special report | UK education M&A

The long game

Deal flow in the education sector continues to be slow despite unprecedented levels of demand. **Daniel Thomas** surveys the UK landscape

UK education M&A is a funny old beast. Investor demand is at an all-time high and sellers can dictate frothy valuations. The need for learning of various kinds increases year on year, and shortfalls in public sector funding hint at a greater role for private delivery in years to come.

And yet experts will routinely tell you the market remains niche, low volume and immature – 20 years behind comparable sectors like health and eons behind the likes of media, technology and services.

According to recent statistics from Catalyst Corporate Finance (see figure 1) there were 45 deals in the first half of 2015, suggesting the full year count may exceed last year's 57 deals. That's good news, but in truth the vast majority of activity has been at the trade end. Only six deals involved private equity (PE) in the period, highlighting the relatively limited amount of institutional investment flowing into the space. Deal value has also fallen reflecting the lack of large assets out there.

Things have definitely been quieter because of the election, and yet activity hasn't surged back since May as some thought it might. This is even more surprising given that the M&A market as a whole is doing so well, with deal volume significantly up this year thanks to the falling cost of debt and pent-up investor demand.

Matt Robb, managing director at Parthenon-EY, believes education's first problem is that political uncertainty still swirls around the government-funded and regulated side of the sector, as businesses ranging from private colleges to skills providers wait to see where budget cuts fall and new regulations are introduced. Add that to a shortage of quality assets, which is driving valuations up to often prohibitive levels, and you have a toxic mix.

Matt Robb, managing director, Parthenon-EY

"It's very tough out there right now. I think part of the problem is that a lot of people's expectations of what an education business is worth were set by private K-12 valuations in the last few years, and the problem with that is that K-12 valuations are mostly political risk free," he says.

Higher education

There have been some surprises in the period, notably Montagu Private Equity's sale of the University of Law (ULaw) to Global University Systems (GUS), owner of the London School of Business & Finance. For one thing, it came less than a month after the election and just over three years after Montagu bought the institution for a sum of around £200 million.

The pairing of the businesses turned heads too, although on reflection it makes a lot of sense. ULaw is a highly respected institution providing legal training through contracts with magic circle law firms, but has been losing ground to rival BPP University. GUS' formidable global marketing reach should help it there, then.

Inversely, GUS should benefit as it groups its UK assets under the quality assurance umbrella of ULaw. One of GUS' most important assets, St Patrick's, the UK's largest private college, was suspended from the student loans system from February to May due to quality concerns, so this couldn't come at a better time. GUS is rumoured to have paid a competitive price for ULaw too.

It's been a tough few years for private higher education institutions (HEI) in general, as scandals involving misuse of public money led to student number controls that curbed growth across the sector. Some thought the Tories would keep their distance after the election but early indications suggest they're still committed to growing the sector.

In its productivity plan in May, the government promised to "remove barriers preventing alternative providers (APs) from entering and growing in the market, and adopt a risk-based approach that safeguards quality". This would involve making it simpler to obtain degree awarding powers and the university title. True to its word, the Coventry-based distance learning provider Resource Development International became the latest AP to be granted the university title in August, which should please its US owner, Capella Education.

Michael Needley, partner, Sovereign Capital

Private equity firm Sovereign Capital owns two APs, the Brighton Institute of Modern Music, which was almost sold last year, and GSM London, which itself hopes to achieve degree awarding powers. Partner Michael Needley says: "The government is making positive noises but we're cautious because implementation is the key in all of this, as we saw with capping where that evolved over the consultation period and changed even as it was being implemented. What we have here is a post-election statement – as always we need to see the detail behind the intent."

It also does nothing to solve another problem – the parlous state of student immigration policy. Non-EEC students lost their automatic right to work after their studies back in 2012, but now the Home Office is considering sending them home straight after graduation where they can apply for a work visa if they wish. It's The move could make many think twice about coming to the UK in the first place, and for private HEIs, whose students are barred from working during their studies as well, recruiting overseas would get even harder.

