PITT STREET RESEARCH

Retech Technology Co. Ltd.

Fast-growing EdTech play

Share Price: A$0.40

Valuation range: A$1.19-1.49

ASX: RTE

Sector: Consumer Services

11 October 2019

China-based Retech Technology (ASX:RTE), creates and distributes e-Learning solutions to corporates such as Mercedes-Benz, McDonald's, Bank of China and Huawei. RTE is one of China's leading online training program providers leveraging its technology to deliver these solutions across platforms, i.e. the Internet, mobile phones, and social media.

Entry into new verticals to leverage existing IP

RTE has recently acquired a Melbourne-based language school to leverage its existing knowledge of live-streaming classes. Through its new joint venture (JV), RTE has expanded into new geographies beyond China. It is also developing a Software-as-a-Service (SaaS)-based, subscription-only platform for Environmental, Social, and Corporate Governance (ESG) courseware. The new verticals and regions are expected to provide a significant revenue jump, with an expected 5-year Compound Annual Growth Rate (CAGR) of 11% in the global e-Learning industry.

Operational synergies to drive margin expansion

As RTE leverages existing content for new corporate clients, its platform for SaaS services and technology (Intellectual Property (IP)) for live-streaming operations, it is expected to drive operational synergies and profitability.

Valuation range of A$1.19–1.49 per share

We have valued RTE at A$1.19 per share in our base case and A$1.49 in an optimistic case, using a blend of DCF and relative valuation. Our assumptions are based on an increase in repeat projects using existing tech for expansion across new verticals and the inclusion of a subscription-based revenue stream via the ESG vertical.

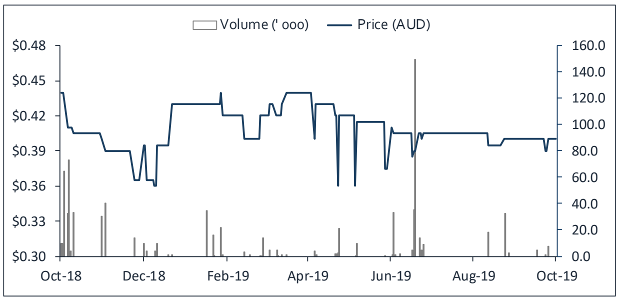
Year to Dec (AUD)[1]	2017A	2018A	2019f	2020f	2021f
Sales (m)	20.5	26.9	35.4	46.6	61.8
EBITDA (m)	9.1	12.8	15.1	20.0	26.6
Attributable Net Profit (m)	7.6	10.2	10.4	15.2	20.5
EBITDA Margin	44.3%	47.4%	42.5%	42.9%	43.0%
RoA	15.4%	17.5%	13.8%	16.8%	18.5%
EPS	3.78c	4.40c	4.46c	6.51c	8.80c
DPS	0.00c	0.00c	0.50c	0.65c	0.88c
EV/Sales	5.1x	3.1x	2.1x	1.3x	0.8x
EV/EBITDA	11.6x	6.6x	4.9x	3.1x	1.8x
P/E	12.6x	9.8x	9.0x	6.1x	4.5x
Dividend yield	0.0%	0.0%	1.3%	1.6%	2.2%

Source: Company, Pitt Street Research

Market Cap. (A$ m)	93.2
# shares outstanding (m)	232.9
# shares fully diluted	249.3
Market Cap Ful. Dil. (A$ m)	99.7
Free Float	50.2%
52-week high/low (A$)	0.54 / 0.36
Avg. 12M daily volume ('1000)	13.6
Website	www.retech-rte.com

Source: Company, Pitt Street Research

Share price (A$) and avg. daily volume (k, r.h.s.)



Source: Thomson, Pitt Street Research

Valuation metrics	
Fair valuation (A$)	1.19-1.49
WACC	11%
Assumed terminal growth rate	1% - 2%

Source: Pitt Street Research

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[1] Values in RMB are shown in the Appendix.

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I. Moving towards a recurring revenue model

RTE provides course content in the form of software that entails a one-time payment. The one-off consulting and platform designing projects are also charged in the form of a pay-as-you-go approach. Following the recent entry into SaaS for its ESG learning solutions, RTE will now also start earning a subscription-based revenue stream. The new model is expected to reduce volatility and bring in a more stable recurring revenue stream. This transition is expected to lead better recognition from investors, who value a stable and consistently growing revenue source.

II. Highly scalable business model drives margins

RTE's unique proposition is its technical advancement in making courseware available across platforms, which we believe is a highly scalable model. Highly customised solutions and Learning Management Systems (LMS) are indispensable to users; therefore, RTE often gets recurring projects. By offering customised solutions, the company generates a relatively high net profit margin (average of the past two years is 36.3%). We anticipate this to further expand by approximately 650 basis points[2] during 2019E-24E, given its fixed cost base and wider spread across geographies and domains.

III. Leveraging technology to expand into adjacent domains

In June 2019, RTE acquired a Melbourne-based language coaching school with several teaching bases marking its entry into a different but related domain. RTE aims to leverage its delivery platforms and tools for live-streaming of cross-border language training. We believe that aided by a cash-rich balance sheet, RTE can make further similar acquisitions to enter unfamiliar but related domains, thereby expanding its high-margin revenue base.

IV. Expanding rapidly across verticals and the APAC region

1) **Growth within China**: The corporate online education and online vocational education markets in China have been growing at a ~20% CAGR over the past five years. RTE has been expanding its wallet share within existing industry segments i.e., retail, finance, tech, and autos. RTE has also ventured into new verticals, i.e. ESG and language coaching. In our opinion, this is expected to further broaden the company's commercial base within China.
2) **Regional expansion**: After China, RTE is extrapolating wider geographical reach and has formed a JV with Japan's leading e-Learning solution company. Eventually, the company aims to cover most of the Asia Pacific region. Through its experience of working with large multi-national companies and government agencies, as well as well-established partners, RTE should be able to achieve this goal without much difficulty. As the global corporate e-Learning industry is expected to grow at a five-year CAGR of around 11%, we expect the new JV to present a substantial growth opportunity for RTE and act as a catalyst for strong future revenue growth.

V. One of the cheapest EdTech players on the ASX

We believe RTE's current valuation does not accurately reflect its growth potential. It is one of the least expensive investment opportunities within the high-growth EdTech industry. Our revenue and profitability forecasts – based on the new operating model, regional expansion, and domain growth – indicate a significantly higher value.

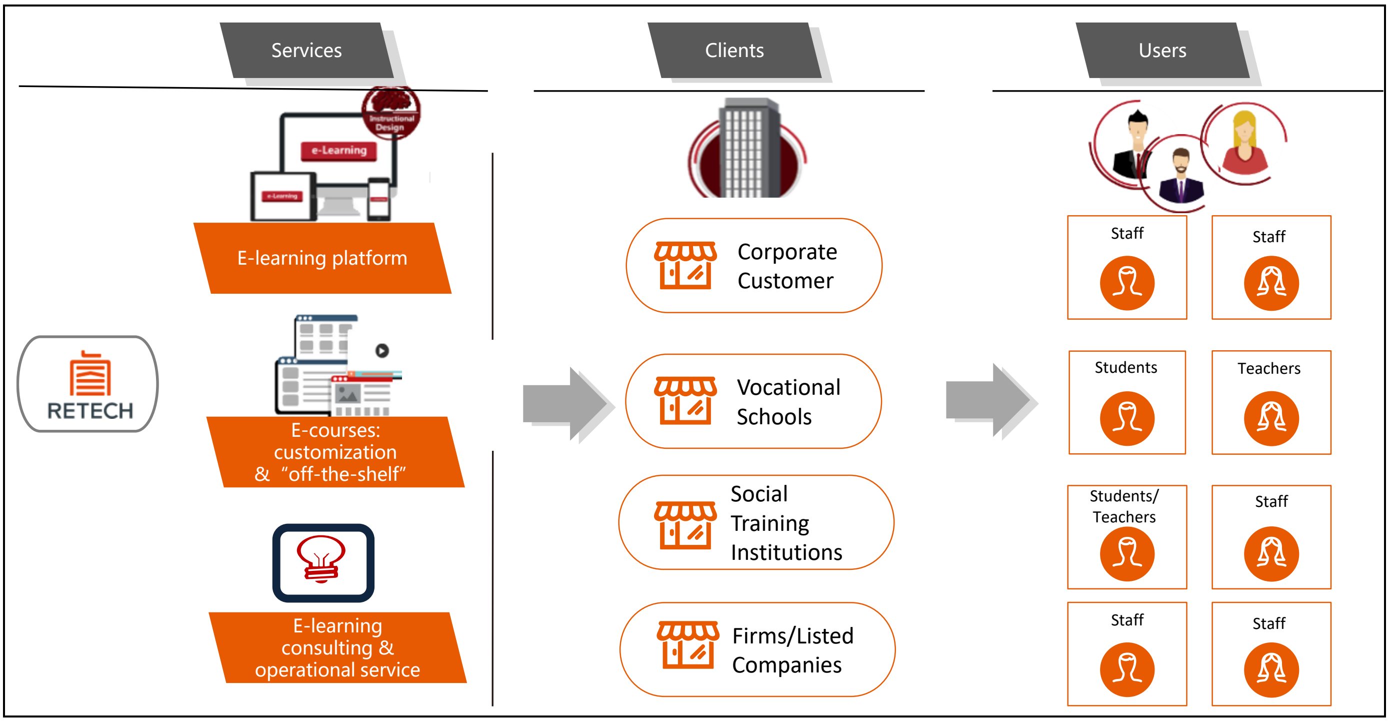
[2] 1 basis point = 0.01%

Leaders in the e-Learning solutions industry

China-based and ASX-listed, Retech Technology (RTE), creates and distributes e-Learning solutions to corporates across industries in China and Australia, such as Mercedes-Benz, Bank of China, Huawei, and Sephora. RTE is one of China's leading digital training programme providers leveraging technological advancements to deliver these solutions across platforms, i.e. the Internet, mobile phones, and social media.

The company provides an integrated LMS through its customised e-Modules and subsequent system integration (Figure 1). RTE is involved in designing e-Courses, creating e-Learning platforms, producing off-the-shelf training modules.

Figure 1: RTE's e-Learning solutions – business process



Source: Company

RTE is a leading service provider in a highly fragmented but exponentially growing Chinese e-Learning solutions industry

RTE also customises and digitises offline modules using its distribution platforms in order to enable the delivery and accessibility of those training programmes online and on demand through secure, dedicated portals.

Unlike most of its competitors, RTE is not a mere content collaborator but a provider of a comprehensive e-Learning solution ecosystem. Its unique speciality lies in developing an integrated training programme delivery platform using instructional design. The company primarily builds content in-house through an experienced and professional team, leveraging more than 100 intellectual property rights and delivers that content using its proprietary infrastructure. Presence across the value chain, from original content to multi-platform delivery tools, has helped RTE build a national footprint and strong connections with a diversified client base across several industries. RTE's long-held good reputation with its varied clientele helps them to secure repeat orders for customised learning modules, along with other one-time software designing and IT consulting work.

The main highlights of the company's learning platforms include multi-layered user management, multi-lingual functionality, review process setting and an online examination engine. The unique features of the courseware include multi-platform adaptability, a dynamic component which can be used among different courses, system simulation, and 3D videos.

Operating Verticals

The company has structured its operations under four main business verticals:

- **Corporate**

  This is the single biggest commercial vertical for RTE. The company started its operations by offering courseware and platforms to Chinese corporate and government organisations across the auto, financial, retail, and technology industries. The e-Learning business operations of RTE revolve around designing and building e-Learning platforms and e-Courseware-related projects for corporate organisations.

  RTE's client list includes Mercedes-Benz, McDonald's, Huawei, state-owned Bank of China, and Zara

  RTE maintains a deep, strategic, and co-operative working relationship with its widespread and diversified client base. Deep-rooted relationships with corporates within a sector support expansion to other similar companies. Also, RTE is able to secure projects from different arms of the same organisation as multi-national companies employ RTE to design learning solutions/platforms for diverse locations/languages, multiple departments, etc. RTE is able to leverage the long-standing relationships, especially during the vendor assessment tendering process used by nearly all state-owned enterprises. The high level of engagement with clients is one of the primary reasons behind **RTE's achievement of ~47% of revenue (2016–18) from recurring projects.** Between 2016 and 2018, RTE had a total of 190 clients, of which 44 (~23%) were repeat clients.

- **Vocational**

  RTE has been assisting vocational training institutes to advance their online education systems. The company has been instrumental in integrating the offline curricula of these institutes with online interactive courses being delivered over its platform. The aim is to align users with workplace-specific skills and knowledge through a cost-efficient and interactive system. RTE is proceeding from O2O mixed training to provide new talent cultivation solutions for secondary and higher vocational schools, on the one hand, and provide truly qualified talents to enterprises on the other hand.

  RTE has advantageously positioned itself as an integrated solution provider of 'industry and education'

  Language Learning

  In 2018, RTE entered the language school space through the acquisition of a Victoria-based private Chinese language training institution. The company's new operations include providing English education services, along with online learning material, in China. RTE is also focussing on using its proprietary technology to provide high quality live streamed language classes.

