be ready to ride the movement without panicking knowing that the Chinese economy continues to grow strongly and China represents a sound investment in the long term
2/ Choose the right sector, ones not too exposed to international pressure and are fundamentally important to China and Asia.

The Education theme is here to stay and large companies will continue to grow, particularly in China. This is a fundamental long-term position. We also view China's strong willingness to support its economy, as a source of long-term stability.
Besides, we see wide and quick price moves as an opportunity to tactically average in or out of positions.