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FIGURE 1: NUMBER OF DEALS SINCE 2008

Source: Catalyst Corporate Finance, deal value disclosed and/or estimated by Catalyst

"At the moment very few private providers can recruit international students so they're left fighting for a diminishing pool of price sensitive domestic students. Some like GSM London have done very well out of it, but I'm not sure how big that market is in the rest of the UK," says Robb.

Skills and corporate training

Before the election skills was the sector generating most excitement among investors, due to renewed commitments from all the main political parties. The government has pledged to increase the number of apprenticeship starts from two to three million this parliament as it tries to lower youth unemployment. And the Department of Work & Pensions will be overhauling the terms of the Work Programme when contracts come up for renewal in 2016 making the skills space as a whole more attractive than it once was.

This perhaps explains why four of the largest government-funded skills training providers have been sold in the last 12 months: Learning Curve, Employment Skills Group, A4e and Avanta, although pricing seems to have been lower than in other areas of the wider education sector, says Jeremy Harrison, partner at Catalyst Corporate Finance. Three PE-owned skills businesses are currently in play too: Sovereign's Lifetime, due to be sold in the autumn, Bridges Venture's Babington, also likely to go before the end of the year and 3AAA, where a process is expected to close shortly.

Despite the recent activity, Harrison is grounded about the opportunities in the space. "In terms of successful exits from funded skills training businesses there has been relatively few in recent years. This is largely down to the relative paucity of trade buyers and the caution adopted by many private equity firms. It is a politically charged segment of the market, and this still can weigh down on M&A. The key to getting a deal is understanding the right people and investors to approach."

Jeremy Harrison, partner, Catalyst Corporate Finance

The big issue, he says, is that skills is an area where the government "can influence, sometimes drastically, a provider's profitability year to year". The days of "high margin, high volume repeatable skills delivery are unlikely to come back in the near term" which is compounded by pressure on adult skills budgets. However, he notes the sustained support in government and appetite for the "sweet spot of 16-18 apprenticeships, particularly in science, engineering, technology and manufacturing disciplines".

The government has confirmed it will make extra funding available to those wishing to deliver more apprenticeships, facilitating expansion; it's also proposed a new levy on big business to help pay for the programme. But it's still unclear whether it will force SMEs to pay towards the cost of an apprenticeship, something that could deter many from taking on apprentices in the first place.

Given the uncertainty Robb believes that the sale of Lifetime, the largest of the skills businesses in a PE portfolio, will be something of a litmus test. The business derives only part of its revenues from government funding, the rest from B2B & B2C training which lowers its risk exposure. If this asset sells well, other investors should be emboldened, but if not then sellers everywhere will need to review their "price expectations and risk appetites". Investors are obviously more enthused by the corporate training sector as it offers B2B and increasingly B2C models, avoiding government funding altogether. It also benefits from an increasing willingness among cash rich corporations to invest in the continued professional development of their staff.

Learning Technologies Group (LTG), a listed corporate e-learning firm, continues to buy and build snapping up Eukleia, a provider of e-learning to the financial services industry, for £7.5 million in July. Last year, Inflexion scored up a hefty £242.7 million by floating FDM, its IT corporate training business.

In addition Herkules Capital bought Seagull, a Norwegian maritime training business with a growing oil & gas training arm, from London's GMT Communications Partners in June. And Blue Water Energy, a London-based private equity firm focused on the energy sector, snapped up Drilling Systems, a provider of simulators, software and training products in April.

Recruitment and nurseries

Teacher recruitment is a space exciting PE and trade investors alike and for good reason. "You've got to look at the end drivers," says Harrison. "There is a looming teacher shortage with pupil numbers growing rapidly given the birth rate. The demands of the classroom and increasing workload are not helping either". In fact, he says, "many teachers are dropping out of the profession early in their careers which will make the problem even more pronounced". Put simply "schools are finding it hard to recruit and retain staff which should favour recruiters".