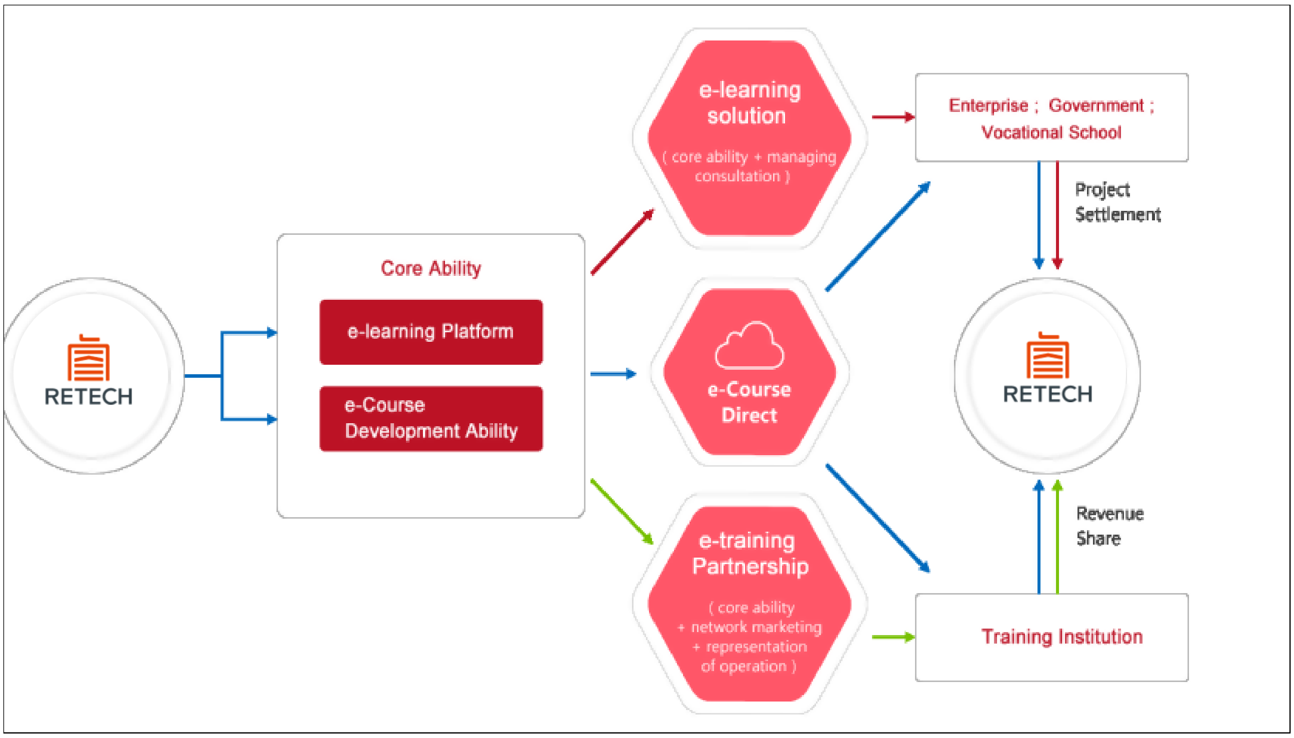
- **Environmental, Social, and Corporate Governance (ESG)**

  Through its 90%-owned subsidiary, Prosage Sustainability Development Limited (Prosage), RTE recently initiated a vehicle to develop e-Learning modules for ESG compliance training. The operational structure of the ESG platform is expected to include courseware related to ESG concepts and its reporting. We believe that as corporates are increasingly required to become ESG compliant, this business vertical will provide a significant growth opportunity for RTE in the medium to long term.

Multiple delivery platforms facilitate multiple revenue streams

To provide a comprehensive e-Learning solution to its different clients, RTE uses all-inclusive, blended delivery channels that enable mass distribution and easy management of programme modules. These include customised modules and off-the-shelf offline training content completely integrated into the client organisation's LMS. These multi-channel delivery processes (Figure 2) enable multiple streams of revenue and earning capabilities — such as software licensing fees, e-Learning platform development fees, consulting fees, LMS maintenance services, and revenue from digitisation and customisation of e-Course content.

Figure 2: RTE's operating model



Source: Company

Currently, each solution is created on a one-time project basis; hence, the price has to be renegotiated with the client for every task, keeping in mind the differentiating factors, i.e. scope of the project, timelines, value proposition, and involvement of RTE's intellectual property. This provides RTE the scope to add value with each project, the possibility of repeat work and drive margin enhancement with every upgrade.

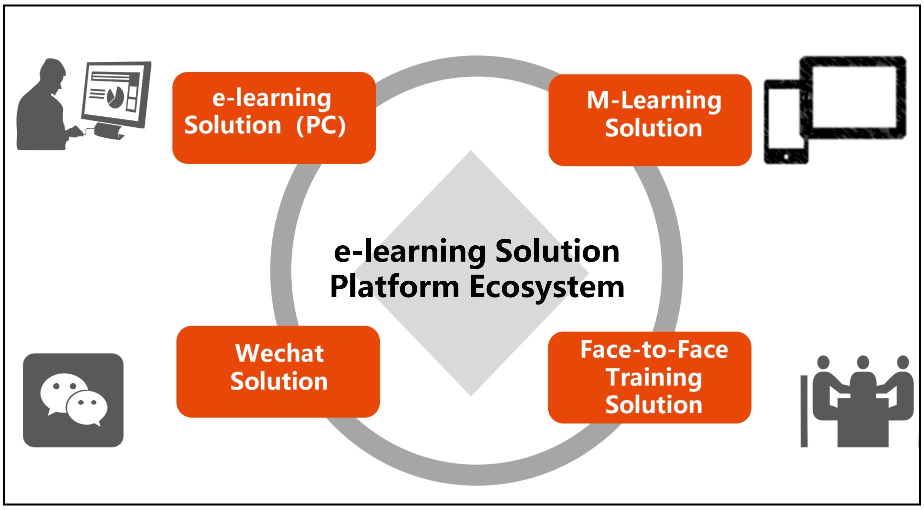
1) E-Learning Platform Solutions

The online platform is the foremost channel of RTE's learning module delivery, comprising a complete blended electronic distribution through a combination of PC, mobile, social media apps, and face-to-face live-streaming tools (Figure 3). These platforms have functions such as Q&A, social learning, and interactive videos to keep the programme user-friendly and simultaneously accelerate the learning process.

RTE is a leader in designing these platforms and adds much in terms of value proposition for its clients, i.e. big data collection, data analytics, and Artificial Intelligence (AI)-based adaptive learning technology, etc. This leads to target knowledge push based on the learners' competence and makes the users' LMS fully competent and adaptive to changing requirements.

RTE's traditional business platform means the revenue stream includes e-Learning platform development fees, software licensing fees, consulting fees, integrated system designing fees, and LMS hosting and maintenance fees.

Figure 3: E-Learning platform solutions



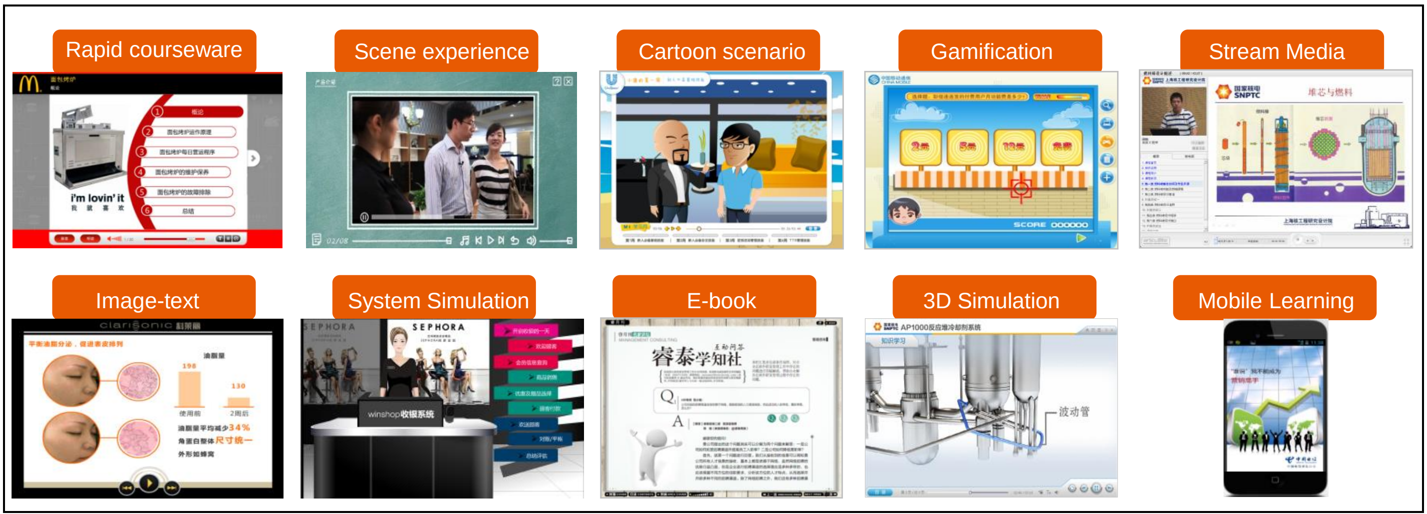
Source: Company

2) Customised and 'off-the-shelf' courses

RTE uses its proprietary e-Learning instructional design to create courseware. The e-Modules that are designed and produced possess different characteristics

- **Customised Solutions**: RTE provides clients with different course materials that can be tailored to their needs. RTE develops on the existing content provided by the partner to produce specified and customised content. Each module is divided into various categories depending on the progress of the user and is presented in different forms, i.e. gamification, video, or interactive text, etc. (Figure 4).

Figure 4: Different customisation options for e-courseware

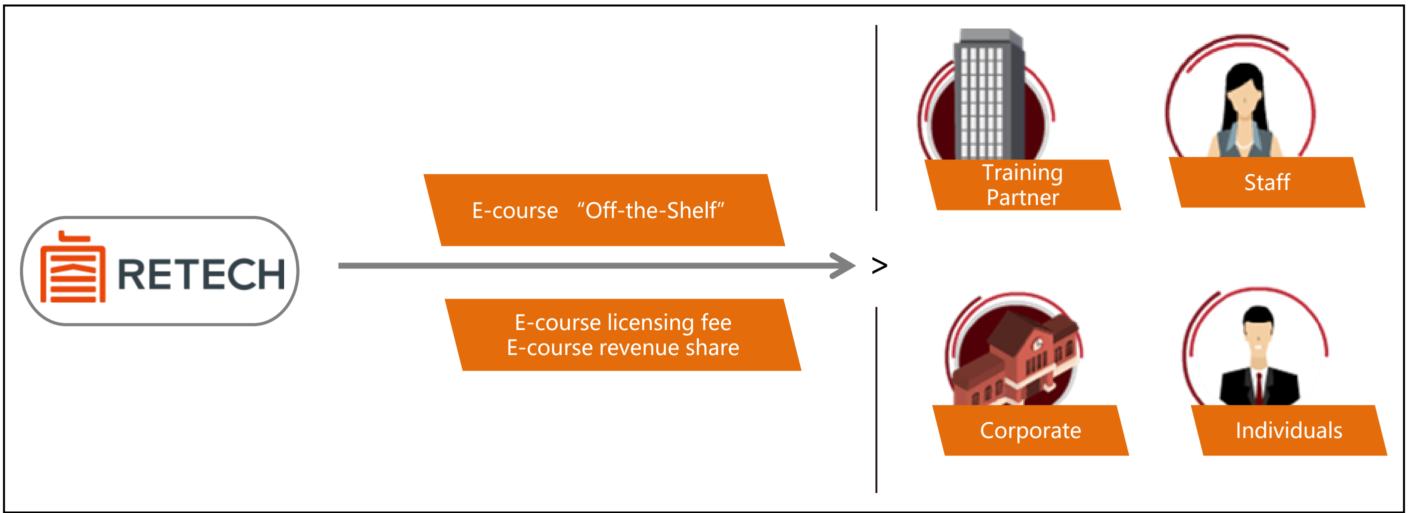


Source: Company

- **'Off-the-shelf' courses**: This is generalised courseware that could be applied to most industrial cases. These e-Courses are primarily developed in-house by RTE using proprietary IP and are mainly in the form of animations and videos.

  RTE's cloud centre is designed to distribute these courses directly to the clients (Figure 5). The company also partners with existing clients to push these courses on their platforms. Apart from the revenue share from any potential courseware distribution partnerships (deducting the fees paid to the original content provider), revenue under these direct distribution business channels primarily comes from e-Course licensing fees.

Figure 5: Direct distribution business process



Source: Company

3) **Consulting and operational services**

RTE undertakes several consulting and operational service assignments for different clients. This line of operation includes provision of a team of experts to engage with the client at the pre-designing/pre-vendor assessment phase and to suggest optimal solutions for their e-Learning/LMS requirements. It does not always result in a platform/e-Course material development project, but it still amplifies a separate high-margin revenue source.

While consulting and operational services can be labelled as supplementary operations, RTE gains immense knowledge and understanding of the various requirements of corporates within a particular industry. Thus, this process acts as both a knowledge base and a revenue stream for RTE.

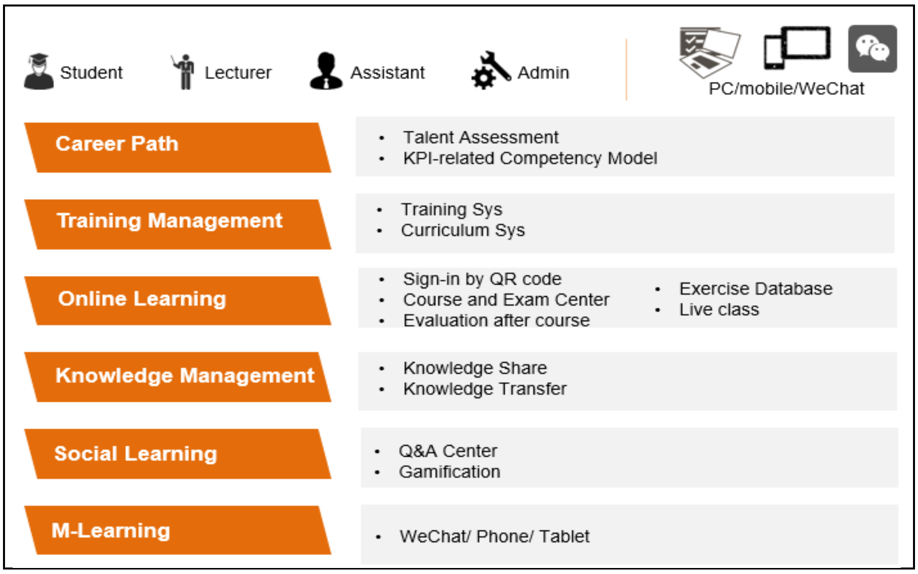
Solution design and delivery structure

Integrated platform design driven by proprietary technology

RTE's e-Learning platforms are designed in a way that the solutions are comprehensive and updated (with regard to technology and usability). Some of the salient features include facilitation of integration with the corporate's existing LMS, multi-user functionality, and international multi-lingual function, etc.

The rationale behind any platform design remains the same, i.e. learning can be done at any time through multiple modes. RTE deploys a multi-channel approach for content delivery which includes PCs, tablets, mobiles (both iOS and Android), eBooks, WeChat integration, and gamification.

Figure 6: Advantages of RTE's platform solutions



Source: Company

By using multiple delivery channels, RTE is able to attract a high degree of engagement by catering to the various learning needs of different types of learners. Additionally, RTE's e-Learning platform solutions are highly robust with regards to meeting clients' various corporate training needs by offering training management, examination organisation, score statistics, performance assessments, and promotions, etc.

Substantial potential to scale up and leverage its platform

In our view, combining the numerous learning and training solutions mentioned above with its multi-channel delivery capabilities, unlocks substantial scalability potential for RTE. For instance, RTE can seek new clients by offering to upgrade their existing LMS to include multiple channels for content delivery. Similarly, the company can seek additional business with its existing clients by offering to expand their current systems to incorporate additional online training management solutions.

Notably, RTE's solution deployment also provides greater flexibility in integrating with clients' LMS architecture. Since the company offers services based on independent functions, rather than the entire system, the clients have the option of customising their systems as per their requirements and manage costs accordingly. Additionally, RTE boasts of strong encryption and anti-hacker technology, an indispensable requirement for corporate clients, especially those in the financial services industry. We believe that these factors will support RTE to further penetrate the corporate vertical market.

Furthermore, in keeping pace with the fast-evolving trends in which students consume content, RTE incorporates social learning and gamification in its platform solutions. Through the WeChat learning platform, RTE provides micro e-Courses that support learning via digestible size content that can be consumed anytime and anywhere. Moreover, since the content is in the form of small and interactive routines, it can be easily integrated with existing applications of clients, and does not occupy much storage in the mobile phones of users.

The WeChat platform also supports interaction between learners by building a social community and deploys gamification functions to activate the interest of the students. Gamification strategies such as online 1-on-1 knowledge contests and ranking boards stimulate the learning interest among students.

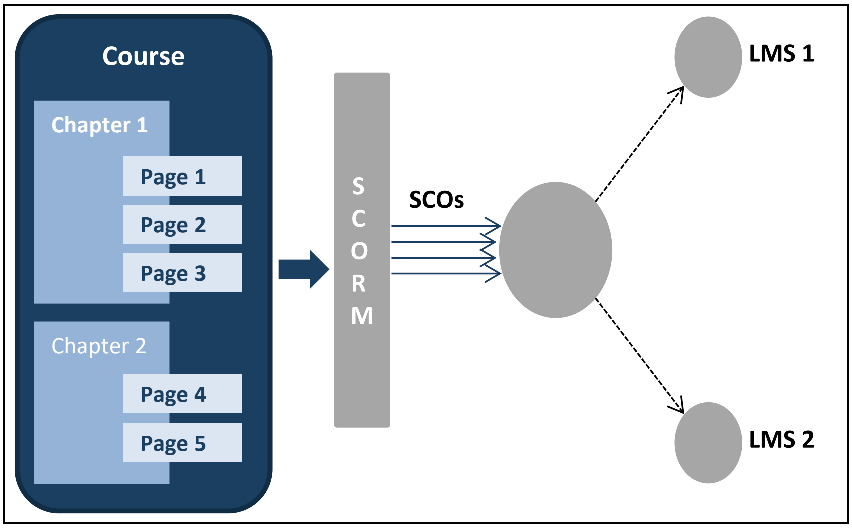
Instructional content design using intellectual collaboration

The company's e-Courseware customisation takes a number of forms, including virtual reality, 3D, video, animation, and gamification

While designing customised learning content for its clients, RTE uses an instructional design based on a concept of performance-oriented e-Learning. The structuring and designing of the module is done in a way that the student has a higher degree of participation. The related functionality includes topic relevance, self-management, problem solving, and learning at one's own pace. The student's interest and engagement are given the utmost priority through interactive instruction, practice, and feedback options.

All the modules are developed in conformance with international standards, such as those of the Sharable Content Object Reference Model (SCORM) and the Aviation Industry Computer-based training Committee (AICC). As it follows a design that is compliant with international standards (Figure 7), RTE's courseware can easily be integrated into clients' existing training delivery platforms. This makes RTE a preferred vendor for most corporates.

Figure 7: SCORM: Global e-Content technical standard



Source: Atomi Systems, Pitt Street Research

Over the years, RTE has amassed more than 110 intellectual property rights and established collaborations with five universities for development of a content designing model

RTE has an in-house team of experienced professionals that undertake instructional design of the training material delivery platforms. Driven by focus on quickly learning, and adopting the latest industrial developments taking place in both the domestic and foreign markets, RTE has also established research labs. Since 2012, the company has jointly established laboratories for instructional design with five leading universities: Beijing Normal University, Capital Normal University, China Normal University, Central China Normal University and Shanghai International Studies University. The team is consistently involved in developing new methodologies to prepare updated and user-supportive learning material, based on research papers, and new courseware design models in collaboration with these labs. RTE's team have been ahead of the curve by implementing new technologies, such as 3D, Augmented Reality (AR) and Virtual Reality (VR).

One of the best practices followed by RTE is the standardisation of design methodology for e-Course materials, for which the company has established its own Quality Management System (QMS). There is a Project Management Officer (PMO) for every project who appoints a specialist to manage and monitor the project performance and delivery. At all stages of project planning and execution, the specialist is expected to control the quality of the e-Learning solution.

Phase-wise delivery structure ensures quality control

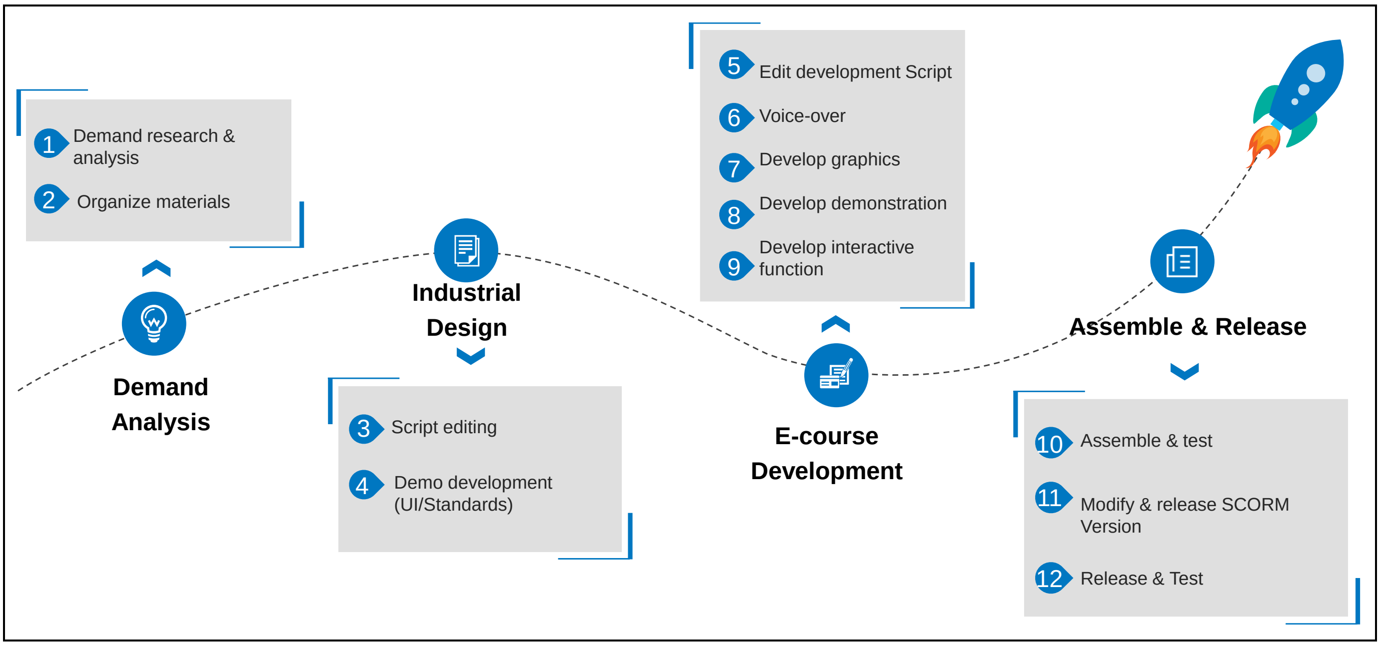
Customer oriented R&D facilitates delivery of quality solutions

RTE has a robust delivery structure for all its e-Learning platform solutions, with the company following a phase-wise delivery structure for all its projects. At every stage/phase (Figure 8), RTE consults with the client to ensure the progress is in line with expectations. This not only ensures that quality is maintained at every stage, but also provides RTE with the opportunity to incorporate any changes, if required. Any required design changes, addition of risk-mitigation features, and defect rectification is discussed at every stage. Phase-wise execution provides RTE with the opportunity to seek approval for incorporating supplementary value-added features that could further enhance the scope of the project, resulting in a smart, integrated LMS.

Once the design and development phases are complete, testing is done to ensure that the solution is running smoothly under different end-user environments. The solution then moves to the acceptance phase (Figure 8).

The capability to manage the entire supply chain, from accumulation of customers to development-process standardisation, subcontractor management, and management of delivery of multi-year projects, provides RTE with a clear competitive advantage, in our view.

Figure 8: E-Course development procedures



Source: Company

Marketing channels

When marketing its product to clients, RTE makes use of a number of strategies to reach potential customers in different verticals:

– **Exploring existing client relationships**. RTE leverages its existing client relationships, enriched over the years through exceptional solutions delivery, to generate new business. Since most of their existing clients are big names in their respective industries (such as Mercedes-Benz, Sephora, and Bank of China), RTE enjoys the advantage of having a strong reputation while it actively seeks and develops new client relationships.

– **Tendering and bidding**. RTE also participates in both formal and informal tendering and bidding processes to gain new clients, i.e. government vendor assessment tenders and bids.

– **Online-to-offline (O2O) direct marketing**. Just as in its solutions delivery model, the company also deploys the O2O strategy to expand its client base. RTE uses both online advertising channels, such as search-engine marketing (e.g., WeChat and Baidu) as well as traditional offline channels, such as trade shows and guest speaking at technology or e-Learning conferences, to generate business.

– **Channel co-operation**. In order to expand into new geographies and verticals, RTE signs co-operation agreements with leading companies and institutes, such as NetLearning, and RISE, to leverage their influence in the market.

Expansion into new verticals to leverage platform

ESG compliance courseware driven by regulation

Regulation drives demand

Driven by the latest policies of regulatory authorities worldwide, the requirement for ESG disclosure is gaining momentum, and firms are in search of smart solutions to maintain compliance. Notably, since the introduction of ESG reporting requirements in 2016, the Hong Kong Exchanges and Clearing (HKEX) has been modifying compliance procedures to better integrate with international standards. In its May 2019 consultation paper reviewing ESG reporting guidelines, the HKEX announced several changes, such as reducing the time taken by companies to publish ESG reports (which currently stands at three months after the publication of annual reports). Additionally, in a move to strengthen social disclosure, the HKEX upgraded several KPIs from 'recommended' to 'comply or explain'.

In our view, to maintain compliance with these fast-evolving requirements, listed companies would need to deploy smart systems. This is where RTE's recently launched SaaS solution – ProSage – comes into play. Introduced to the Hong Kong market in November 2018, ProSage was developed in partnership with the former management team of Tricor Consulting Ltd.

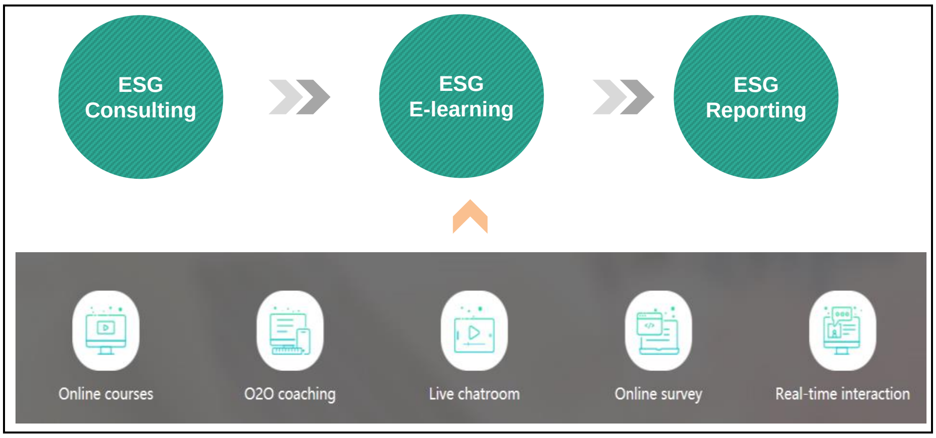
ProSage offers a one-stop shop solution for a listed company's requirement to maintain ESG reporting compliance

Through ProSage, the company provides ESG strategy consulting services, as well as a SaaS platform for online data management services for KPI monitoring (Figure 9). Additionally, ProSage also provides e-Learning courseware and O2O training through its e-Learning platform, PopSage.

RTE's marketing strategy for ProSage is to enter into revenue-sharing agreements with firms that provide investor relations and related consulting services to publicly listed companies. ProSage provides its e-Learning courseware and platform in exchange for a share of the payment made by the listed company to the third-party sustainability consultants.