Last year ICG backed an MBO at Teaching Personnel, valuing the firm at a whopping £300 million, and there has been a spate of smaller deals since then. TES Global, the international teacher networking business, has snapped up a clutch of recruitment businesses in the last 12 months, both at home and abroad; Impellam Group bought Career Teachers for £22.3 million in March 2014; and Sovereign acquired Synarbor for £18 million this July.

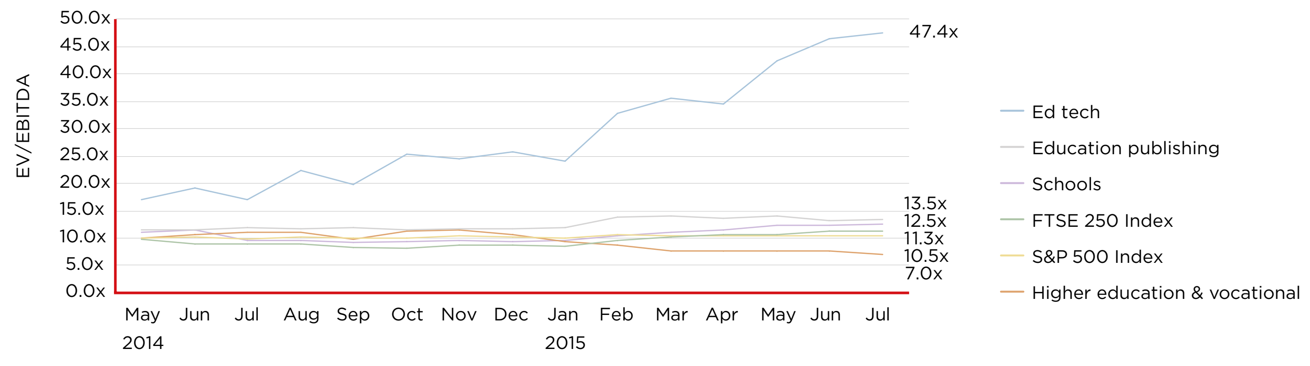
One risk to investors is that the school landscape has been fragmented by academisation, which increases the cost of acquisition for any sort of supplier (although the onward march of academy chains should offset this). The Pupil Premium also underpins much of the spending in this area, creating a degree of political risk should it ever be curtailed. "You have to be confident when you take on a small business that you know how to defend yourself against the big guys because they are making pretty significant investments," adds Robb.

We've seen a fair bit of activity at the lower end of the nursery space this year, though no major deals. Chains such as Bertram and Asquith continue to make bolt-on acquisitions and Kids 1st, an 11-site group in the North East, has been put up for sale and could fetch up to £25 million say sources. In a related deal, vocational awarding body NCFE acquired the Council for Awards in Care, Health and Education (Cache) – the UK's leading provider of qualifications for the early years care space – for an undisclosed sum in August.

> 'At the moment very few private providers can recruit international students so they're left fighting for a diminishing pool of price sensitive domestic students'

The sector is being exercised by a pledge to double free childcare hours for parents from 15 to 30 in 2016, which according to some estimates could create 600,000 more childcare places. But much hinges on whether the government will increase hourly funding rates by enough to make the policy viable. The National Day Nursery Association claimed in April that, based on current hourly rates, English nurseries lose an average of £809

FIGURE 2: CATALYST EDUCATION & TRAINING VALUATIONS INDEX



Source: Catalyst Corporate Finance

per year for each funded place for three- and four-year olds.

Doubling free hours without lifting the rates could end up making things even harder on providers. In the next few years big groups should prosper regardless, however, given their economies of scale. This perhaps explains why Phoenix Equity Partners bought Just Childcare, a platform asset, in November with the intention of building a 30-strong nursery chain.

Publishing and K-12

According to Phil Stone, partner at Plural Strategy Group, there's a "strong expectation of more activity around education publishing" in the next few years.