We believe that partnering with global third-party consultants, such as KPMG and Tricor Consulting, would provide a substantial market opportunity to ProSage. Leveraging on the success of partnerships signed to date in Hong Kong, including clients such as the Hong Kong Export Credit Insurance Corporation and Carbon Care Asia Limited, ProSage could also expand to other major APAC markets, such as Singapore and China.

Figure 9: Key services provided by ProSage for ESG reporting compliance



Source: Company

Language learning: live-streaming of classes across borders

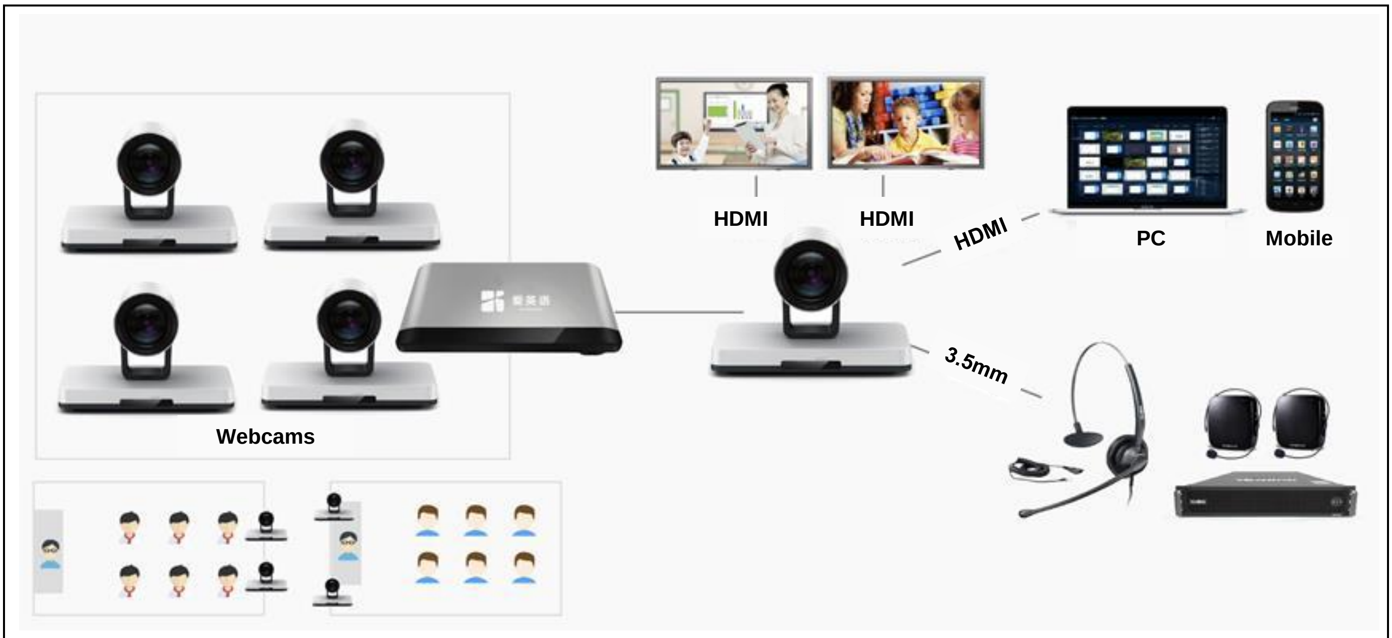
Another key new vertical that RTE recently expanded into is the online language-learning market. Responding to the current market demand among students in the APAC region, RTE introduced its AI English and AI Mandarin brands earlier this year.

Targeting tier 3 and tier 4 cities in China

Particularily in China, the demand for good English learning resources continues to increase every year as more and more students sit for the university entrance exam – Gaokao – which includes English as one of the three cumpulsory subjects. While students in tier 1 and 2 cities of China benefit from access to the finest learning resources, students in tier 3 and 4 cities do not have the same privilege.

To tap this highly lucrative vertical, RTE introduced the AI English brand, under which it provides live-streamed English tuition to these students through its partnerships with primary and secondary schools, kindergartens, and training institutes. Through its broadcasting studios, RTE deploys a Chinese–Australian 'dual-teacher' model, under which an Australian teacher provides English lessons in real time with the help of an in-class Chinese teacher (Figure 10).

Figure 10: Indicative model for live-streaming of AI English classes



Source: Company

Notably, RTE had already secured co-operation agreements with various education institutions before the launch of the AI English brand in July 2019 and officially signed these institutes on the day of the launch. These institutes include East China Normal University Press, Keruikezhi Education, Lingua Education, Angel Planet Education, and RISE. RISE Education is a Nasdaq-listed, leading after-school English language training group with ~200k students in owned and franchised centers across 90 cities in China.

In our view, the ability of RTE to secure these contracts is indicative of the demand for such immersive learning techniques in the Chinese market. These partnerships are also expected to drive future expansion into this vertical by way of market penetration.

Additionally, going forward, RTE plans to deploy its AI technology to provide professional applications such as AI speech intelligence systems, social learning systems, AI content promotional systems, and language ability evaluation systems.

We believe that expansion into these new verticals also provides diversification benefits to RTE's revenue stream.Venturing into ESG and English verticals, which are distinct from the traditional corporate route that RTE has taken until recently, will serve as a hedge against over-reliance on a few key clients.

New partnerships to expand into new markets

Partnership with NetLearning in Japan the first step

In order to expand into the Japanese e-Learning market, RTE entered into a strategic partnership with NetLearning in 2017. NetLearning is a Tokyo-based e-Learning solutions provider that currently offers ~8.9k courses to ~4.9k clients (which include corporates and schools).

NetLearning opens the door for RTE to expand in the APAC region

The result of this partnership is the creation of the JV – Shanghai Reunet Technology Co. Ltd. (Reunet) – in which RTE holds the controlling stake (60% as of 31 December, 2018). Through Reunet, RTE has been able to further expand its footprint in the APAC region by cementing its foothold in the Chinese market, as well as entering the new markets of Japan and Southeast Asia. While the partnership allows RTE to make NetLearning's rich e-Learning content library available to Chinese clients, the company is also able to bank on NetLearning's brand value and market share to expand into the overseas markets of Singapore and Hong Kong.

Moreover, RTE is currently leveraging Reunet's technology to develop its e-Learning SaaS platform. In our view, the completion of this platform would unlock considerable market penetration potential for RTE. This is primarily because the SaaS platform will allow RTE to reduce the customisation effort for single client, thereby speeding up the process for market penetration.

Target market grows to include all of Asia

In our view, RTE has the ability to expand further into the Asian markets of Japan, South Korea and Hong Kong by leveraging its e-Learning technology.

Substantial opportunities in Japan, South Korea and Hong Kong

As in China, in Japan and South Korea, great emphasis is placed on education, with more and more parents looking to enrol their children in after-school classes. For instance, Riso Kyoiku Co, a Japanese cram school, is able to charge JPY1.2–1.5m annually, on average, for its private tutoring courses for students of all ages. With more partnerships similar to the one with NetLearning, we believe RTE would be able to take advantage of this substantial opportunity.

Similarly, with the Hong Kong launch of Prosage in November 2018, RTE gained access into another new market in the APAC region. On the back of growing concerns of the Hong Kong Monetary Authority (HKMA) regarding ESG compliance by HKEX-listed companies, RTE has substantial growth potential in the region.

Applying e-Learning to live-stream coaching classes

Acquisition of Aushen Group for its Coaching School Business

Through its advanced live-streaming technology, which boasts a delay of <40 milliseconds, RTE can tap the huge cross-border language-learning markets of China and Australia

RTE recently expanded into the Australian market by acquiring a 51% stake in Aushen Group Pty Ltd for an initial consideration of A$408,000 plus a variable consideration according to the performance of Aushen in the following 3 years, with the total consideration capped to A$816,000. The Aushen Coaching School is a private tutoring institute that provides language (English and Mandarin) and subject (mathematics and writing) tuitions, as well as scholarship test prep, through six campuses located in Victoria, Australia.

The acquisiton allows RTE to grow its language learning vertical in the overseas market by taking advantage of the growing demand for qualified Chinese teachers in Australia. Furthermore, we believe that providing online English classes, taught by experienced Australian teachers, to the large student population in China unlocks substantial growth potential for RTE.

As per the latest data provided by the Chinese Ministry of Education, there are 300–400m English language learners in China. Given the demographic shift towards digitalisation currently occuring in China, RTE has a large addressable market at its disposal.

Moreover, utilising Australian teachers also provides RTE a time zone and quality advantage over peers such as VIPKid, which only employs teachers from North America, or 51Talk, which employs teachers from the Philippines[3]. Notably, the time difference between Australia and China is only two hours, whereas it is 12 hours between China and the US.

Utilising advanced e-Learning technology to assist in administering cross-border live-streamed tuition

RTE deploys its O2O business model for overseas expansion, whereby it leverages its advanced e-Learning technology to enter new markets. A case in point is the aforementioned Aushen acquisition, where RTE uses its 4K live-streaming platform to provide English and Mandarin lessons to students in China and Australia respectively, using qualified teachers from native-language countries.

Another advantage of RTE's live-streamed tuition is that it meets the vast requirement for foreign English teachers in tier 3 and 4 cities in China. Due to the inability to attract foreign teachers to the region, these cities have largely not benefited from learning English from native speakers.

Currently, RTE has a huge pipeline for developing new live-stream studios that are expected to come online by the end of 2019. We believe that if the company is able to go through with this plan, it will be able to cash in on the extensive opportunities in the cross-border language-learning space.

International teachers to provide language coaching

We believe that RTE's ability to source foreign teachers to tutor in their native language is a huge plus. Through its AI English and AI Mandarin brands, the company deploys a 'dual-teacher classroom' wherein an Australian teacher provides English lessons through a live broadcast in the presence of an in-class Chinese teacher (Figure 11). This model tackles the issue of lower

[3] Sourced from a May 2019 article on chinadaily.com.cn - '*Online English education sector records 168% growth but challenges remain*'

retention of focus among students, which is problematic in the online learning model.

Figure 11: Live-streamed dual-teacher classroom

Source: Company

Real size foreign teachers help maximise students' engagement levels

Moreover, RTE's use of AI technology makes the instruction more interactive and engaging. When combined with real-time response from the foreign teacher, it further ensures maximum attention from students.

Internationally accredited teachers and content

RTE employs teachers from Australian universities, including Federation University, the University of Melbourne, and Monash University, for its AI English platform. Moreover, to ensure the quality of instruction, the employed teachers must hold English teaching qualifications, such as TESOL (Teaching English to Speakers of Other Languages) and TEFL (Teaching English as a Foreign Language) certificates.

Similarly, for its partnership with RISE, RTE combines its e-Learning platform and technology with the franchise's global quality education content. RISE uses internationally accredited education resources from Houghton Mifflin Harcourt Group (HMHG) that have been curated over 185 years.

Furthermore, RTE also has access to Oxford University Press' first-rate English Language Training (ELT) content. In our view, combining these premium content modules with RTE's 4K live-streaming and online gaming technology provides significant growth potential to the company.

Global e-Learning industry rapidly expanding

Education in its current form attracts high spending globally, by governments, social communities and private individuals. According to HolonIQ estimates, global education expenditure is expected to touch US$10tn by 2030 (Figure 12). However, the persistently increasing cost of education often makes this investment look insubstantial. Consequently, there has been a constant struggle to provide affordable education to the masses, and this has given birth to the need for e-Learning.

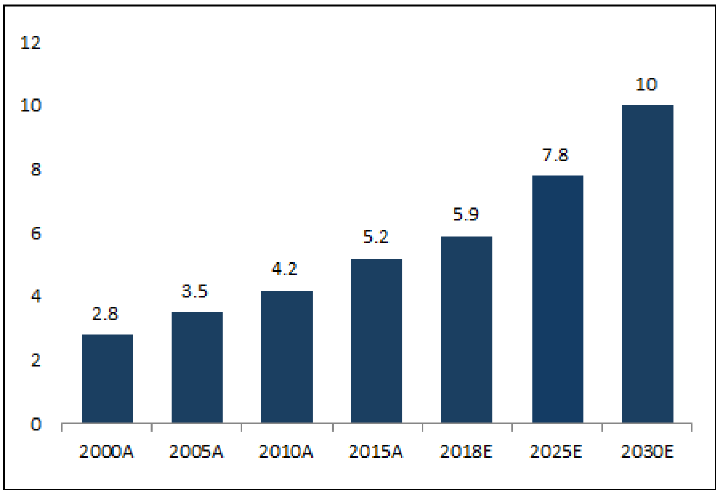
e-Learning market growing by 9.5% CAGR through 2026

Aided by the increasing penetration of the Internet, the global e-Learning market is expected to expand substantially in the medium term. According to Research and Markets, the global e-Learning market is expected to grow at a CAGR of 9.5% to reach US$398bn by 2026 (from US$176bn in 2017).

The major reasons for this acceleration are:

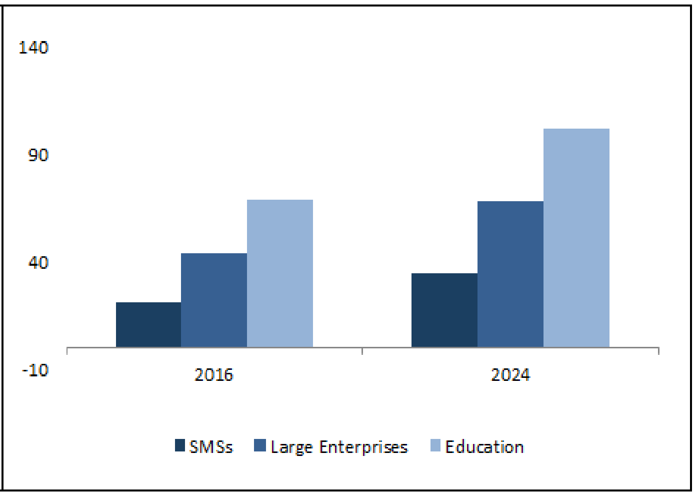
- The need for flexible learning solutions in corporates,
- The growing importance of parallel vocational education, and
- The advent of technology-driven delivery platforms (Figure 13).