"A lot of businesses that were acquired in the previous peak were acquired by PE and very often had too much debt and were forced to restructure. They might now be in a much healthier position and I would expect quite a bit of M&A in this space."

Robb agrees, noting recent calls from the government for all teachers to use core textbooks as opposed to, say, open resources in isolation. This could be very good news for the industry, which has seen profits from book sales fall in the last few years due to digitisation.

Already there is speculation that Usborne, the children's book publisher, is looking for a buyer; the business is enjoying strong growth too, reporting profit of £8.9 million for the year ended 31 January 2014, up 26% from £7 million the year before.

Pearson, the industry behemoth, has been shuffling its portfolio, selling trophy assets *The Economist* and *Financial Times*, and its schools enterprise resource planning business Power School to Vista Equity Partners for £222 million in June. Chief executive John Fallon says the group is trying to streamline and get back to its core business of supporting learning outcomes.

Investors love private schools as they offer longer lengths of pupil stay, are parent sponsored and avoid government funding completely. Enrolment is also at an all-time high and there are increasing opportunities to open campuses abroad. But the sector still moves slowly, the number of available assets is limited and there are no mega-deals on the horizon.

"Compared to the institutional money looking to invest in it, the sector is possibly not large enough," says Needley, whose firm owns the private school group Astrum. "It's also well known to be a busy space and the interest in high quality operators remains constant."

This year a few groups have made bolt-ons including Riverston, which bought Beech Hall School in Macclesfield in June, and Radnor House (owned by Albion Ventures), which acquired Combe Bank School for £9.5 million in February.

More is happening offshore as demand for British curriculum schools blossoms. International school group Cognita, owned by Bregal Capital and KKR Private Equity, raised a £280 million bond this summer to fund its expansion. And Nord Anglia, which was established in the UK but is now headquartered in Hong Kong, bought six schools from US group Meritas for $575 million (£377 million) in April, taking its portfolio to 41 schools in 15 countries.

What next?

While it's easy to be pessimistic, Harrison says we can expect to see an uptick in deal activity in the next 12 months. "The election result has been a decisive one, which has led to a view that policy is going to continue in broadly similar form to that of the coalition. Net, that probably means there will be more activity in the next 12 months and I expect that going into a new five year parliament, if you're going to sell a business, then you'll probably do it earlier in the election cycle rather than later."

He also points out that, despite the risks inherent to each subsector, the general sentiment towards the education sector amongst large corporate groups and investors is very favourable. Every business must be judged by its individual merits and for high quality businesses, well prepared for sale, excellent prices can still be achieved.

That said, education M&A is more likely to evolve gradually than proliferate wildly. As a sector banker who prefers not to be named explains, education remains a small, low volume and niche sector right across Europe. Part of the problem is that it is just not recognised as an asset class in Europe as it is in the US, and that makes attracting institutional investment hard. The level of privatisation in education also lags far behind comparable sectors like health.

"I think the sector is 15-20 years behind the health sector," he says. "Health 20 years ago was mainly regional, not national or international, a lot of it was mom and pop and un professionalised, a lot of it was very small apart from things like big pharma. Education is at the same point: you see many small businesses and very few with ebitda over £10-20 million."

Most of the large private equity funds cannot stretch down to that level, so clearly we could do with some bigger companies giving rise to larger and more frequent deals. For that to happen we'd need a conjunction of factors, he says. "You need management teams to be professionalised which means taking people from outside the education sector and you need some more big roll ups like Busy Bees or Alpha Plus. They will lead the way and show it can be done."

Clearly this will take time, but that doesn't mean the education M&A market should be written off in the near term. Sovereign Capital, the UK's most prolific investor in education, demonstrates how those prepared to learn the sector's mores and quirks can do well out of it.

For one thing the firm has a forensic direct origination approach that focuses on finding "intergenerational changes of ownership", which only come about every so often, says Needley. It also favours a 10-15 year plus approach, where it may spend years developing a relationship with a business off market before actually investing. "It's all about building relationships and being a social investor," he says.