Figure 12: Total global education expenditure (in US$ trillion)



Source: HolonIQ and Pitt Street Research

Figure 13: Global e-Learning market size



Source: IBIS and Pitt Street Research

Despite the significantly higher amount of money flowing into education currently, digitalisation forms only ~3% of total investment. However, this is expected to improve with tech companies solidifying their collection of products and services, i.e. online, mobile, live-streaming, and hi-tech delivery platforms, etc.

m-Learning market to grow by 31% CAGR in next 10 years

According to HolonIQ estimates, by 2025, ~4.4% of the total expenditure on education (US$342bn) will be on digitalisation. Increased availability and penetration of smart portable devices will pave the way for mobile learning (m-Learning), which is expected to grow at a 10-year CAGR of 31% and reach US$38bn by 2020. All this bodes well for RTE, which is expanding beyond its home market of China.

Robust growth in the corporate e-Learning market

Driven by the need to retrain workforces in order to reduce the skill gap as jobs continue to upgrade and transform with technology, the corporate e-Learning market is expected to witness substantial growth in the short to medium term. In a recent report on corporate e-Learning, Technavio estimated that the global corporate e-Learning market would grow at a CAGR of 11% over 2018–22, to reach a market size of US$30bn.

The key driving force behind this acceleration has been the structural change that education/training is undergoing (Figure 14), with e-Learning offering substantial advantages:

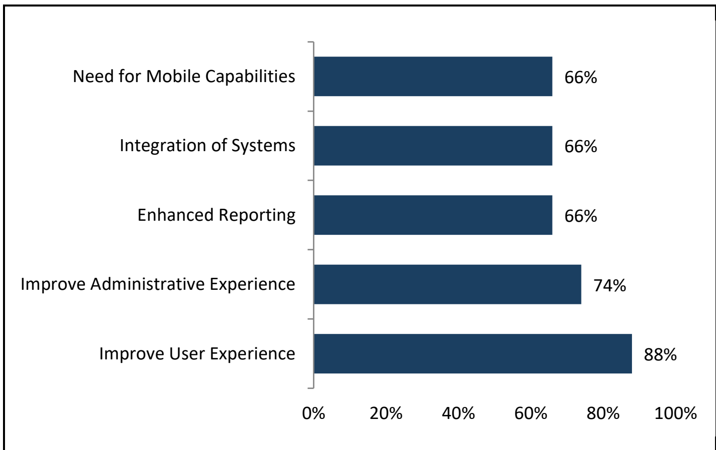
– **Facilitates training of geographically displaced employees**. With the proliferation of globalisation, companies have undergone vast geographical expansion. However, as their geographical footprint and number of employees increase, the dispersion of training and Learning & Development (L&D) becomes more challenging. This is where e-Learning solutions come into play – by facilitating the seamless diffusion of courseware to all the employees of a company, as long as they are connected to the Internet.

– **Measurability and flexibility**. Powered by data analytics, LMS allow employers to measure the effectiveness of a training programme by analysing KPIs. These LMS also allow for flexibility in undertaking a training programme, positively impacting employees' ability to grasp the content.

– **Demographic shift towards lifelong learning**. According to recent data by Pew Research, 73% of adults consider themselves to be lifelong learners, while 63% of working adults are professional learners. These statistics suggest a growing demand for learning content, even after the attainment of job-related requisite qualifications. In our view, these trends provide substantial growth potential to the e-Learning industry as a whole.

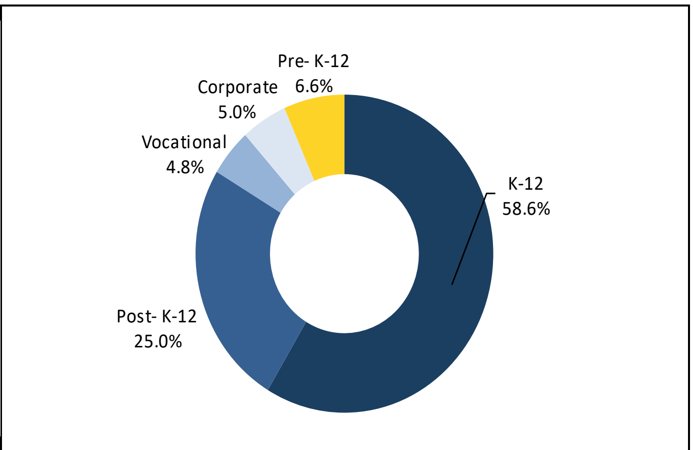
– **Small and Medium Businesses (SMBs) driving growth**. Driven by the low cost of deployment advantages of 'off-the-shelf' e-Courseware, the demand for e-Learning solutions is rapidly growing as more SMBs adopt this system.

Figure 14: Top reasons for changing LMS



Source: Docebo and Pitt Street Research

Figure 15: Global education expenditure – by sector



Source: IBIS and Pitt Street Research

The rapidly growing Chinese online education space

Aided by demographic advantages, government support and the requirement for language upgrades, the Chinese online education market has witnessed extremely high growth over the last decade. As per the iResearch Consulting Group, China's online education market stood at CNY252bn (~A$52.6bn[4]) in 2018 and is expected to continue to grow at an average of 21.2% to reach CNY543bn (~A$113.3bn[4]) by 2022 (Figure 16).

Historically in China, higher and vocational education have held the largest share (~78% in 2018) of the overall online education market (Figure 17); however, due to the increasing gap between the skills of Chinese graduates and evolving requirements in the job market, the vocational education sector is expected to witness substantial growth. As per the iResearch Consulting Group, in China, the share of vocational education in total online education is expected to grow to 27.1% by 2022 vs. 24.8% in 2018.

Figure 16: Revenue of China's online education market

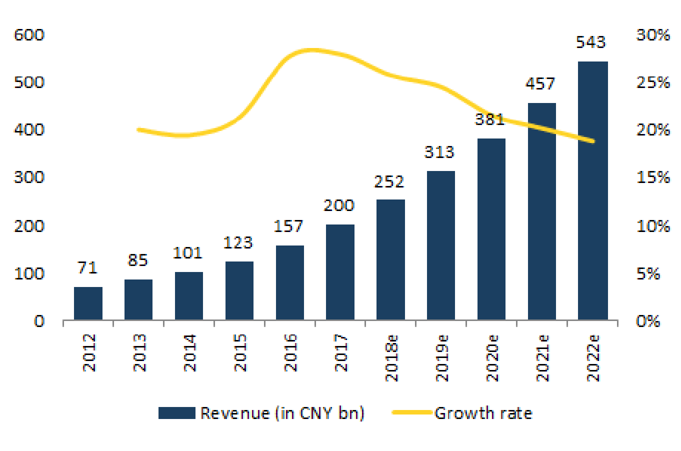
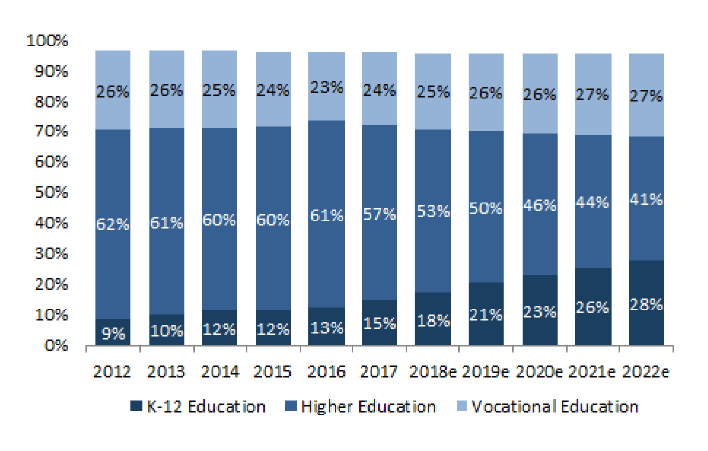


Figure 17: Breakdown of Chinese online education market



Source: iResearch Consulting Group

Why is Asia attractive to EdTech companies?

The APAC region has gained much traction in the e-Learning industry. Notably, in 1H 2019 China attracted US$1.3bn in global investments for its EdTech segment through 167 deals, significantly higher than the US$962m raised in the US during the same period (Figure 18). This is primarily due to the following reasons:

- **Large population**. The APAC region accounts for ~59% of the world's population on account of two of the most populous economies, China and India. Moreover, as per the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) (2017), 58% of the world's youth population (aged between 15 and 24) resides in the APAC region. In our view, the huge population of youth provides substantial growth opportunities for the e-Learning market, including RTE. Additionally, the replacement of the one-child rule with the two-child policy in China will provide further stimulus to the company on the back of a growing student population.
- **Growing number of internet users.** As per the recent report, *Internet Trends 2019,* by venture capitalist, Mary Meeker, more than half of the

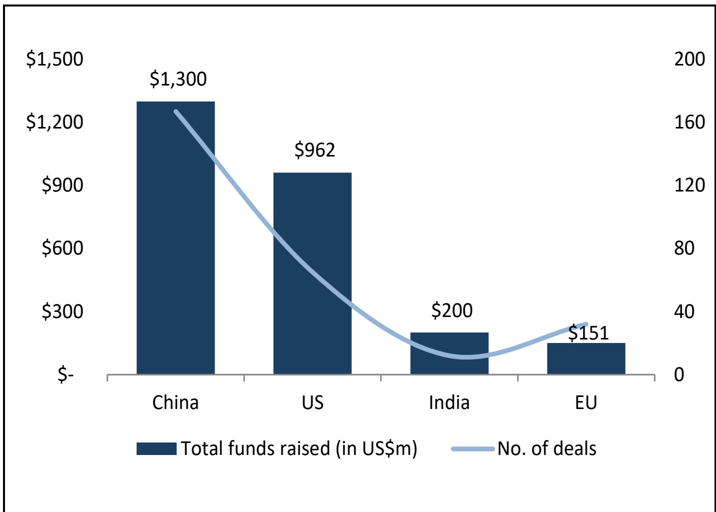
[4] Conversion rate of 0.2087 (RMB/AUD) as of 2 October 2019; sourced from S&P Capital IQ.

world's population is now online. Notably, 53% of the online populace comes from the APAC region. With internet penetration rates expected to grow within the region (Figure 19), APAC represents ample opportunity for the expansion of e-Learning.

Increasing penetration of the Internet, low costs, and convenience of use are driving the adoption of e-Learning in the APAC region

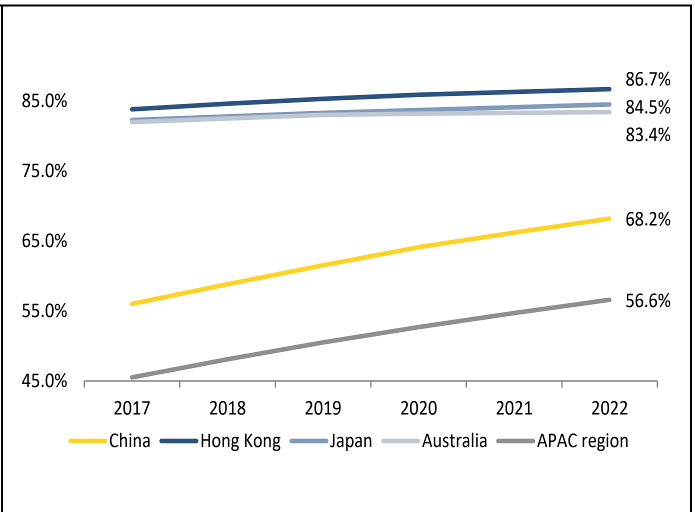
- **Cultural influences.** Asian parents put great emphasis on their children's education, particularly the education provided during after-school hours. This is primarily driven by the need to secure the future of their children, as well as their own retirement and ties back to the huge population problem that makes the job market highly competitive. Consequently, the convenience and low-cost advantages provided by online education are driving its increasing adoption in the APAC region.
- **Government support.** Over recent years, the governments of various Asian countries (such as China and Australia) have undertaken initiatives to utilise digital learning technologies in order to achieve market penetration. Some of these initiatives include the 'Digital Education Revolution' by the Australian government and the 'Education Modernisation Plan 2035' of the Chinese government. Notably, the goals stated under the Chinese Education Modernisation Plan 2035 highlight vocational training and lifelong learning, which support medium-term growth for RTE.

Figure 18: Global EdTech investment trend in 1H 2019



Source: Crunchbase, EdSurge, EqualOcean and Pitt Street Research

Figure 19: Growth in internet user penetration rates in APAC



Source: eMarketer and Pitt Street Research

Vocational education in high demand in Asia

Skilled labour shortages drive investment in education

Recently, the mismatch between the requirements of the job market and the skills of university graduates has become a major problem in Asia, particularly in China. As per a research report by McKinsey, demand for high-skilled workers in China (those with a university or vocational education) is expected to exceed supply by 24m workers by 2020, resulting in an opportunity cost of ~US$250bn.

This need has not gone unnoticed by the government, as evidenced by the allocation of CNY100bn (~A$20.9bn[5]) by the Chinese State Council towards the expansion of a vocational skills training system in the country. In February 2019, the Chinese government announced the National Vocational Education Reform, which aims to increase vocational training opportunities by offering

[5] Conversion rate of 0.2087 (RMB/AUD) as of 2 October 2019; sourced from S&P Capital IQ.

secondary vocational education opportunities to students who did not complete high school.

In our view, as these reforms progress, the addressable vocational education market for RTE would also expand, thereby offering market penetration opportunities to the company. Notably, RTE has managed to establish cooperative relations with several government vocational schools, such as Shanghai Urban Construction Vocational College, Shanghai Commercial School, Shanghai Communications School and Shanghai Mechanical Industry School. RTE is also a member unit of Shanghai Vocational Education Group for Commerce and Trade and Hongkou Vocational Education Group. We believe these relations would greatly support RTE in taking advantage of the aforementioned reforms taking place in China — boosting development among vocational colleges, industrial enterprises and other organizations.

Additionally, RTE has the advantage of leveraging its corporate training by integrating it with the vocational curriculum, thereby creating a more job-ready workforce for corporates. We believe that this ability also provides substantial upside potential to the company. Remarkably, RTE has managed to add 30 clients in Shanghai, the hub of online vocational education, and 16 more in the rest of China. The company expects to further expand its client portfolio by leveraging on its cooperation with Yunnan Jiaotong College. In our view this is evidential of RTE's acceptance in the market.

APAC online language-learning market to reach US$10.5bn

As the world gets smaller through the Internet, the need for cross-border communication grows to support international business relations. This has led to a rise in demand for online language-learning courses. The growing requirement of platforms and tools that can support higher user involvement and collaboration is leading to the emergence of more cloud-based solutions. With the greater advent of technology, live-streaming of language classes is gaining equal traction. As per the latest report by Research and Markets, the global online language learning market is expected to expand at a CAGR of 13.1% over 2019–25, reaching US$10.5bn.

Considered a crucial language for business and mandatory for university entrance exams, English continues to hold importance among both academic and corporate learners in the APAC region. However, due to a lack of foreign English teachers, especially in tier 3 and 4 cities across the region, students have been deprived of learning the language from native speakers; e-Learning is helping to bridge this gap.

The language-learning market paves a two-way street for RTE as it leverages its technology to offer tuitions in both English and Mandarin

As per the latest report by The Insight Partners, the APAC digital English language-learning market is expected to grow at a CAGR of 17.2% over 2019–27, to reach US$5.9bn. In our view, entry into this vertical presents a substantial growth opportunity for RTE.

Likewise, there is a significant gap in Mandarin tuition internationally with a shortage of qualified teachers. According to TES, to fulfil current Chinese language programmes in the UK could require 23,000 native Mandarin teachers: substantially more than the 3,000 teachers available by the end of 2020.

Chinese EdTech market is highly fragmented

Perfect opportunity for further acquisitions

The Chinese e-Learning market is highly competitive, with a large number of both public and private players. As of February 2019, there were 713 EdTech start-ups in China, including some of the largest operators in the industry, such as DaDaABC, VIPKid, 17zuoye, and iTutorGroup. Conversely, the number of listed Chinese EdTech companies is still small.

The large number of small companies in the Chinese EdTech market provides ample opportunities to RTE for inorganic growth

In our view, this disparity between the number of listed and private entities in the market provides substantial opportunities for companies like RTE, whose robust margins offer enough momentum to execute acquisitions. Through this inorganic expansion, RTE can take advantage of the new technology that start-ups build in order to attract the attention of Venture Capitalists (VCs).

Key competitors in the Chinese EdTech space

In light of RTE's recent shift in focus towards entry into the new vertical of language learning, as well as expansion in the vocational education space, we believe it is imperative to take stock of the current competition in the Chinese EdTech market. The following public companies, restricted in terms of market capitalisation of up to US$1.5bn, adequately represent the competition that RTE faces in the EdTech space:

- **Koolearn Technology Holding** (SEHK:1797). Koolearn is a subsidiary of New Oriental and provides online classes for K-12 in after-school tutoring, as well as college entrance prep and English language lessons to students in China.
- **Sunlands Technology Group** (NYSE:STG). STG offers post-secondary degree/diploma-oriented courses, as well as professional courses, through its online platform. The company also offers counselling and professional assistance to students to help them make informed decisions regarding their higher education.
- **China E-information Technology** (SEHK:8055). An investment holding company, China E-information offers online education courses in skills training and industry certifications to Chinese students. It also provides education consultation services.
- **3P Learning** (ASX:3PL). 3P Learning provides online courses in maths, spelling, literacy, science, and e-Safety. It currently serves ~5m students worldwide through 17,000 schools.

RTE's proven track record in corporate e-Learning places it in a prominent position in the industry

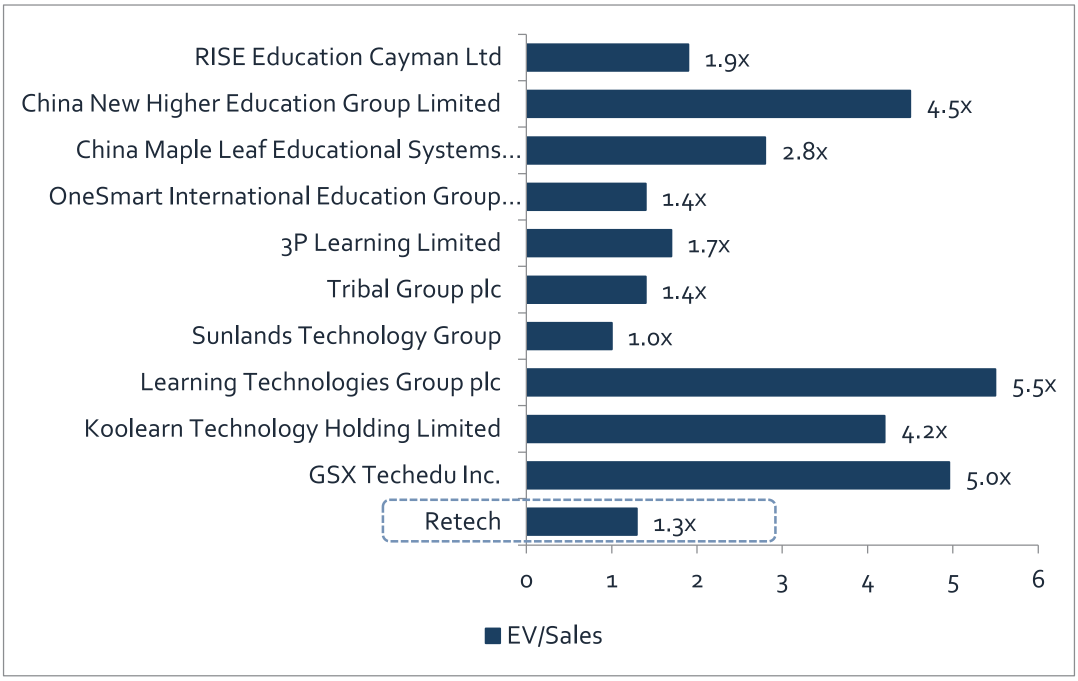
The company's corporate training vertical, though a small part of the overall e-Learning market, offers lucrative opportunities as more SMEs look at technology solutions to meet their training requirements. Particularly in China, there are a number of companies listed on the National Equities Exchange and Quotations (NEEQ), including Newway Software, Km eLearning, Ubilearning Technology, and Success Path.

However, we believe that given the robust operating margins of RTE, as well as the strong IP around its technology (RTE holds more than 110 intellectual property rights), it has the potential to reach the scale of large international players, such as LTG and Skillsoft.

– **Learning Technologies Group** (AIM:LTG). LTG is a large multinational provider of corporate e-learning and human resource software solutions, listed in London, with a market cap of US$1.1bn. LTG offers both off-the-shelf and bespoke e-learning solutions, and provides consultancy services for governance, risk and compliance training to organisations.
– **Skillsoft**. Skillsoft provides e-Learning content for corporate training and human capital management software to the US Federal Government, as well as companies in the financial services, healthcare, and manufacturing industries, including ~65% of the Fortune 500 companies. The company also provides environmental health and safety compliance training courseware to its target industries. Skillsoft was acquired in 2014 for US$2bn by Charterhouse Capital Partners.

In our view, the strong growth trajectory depicted by these companies indicates an upside potential for RTE (Figure 20). RTE seems to have substantial room for further expansion in its existing industries (finance, automobile, retail and technology) through both off-the-shelf and bespoke e-Learning solutions.

Figure 20: Relative to mature peers, RTE is trading at a significant discount (EV/Sales: CY 2020)



Source: S&P Capital IQ, Pitt Street Research

RTE betting on new growth engines

New verticals to drive next leg of growth

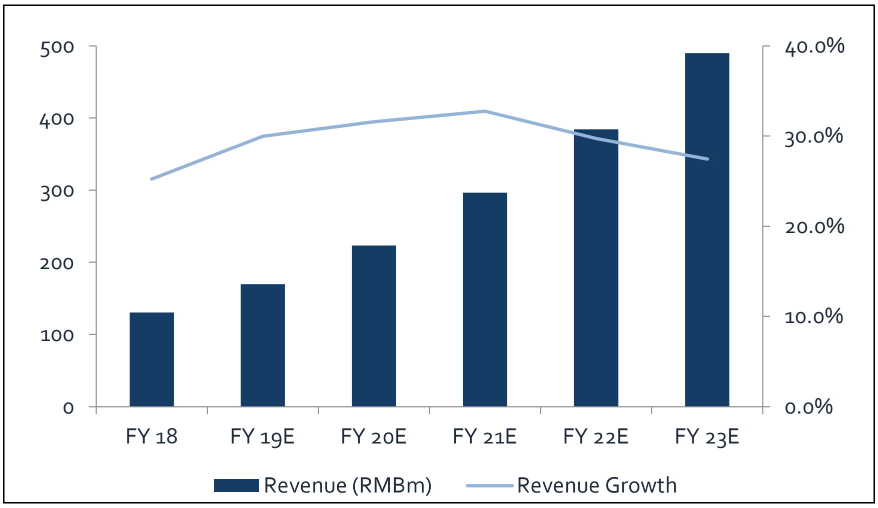
Given the scalable business model of RTE, we expect it to replicate equally across regions and verticals. We expect the total revenue to post a 30% CAGR (Figure 21) over FY 2018–23E. This growth will primarily be driven by strong demand for enterprise online training solutions in mainland China, especially in the finance, auto, and high-tech industries. This will be backed by steady growth from its new engines, including LMS solutions for vocational schools, ESG e-Learning platforms and AI English. Entry into new regions and domains will provide an additional push.

Share of recurring revenue is increasing

The contribution from recurring revenue/repeat business has been increasing steadily – 33% in FY 2017, 49% in FY 2018, and 70% in 1H 2019. Considering that the ESG platform currently under development will also be based on the subscription model, the contribution of stable, recurring revenue (in total revenue) will increase further.

Regarding the language-learning business, RTE will co-operate with training institutions, kindergartens, and schools instead of selling e-Courses to customers directly, thus procuring a stable source of students and earning recurrent revenue.

Figure 21: Revenue growth projections through FY 2023E



Source: Pitt Street Research

New verticals to drive growth

In China, the current scenario demonstrates significant demand for vocational schools and there are positive government policies in place in order to improve their e-Learning systems. This scenario, coupled with the immense potential to expand the AI English business and the ramp-up in RTE's new verticals (vocational school, ESG, and language learning) is estimated to have a pronounced impact on the revenue growth in the medium to long term.

As Retech's business operations from new verticals rise, we expect that revenue contribution of the traditional corporate vertical should taper down from 93% in FY 2018 to 71% in FY 2021E. Amongst the new verticals, vocational school and ESG are expected to emerge as the highest revenue contributors, with a share of 10% each, followed by the language-learning vertical (9%) in FY 2021E (Figure 22).

Figure 22: RTE's vertical-wise revenue breakdown

Revenue Breakup (%)	FY 17	FY 18	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E
Corporate Clients	94.1%	93.3%	86.1%	78.5%	71.0%	65.7%	61.9%
Vocational School	5.9%	6.7%	7.8%	8.8%	10.0%	11.5%	13.1%
ESG	0.0%	0.0%	3.5%	6.7%	10.1%	12.5%	13.7%
Language Learning	0.0%	0.0%	2.6%	5.9%	8.9%	10.3%	11.3%

Source: Pitt Street Research

We expect that the move towards the recurring revenue model from the current project model will be a big change for RTE, and its effect will be visible in both revenue growth and stability.

RTE has positioned itself in the highest band of the e-Learning industry value chain in China. While its competitors mostly focus on either e-Learning platforms or e-Courses, RTE offers both services, which support large-scale corporates through customised e-Courses in order to serve the diversified demands of clients. Through outsourcing labour-intensive work, the company now focusses more on design improvements and project management.

On the back of its competitive advantage in core operations and a move towards the recurring revenue model and expansion within several new domain verticals, RTE is expected to expand its commercial base exponentially in the near-medium term.

Gross margin to remain stable at ~63%

In the ever-evolving tech industry, increases in Research and Development (R&D) expenses are common, and RTE is not immune to it. It is currently developing a SaaS platform for ESG compliance courseware, and this is expected to keep the cost relatively high. As the new verticals, including ESG and language learning, are in the investment phase, we believe that the gross margin is expected to remain around the 63% level during FY 2018-23E and not expand much in the medium term.

Considering the significant investment made by RTE, FY2019E could witness contraction of margins. The downward trend is expected to retract from FY2020-21E onwards

Historically, RTE's business operations support higher Earnings Before Interest, Tax, Depreciation, and Amortisation (EBITDA) margins, mainly driven by customised e-Learning solutions for corporate clients. However, owing to the strategic acquisition of Australia's Aushen Coaching School in the language-learning space, the payroll (new teachers) and rental expenses (teaching studios) are expected to increase in the short to medium term. Thus, the EBITDA margin is expected to dip from 47.4% in FY 2018 to 42.5% in FY 2019E.

However, going forward, RTE is expected to maintain the expansion in its profitability as it utilises the industry standardisation strategy. Through benchmarking its products, RTE has accumulated courseware development experience, which can be applied to clients in the same industry, thereby consistently expanding profitability over each subsequent project.

The steady growth in the traditional corporate vertical, the ramp-up of new verticals, and the prudent cost-management strategy are expected to boost earnings quality and improve the EBITDA margin. Thereby, the EBITDA margin is expected to improve, reaching 44% by FY 2023E (Figure 23).

Figure 23: Growth and profitability

Growth and Margins (%)	FY 17	FY 18	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E
Revenue Growth YoY	-	25.2%	30.0%	31.6%	32.7%	29.7%	27.4%
Gross margin	62.7%	63.1%	63.4%	63.2%	63.0%	62.9%	62.8%
EBITDA margin	44.3%	47.4%	42.5%	42.9%	43.0%	43.2%	43.9%
EBIT margin	43.6%	45.7%	40.2%	40.6%	40.7%	40.9%	41.7%
Attributable profit margin	37.1%	37.7%	29.2%	32.5%	33.2%	33.9%	34.9%

Source: Pitt Street Research

Cash-rich balance sheet provides flexibility to pursue opportunistic acquisitions

Over the past few years, RTE has demonstrated its ability to post a more than 23% Return on Equity (RoE, Figure 24). Furthermore, its balance sheet position remains comfortable, with a low debt-equity ratio (0.2x as of 30 June, 2019). During FY 2018–23E, the average Operating Cash Flow (OCF) generated is expected to be 78% of EBIT, led by the repeat nature of e-Learning platform projects and greater client stickiness. The company is estimated to generate an OCF of approximately RMB120m in FY 2022E.

RTE is scouting for acquisitions in the vocational schools space and for tools to close operational gaps

To generate higher alpha for shareholders, it is imperative that RTE consistently expands its line of operations and domain verticals. To this end, it is important to fill technological gaps. Aided by a strong balance sheet (cash and cash equivalents worth approximately RMB99m as of 30 June, 2019), we expect that RTE could make further bolt-on acquisitions.

In China, the company is considering acquiring firms that have LMS for the vocational schools segment. RTE expects to undertake these acquisitions over 2H 2019–1H 2020. Similarly, in Australia, RTE is looking for target companies that have similar businesses in order to drive synergies and gain market share. To plug gaps in e-Publishing and digitalisation of operations, RTE is also seeking acquisitions of certain software (Digitalisation tool) to complement its existing tools. Its steady cash flow is sufficient to fund all the aforementioned ventures.

RTE is expected to utilise its steady cash flow to expand its language-learning business. Apart from the promotion of its AI English brand, the company is expected to invest in its dual-teacher live broadcast teaching methodology. RTE is expected to incur significant capex on the language learning vertical by establishing live-teaching studios in FY 2019E.

Figure 24: Cash and Return Ratios

Cash and Return Ratios (%)	FY 17	FY 18	FY 19E	FY 20E	FY 21E	FY 22E	FY 23E
Total Cash / Total Assets	18.6%	32.5%	34.2%	40.2%	45.5%	51.1%	56.1%
Total Liabilities / Total Assets	33.7%	26.1%	24.6%	22.6%	20.9%	19.1%	17.5%
RoE	23.2%	23.7%	18.3%	21.7%	23.3%	24.3%	24.9%
RoA	15.4%	17.5%	13.8%	16.8%	18.5%	19.7%	20.6%
Operating Cash Flow / EBIT	29.0%	94.5%	73.2%	74.8%	74.7%	75.5%	76.1%

Source: Pitt Street Research

Undervalued despite strong fundamentals

We have deployed a weighted average valuation methodology to derive RTE's long-term value, assigning equal weight to relative valuation based on comparable company analysis and a DCF calculation.

Peer group-based valuation suggests RTE is trading at a discount

Given RTE's core activity providing e-Learning solutions to corporate clients, we have considered a peer group that comprises EdTech global firms engaged in a similar line of business, along with generic Chinese education firms (Figure 25). The company's entry into new verticals, including ESG, language learning, and vocational training is expected to drive revenue growth in the medium-long term.

Benchmarked against a group of international peers

As RTE derives ~90% of its revenues from its core corporate e-Learning vertical, it has been benchmarked against the following global firms involved in the online e-Learning space: GSX Techedu (NYSE: GSX), Koolearn Technology (SEHK: 1797), Learning Technologies (AIM: LTG), Sunlands Technology (NYSE: STG), Tribal Group (AIM: TRB), and 3P Learning (ASX: 3PL). We have also included generic Chinese education peers, such as OneSmart International (NYSE: ONE), China Maple Leaf (SEHK: 1317), China New Higher Education (SEHK: 2001) and Rise Education Cayman (NasdaqGM: REDU).

Figure 25: Peer group valuation

EV/Sales	Sector Average	Discount/ Premium	Effective Multiple	FY 2020E Sales	Implied EV (RMBm)
Base Case	2.94x	0.0%	2.94x	223.2	655.2
Bull Case	2.94x	15.0%	3.38x	223.2	753.5

Source: Pitt Street Research

RTE expected to rerate towards valuations of larger players

With RTE gradually moving towards a more recurring subscription model, we expect it to start trading in line with bigger, more developed players. Additionally, because RTE represents a blend of technology and vocational education, higher multiples are justified. On the back of robust earnings, expanding margins, and a sound financial position, we have applied a 15% premium in our bull case. Trading at a peer average Enterprise Value (EV)/Sales multiple of 2.94x for FY 2020E, RTE would have an implied EV of RMB655.2m or an equity value of A$0.60, per share (Figure 26).

Figure 26: Relative valuation per share

Equity value determination (RMBm unless specified otherwise)	
EV / Sales Multiple	2.9
Sales 2020E	223.2
Implied EV	655.2
Net debt (cash)	(59.3)
Minority interest	0.5
Provisions	-
Equity value	**714.0**
FY 2020 Diluted Shares (m)	250.4
Implied price (RMB)	2.85
Exchange Rate	0.21
Implied price (AUD)	**0.60**
Current price (AUD)	0.40
Upside (%)	*48.8%*

Source: Pitt Street Research

DCF calculation suggests large upside to current price

Our DCF model yields a 10.97% Weighted Average Cost of Capital (WACC) for RTE (risk-free rate of 0.9%, a beta of 1.2, and an equity risk premium of 8.5%). Applying this discount rate to our free cash flow projections through FY 2029E and a terminal growth rate of 1%, RTE yields a value of A$1.79, per share (Figure 27).

The profitability is expected to increase substantially owing to the steady long-term growth prospects of the corporate e-Learning space, the creation of cross-selling opportunities across regions through the strategic acquisition of Australia's Aushen Coaching School and the recent entry into other new verticals, such as ESG and vocational training. This would provide enough of a margin for lower discount rates over the medium term, leading to a further increase in the share price.

Figure 27: DCF using various WACCs

Sensitivity Analysis										
WACC		**10.97%**								
Terminal Growth Rate		**1.00%**	**Change in WACC**							
Implied Price (AUD)		**1.79**	*10.2%*	*10.5%*	*10.7%*	*11.0%*	*11.2%*	*11.5%*	*11.7%*	*12.0%*
		0.25%	1.88	1.83	1.77	1.72	1.67	1.63	1.58	1.54
		0.50%	1.91	1.85	1.80	1.74	1.69	1.65	1.60	1.56
		0.75%	1.94	1.88	1.82	1.77	1.72	1.67	1.62	1.57
Change in Terminal Growth Rate		*1.00%*	1.97	1.91	1.85	**1.79**	1.74	1.69	1.64	1.59
		1.25%	2.00	1.94	1.87	1.82	1.76	1.71	1.66	1.61
		1.50%	2.03	1.97	1.90	1.84	1.79	1.73	1.68	1.63
		1.75%	2.07	2.00	1.93	1.87	1.81	1.76	1.70	1.65

Source: Pitt Street Research

Fair value of A$1.19–1.49 per share

Our base case value of A$1.19 per share has been derived using a weighted average valuation methodology, which assigns equal weight to our relative valuation and our DCF calculation (Figure 28). Our bull case calculation results in a valuation of A$1.49. Both cases imply a substantial upside from the current share price.

Figure 28: Weighted average valuation: Base and bull case

Methodology	Weight (%)	Share price (AUD)
DCF	50.0%	1.79
Relative valuation	50.0%	0.60
Composite		**1.19**
Current Price		0.40
Upside/ Downside (%)		**198.6%**

Methodology	Weight (%)	Share price (AUD)
DCF	50.0%	2.31
Relative valuation	50.0%	0.68
Composite		**1.49**
Current Price		0.40
Upside/ Downside (%)		**273.4%**

Source: Pitt Street Research

Conclusion

RTE's unique value proposition sets it apart from competition

On a standalone basis, there are several players in each of the four verticals of corporate e-Learning, vocational training, ESG and online language learning. However, we believe RTE stands out among the competition due to its capability to
serve all four markets. Additionally, RTE's peers focus on providing only an e-Learning platform or e-Courses.

However, RTE offers both a self-developed e-Learning platform (ideal for large corporates as they have a large user base), as well as off-the-shelf and customised e-Learning courses. Moreover, we believe that the shift in RTE's strategy to expand into new verticals and geographies provides it with a considerable hedge against turbulence in the core markets.

While corporates may change their L&D spend on the basis of the state of the industry, parents will continue to invest in their children's education in order to secure their futures. This, we believe, will drive the share price as new operational strategies are executed.

Risks

In our view, there are four main risks associated with investing in RTE:

- Execution risk: As the company has recently ventured into two new related but unknown verticals (ESG and language learning), there are risks regarding the ability of management to successfully execute the expansion strategy for its new operations.
- Concentrated revenue mix: During 1H 2019, approximately 70% of revenue was from repeat clients, while only 30% was from new clients. In our view, this high reliance on existing clients represents a risk since the termination of a contract with a major client would severely impact the revenue stream. However, we believe that RTE's latest shift in corporate strategy to expand into new verticals provides some protection against this risk.
- Economic downturn in focussed industries: Because RTE sources the majority of its revenues from corporate clients (approximately 90% in 1H 2019), it makes the company vulnerable to economic downturns in its focussed industries (such as finance, retail, and auto). In times of turbulence, corporates are quick to cut their non-core operations, i.e. Learning and Development (L&D) expenses.
- Lack of share trading and liquidity: The company has a concentrated shareholder base with the top 10 investors holding more than 80% of its share capital. Following its IPO in 2017, a number of Chinese companies listed on ASX have been de-listed, further discouraging trading in its shares. With a solid business, quality international auditors (Grant Thornton), a longer track record, and a more active approach to investor relations, the company is confident it can address this issue to bridge its liquidity discount.

SWOT Analysis

Strengths & Opportunities	Weaknesses & Threats
- RTE boasts a healthy financial performance as evidenced by a gross margin of approximately 63% in FY 2017 and FY 2018, and a net margin of approximately 37% during the same period. - The company has a substantial cash balance (RMB211m or A$43m as of 30 June, 2019), which positions it favourably to fund its future growth plans. RTE currently requires cash to fund its R&D expenses (for developing the SaaS platform), investments in new verticals (ESG and AI English), and to execute acquisitions. - Over the past 10 years, RTE has established strong relationships with large clients in the core business of corporate e-Learning. It therefore enjoys customer stickiness, with approximately 23% of clients over 2016–18 being repeat customers. - RTE's proven track record with major brands in focus industries, such as Bank of China in the finance industry, provides the perfect launchpad for further market penetration as it reduces the time needed to develop courseware for new clients. This is further fuelled by RTE's suite of off-the-shelf e-Courses. - Entrance into the new vertical of language learning and expansion into vocational education offer RTE the opportunity to tap into the highly lucrative Chinese EdTech market. - RTE's current model of partnering with/acquiring local experts in other geographies provides significant potential for expanding their footprint in the APAC region. Successful partnerships with global entities in particular (such as in the ESG vertical) offer substantial room for expansion in countries where the third-party firm operates.	- While recurring revenues from existing clients have a positive impact on the top line, it also signifies over-reliance on key clients. Notably, approximately 47% of revenues earned over 2016–18 was from repeat clients. - Given that RTE has recently ventured into related but unknown verticals, much depends on the ability of its management to successfully execute the new corporate strategy. - Concentrated ownership is a blessing and a curse. The company needs to address the lack of liquidity in its stock to truly realise its potential.

Appendix

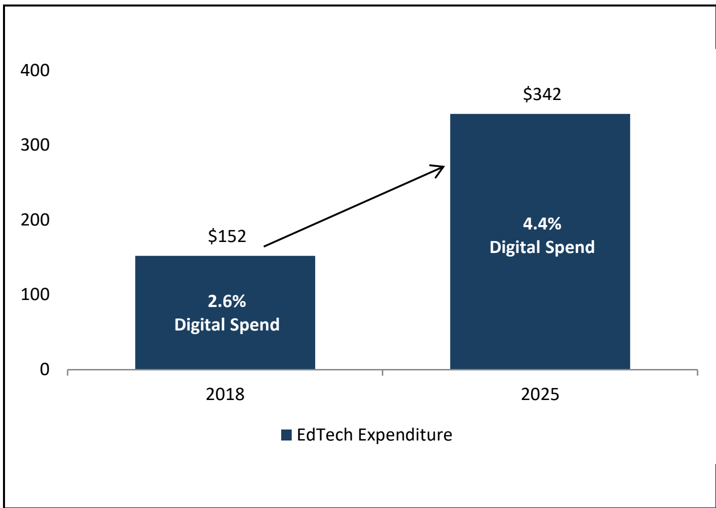
Appendix I: Management team

	Name and Designation	Profile
	Liu Cheng (Jack) **Chief Executive Officer**	• Liu Cheng was part of the founding management team of RTE and has more than 10 years' experience in sales, marketing, and business and strategic management. • In 2000, he co-founded Retech with Ai Shungang, the current non-executive chairman of the company. • Cheng holds a Master's in Business Management from Nanjing University of Post and Telecommunications.
	Lin Yan (Grace) **Chief Financial Officer**	• Lin Yan has substantial experience in the financial industry, including stints at Capgemini Consulting (China) and Ernst & Young (China). • She is a qualified Certified Management Accountant (CMA) and holds a Master's in Business Management from Shanghai Finance and Economy University.
	Wang Gongshi (William) **Vice President**	• Wang Gongshi has more than 10 years' of experience in the fields of marketing and sales. • Prior to joining RTE, he served as the Vice Sales Director for Jiangsu Province of Yulong Computer Communication Co. (an affiliate of China Wireless Group). • He holds a BA in Marketing from Nanjing University of Post and Telecommunications.
	Roy FUNG **CEO of ProSage (HK)**	• Roy FUNG has over 20 years of experience in Asia Pacific business consulting. Roy was Managing Director of Tricor Consulting Limited, also President of StepStone China, CEO of LEVEL4 Performance Consulting, Country Manager of Wilson Learning China, HR Development Director of American Express International, and Senior Quality Assurance Manager of Hang Seng Bank • Roy served as Chairman of the Board of the Dialogue-in-the-Dark Foundation, and was a member of the Executive Council of the HK Institute of Human Resource Management (IHRM). Currently he is the Co-chairperson of the IHRM IT Advisory Group. • Roy holds a Bachelor's Degree from the Chinese University of Hong Kong.
	YANG Binbin **GM of Ai English (China)**	• Yang has served in large-scale enterprises such as Japan Ricoh Group, Japan Sharp Corporation, and Softcom Group, and has served as technical directors and other technical management positions. • He has over 15 years of experience in smart equipment, Internet products, international cooperation, international academic exchanges, etc. • Yang holds a Bachelor's in Computer Science and Technology, and a Master's in Business Administration.

Source: Company, Pitt Street Research

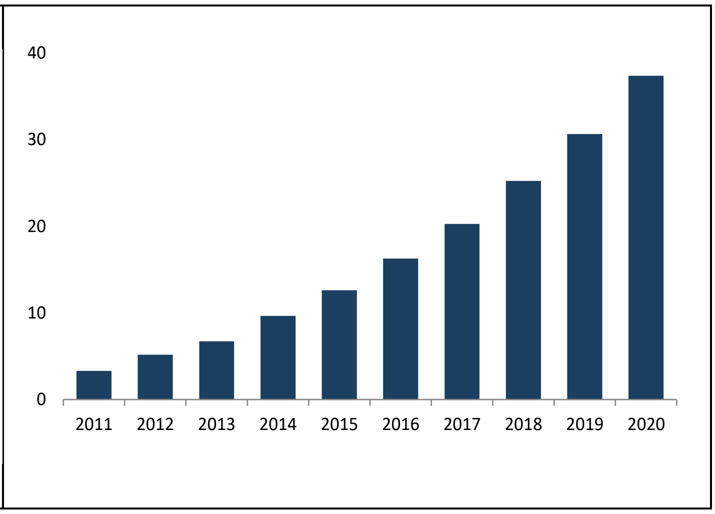
Appendix II: Global e-Learning market statistics

Figure 29: Global education technology expenditure (US$bn)



Source: HolonIQ and Pitt Street Research

Figure 30: Global m-Learning market size (US$bn)



Source: Docebo and Pitt Street Research

Appendix III: Financial summaries (A$)

Figure 31: Key financial data in A$[6]

Year to Dec (A$)	2017A	2018A	2019f	2020f	2021f
Sales (m)	20.5	26.9	35.4	46.6	61.8
yoy growth		31.3%	31.5%	31.6%	32.7%
EBITDA (m)	9.1	12.8	15.1	20.0	26.6
Net Profit (m)	7.6	10.2	10.4	15.2	20.5
EBITDA Margin (%)	44.3%	47.4%	42.5%	42.9%	43.0%
RoA (%)	15.4%	17.5%	13.8%	16.8%	18.5%
EPS before extr. & amort.	4.04c	4.80c	4.46c	6.51c	8.80c
EPS	3.78c	4.40c	4.46c	6.51c	8.80c
DPS	0.00c	0.00c	0.50c	0.65c	0.88c
EV/Sales	5.1x	3.1x	2.1x	1.3x	0.8x
EV/EBITDA	11.6x	6.6x	4.9x	3.1x	1.8x
P/E	12.6x	9.8x	9.0x	6.1x	4.5x
Dividend yield %	0.0%	0.0%	1.3%	1.6%	2.2%

Source: Pitt Street Research

[6] Y2017: Conversion rate of 0.19675 (RMB/AUD) as of 31 December 2017; sourced from S&P Capital IQ.
Y2018: Conversion rate of 0.20629 (RMB/AUD) as of 31 December 2018; sourced from S&P Capital IQ.
Y2019-21: Conversion rate of 0.2087 (RMB/AUD) as of 2 October 2019; sourced from S&P Capital IQ.

Figure 32: Financial summary in A$m[7]

Profit & Loss (A$m)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Sales Revenue	20.50	26.92	35.40	46.58	61.83	80.20	102.20
Operating expenses	(4.19)	(5.52)	(7.38)	(9.45)	(12.36)	(15.84)	(19.34)
Adjusted EBITDA	9.41	12.69	14.64	19.47	25.86	33.62	43.48
Depn & Amort	(0.13)	(0.47)	(0.81)	(1.07)	(1.42)	(1.84)	(2.25)
Adjusted EBIT	9.28	12.22	13.83	18.40	24.44	31.77	41.23
Net Interest	0.22	0.40	(0.30)	(0.17)	0.08	0.49	0.89
Profit before tax (before exceptional)	9.50	12.62	13.53	18.23	24.51	32.26	42.12
Tax expense	(1.57)	(1.60)	(3.38)	(3.37)	(4.41)	(5.65)	(7.16)
Abnormal + Minorities	(0.94)	(1.26)	(0.20)	(0.30)	(0.40)	(0.53)	(0.70)
NPAT	7.61	10.16	10.35	15.15	20.50	27.15	35.66

Cash Flow (A$m)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Profit before tax	8.87	11.55	13.53	18.23	24.51	32.26	42.12
Depreciation & amortization	0.13	0.47	0.81	1.07	1.42	1.84	2.25
Change in trade and other receivables	(5.90)	0.97	(1.34)	(2.45)	(3.34)	(4.03)	(4.82)
Change in trade payables	0.89	0.89	1.06	1.61	2.20	2.62	3.16
Other operating activities	(0.27)	(0.47)	(0.76)	(0.90)	(1.25)	(1.66)	(2.14)
Operating cash flow	2.59	11.61	10.42	14.14	18.79	24.74	32.47
Capex (- asset sales)	(0.74)	(0.25)	(3.72)	(1.86)	(2.47)	(2.41)	(3.07)
Other investing activities	(4.63)	0.07	0.00	0.11	0.15	0.21	0.29
Investing cash flow	(24.26)	0.09	(3.71)	(1.35)	(1.75)	(1.40)	(1.65)
Dividends	-	-	(1.17)	(1.52)	(2.05)	(2.72)	(3.57)
Equity raised (repurchased)	25.05	-	-	-	-	-	-
Debt raised (repaid)	6.40	-	-	-	-	-	-
Other financing activities	(0.17)	(0.31)	(0.15)	(0.14)	(0.14)	(0.11)	(0.11)
Net change in cash	8.94	10.21	4.83	10.59	14.34	20.11	26.73
Cash at End Period	9.85	20.54	25.61	36.20	50.54	70.65	97.38
Net Debt (Cash)	(4.22)	(14.12)	(19.12)	(29.71)	(44.05)	(64.16)	(90.89)

Balance Sheet (A$m)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Cash	9.85	20.54	25.61	36.20	50.54	70.65	97.38
Total Assets	52.89	63.27	74.81	90.16	110.97	138.16	173.51
Total Debt	5.63	6.41	6.49	6.49	6.49	6.49	6.49
Total Liabilities	17.81	16.53	18.37	20.39	23.14	26.43	30.39
Shareholders' Funds	35.08	46.74	56.44	69.78	87.83	111.73	143.12

Ratios	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Net Debt/Equity (%)	NM	NM	NM	NM	NM	NM	NM
Interest Cover (x)	NM	NM	46.37	108.75	NM	NM	NM
Return on Equity (%)	23.2%	23.7%	18.3%	21.7%	23.3%	24.3%	24.9%

Source: Pitt Street Research

[7] Y2017: Conversion rate of 0.19675 (RMB/AUD) as of 31 December 2017; sourced from S&P Capital IQ.
Y2018: Conversion rate of 0.20629 (RMB/AUD) as of 31 December 2018; sourced from S&P Capital IQ.
Y2019-21: Conversion rate of 0.2087 (RMB/AUD) as of 2 October 2019; sourced from S&P Capital IQ.

Figure 33: Key financial data in RMB

Year to Dec (RMB)	2017A	2018A	2019f	2020f	2021f
Sales (m)	104.2	130.5	169.6	223.2	296.3
yoy growth		25.2%	30.0%	31.6%	32.7%
EBITDA (m)	46.1	61.8	72.1	95.7	127.4
Net Profit (m)	38.7	49.2	49.6	72.6	98.2
EBITDA Margin (%)	44.3%	47.4%	42.5%	42.9%	43.0%
RoA (%)	15.4%	17.5%	13.8%	16.8%	18.5%
EPS before extr. & amort.	20.54c	23.26c	21.39c	31.17c	42.18c
EPS	19.23c	21.34c	21.39c	31.17c	42.18c
DPS	0.00c	0.00c	2.41c	3.12c	4.22c
EV/Sales	5.1x	3.1x	2.1x	1.3x	0.8x
EV/EBITDA	11.6x	6.6x	4.9x	3.1x	1.8x
P/E	12.6x	9.8x	9.0x	6.1x	4.5x
Dividend yield %	0.0%	0.0%	1.3%	1.6%	2.2%

Source: Pitt Street Research

Figure 34: Financial summary in RMBm

Profit & Loss (RMBm)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Sales Revenue	**104.20**	**130.50**	**169.62**	**223.18**	**296.26**	**384.28**	**489.72**
Operating expenses	(21.28)	(26.75)	(35.36)	(45.26)	(59.24)	(75.91)	(92.66)
Adjusted EBITDA	**47.82**	**61.50**	**70.16**	**93.29**	**123.90**	**161.08**	**208.32**
Depn & Amort	(0.64)	(2.27)	(3.90)	(5.13)	(6.81)	(8.84)	(10.77)
Adjusted EBIT	**47.18**	**59.24**	**66.26**	**88.15**	**117.08**	**152.24**	**197.54**
Net Interest	1.10	1.94	(1.43)	(0.81)	0.36	2.36	4.28
Profit before tax (before exceptional)	**48.28**	**61.17**	**64.83**	**87.34**	**117.44**	**154.60**	**201.82**
Tax expense	(7.95)	(7.74)	(16.21)	(16.16)	(21.14)	(27.05)	(34.31)
Abnormal + Minorities	(4.76)	(6.13)	(0.97)	(1.43)	(1.93)	(2.55)	(3.35)
NPAT	**38.69**	**49.23**	**49.59**	**72.61**	**98.23**	**130.10**	**170.87**

Cash Flow (RMBm)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Profit before tax	45.09	56.01	64.83	87.34	117.44	154.60	201.82
Depreciation & amortization	0.64	2.27	3.90	5.13	6.81	8.84	10.77
Change in trade and other receivables	(29.99)	4.72	(6.42)	(11.74)	(16.02)	(19.29)	(23.11)
Change in trade payables	4.51	4.31	5.10	7.70	10.54	12.58	15.16
Other operating activities	(7.06)	(11.02)	(17.47)	(20.68)	(28.76)	(38.18)	(49.08)
Operating cash flow	**13.19**	**56.29**	**49.95**	**67.76**	**90.02**	**118.54**	**155.57**
Capex (- asset sales)	(3.75)	(1.23)	(17.81)	(8.93)	(11.85)	(11.53)	(14.69)
Other investing activities	(119.55)	1.67	0.04	2.45	3.47	4.84	6.77
Investing cash flow	**(123.30)**	**0.44**	**(17.77)**	**(6.47)**	**(8.38)**	**(6.68)**	**(7.92)**
Dividends	-	-	(5.61)	(7.26)	(9.82)	(13.01)	(17.09)
Equity raised (repurchased)	127.32	-	-	-	-	-	-
Debt raised (repaid)	32.54	-	-	-	-	-	-
Other financing activities	(4.34)	(7.23)	(3.42)	(3.26)	(3.11)	(2.49)	(2.49)
Net change in cash	**45.41**	**49.50**	**23.15**	**50.76**	**68.71**	**96.36**	**128.08**
Cash at End Period	50.06	99.56	122.70	173.47	242.17	338.53	466.60
Net Debt (Cash)	(21.47)	(68.47)	(91.61)	(142.37)	(211.08)	(307.44)	(435.51)

Balance Sheet (RMBm)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Cash	50.06	99.56	122.70	173.47	242.17	338.53	466.60
Total Assets	268.82	306.70	358.47	432.03	531.71	661.99	831.40
Total Debt	28.59	31.09	31.09	31.09	31.09	31.09	31.09
Total Liabilities	90.53	80.11	88.04	97.68	110.88	126.63	145.62
Shareholders' Funds	178.29	226.59	270.42	334.35	420.83	535.36	685.79

Ratios	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Net Debt/Equity (%)	NM	NM	NM	NM	NM	NM	NM
Interest Cover (x)	NM	NM	46.37	108.75	NM	NM	NM
Return on Equity (%)	23.2%	23.7%	18.3%	21.7%	23.3%	24.3%	24.9%

Source: Pitt Street Research

Appendix IV: Major awards and qualifications in recent years

- 2019 Quality Management System Certification (GB/T19001-2008/ISO9001:2008);
- 2019 Information Security Management System Certification (ISO/IEC27001:2013);
- Software Company Certificate in 2019;
- 2018 Bo Ao Award – "Online Courseware Customized Excellent Service Provider";
- 2018 Shanghai Software Enterprise of Competitiveness;
- Technology-based SME in 2018;
- Software product certificate in 2017;
- 2017 Bo Ao Award – "Excellent Mobile Learning (APP) Service Provider"

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