Most agree that the space will keep growing as the private sector plays a greater role in meeting shortfalls in state capacity. What would really help in the short to medium term, however, is more clarity from politicians.

"The problem with education is that politicians love to meddle," says Robb. "You can't imagine if Michael Gove was health secretary him standing up and saying, 'I think we should treat cancer patients with a different mix of drugs and surgery'. Everyone would laugh at him. But he can say we should teach history as though it was x, y and z."

In short, he'd like to see five years of stable regulation that facilitates stable growth, and in particular the removal of students from immigration quotas.

"At the moment the government is messing up the sector and that makes it hard for investors to have a lot of confidence – but I think it will change." ■

FIGURE 3: SELECTED UK TRANSACTIONS

Date	Company	Segment	Target Description	Acquirer	Deal value (£m)
Jun-15	University of Law	HEI	Provider of law training and degrees	GUS	n/d
May-15	Epigeum	Ed tech	Publisher of online courses	Oxford University Press	10.7
Apr-15	A4e	Training	Employment and skills training	Staffline	34.5
Mar-15	Learning Curve	Training	Vocational skills training	MML	n/d
Feb-15	Kallidus	Ed tech	Learning, performance, and talent management solutions	Fleming Family and Partners	n/d
Dec-14	Employment Skills Group	Training	Employment and skills training	Interserve	25.0
Nov-14	Just Childcare	Childcare	Nursery and daycare services	Phoenix Equity Partners	n/d
Jun-14	Vision For Education	Education staffing	Supply teaching agency	TES Global	n/d
May-14	Teaching Personnel	Education staffing	Teacher recruitment agency	ICG	300.0
May-14	Avanta Enterprise	Training	Private sector employment training	Staffline	65.5
Mar-14	Careers Teachers	Education staffing	Teacher staffing and recruitment	Impellam	22.3

Source: Catalyst Corporate Finance

"The election result has been a decisive one, which has led to a view that policy is going to continue in a broadly similar form to that of the coalition"

EU incorporated

European ed tech M&A continues to lag behind the US but there's no shortage of innovation, finds **Kirsten Noben**

According to Edukwest data, US investment in ed tech reached a gargantuan $1.36 billion (£860 million) last year across 201 rounds involving 386 investors. The gap with Europe by comparison is wide; here start-ups raised €130 million (£94.7 million) in 55 rounds with 100 investors. Some lament the lack of venture capital on the continent and wonder if the gap will ever be bridged. Others think we should relax and say it's just a matter of time before the sector takes off.

"Funding rounds are not indicative of a lack of early stage activity," says Jan Matern, chief executive at Emerge Venture Lab, an incubator. "There are many awesome founders that are creating products that will get funding in the next one or two years."

For those thinking of investing the space, some clear hotspots are emerging, one being vocational and lifelong learning (see page 38 for analysis). To date Britain's Immerse Learning, which uses 3D avatar gaming to deliver virtual instructor-

led training, has raised $2 million. And one of Europe's budding coding camps, Germany's CareerFoundry, raised €1.2 million in June from Tengelmann Ventures and Mendeley (owned by Elsevier).

Language learning is also busy, with Germany's Babbel, a mobile learning app, raising $22 million in a round led by Scottish Equity Partners in July. In addition London-based Busuu, a competitor, has forged partnerships with Pearson and now boasts some 40 million users worldwide. Publisher McGraw-Hill Education recently invested €6 million in the app which should help it compete with stateside challenger Duolinguo, which is backed by Google.

The school space has seen some interesting deals including Civitas Learning's acquisition of BlikBook, a British platform that helps lecturers to manage workload, in July. Thirdspace – an online tutoring platform sold into schools – raised £1.5 million that month from Nesta, Ananda Social Venture Fund and a group of angel investors. And then there is London-based Quipper, a learning management system for students and teachers, which raised $10 million from Fund Atomico (headed Skype founder Niklas Zennstrom), Benesse Holdings and Globis Capital Partners.

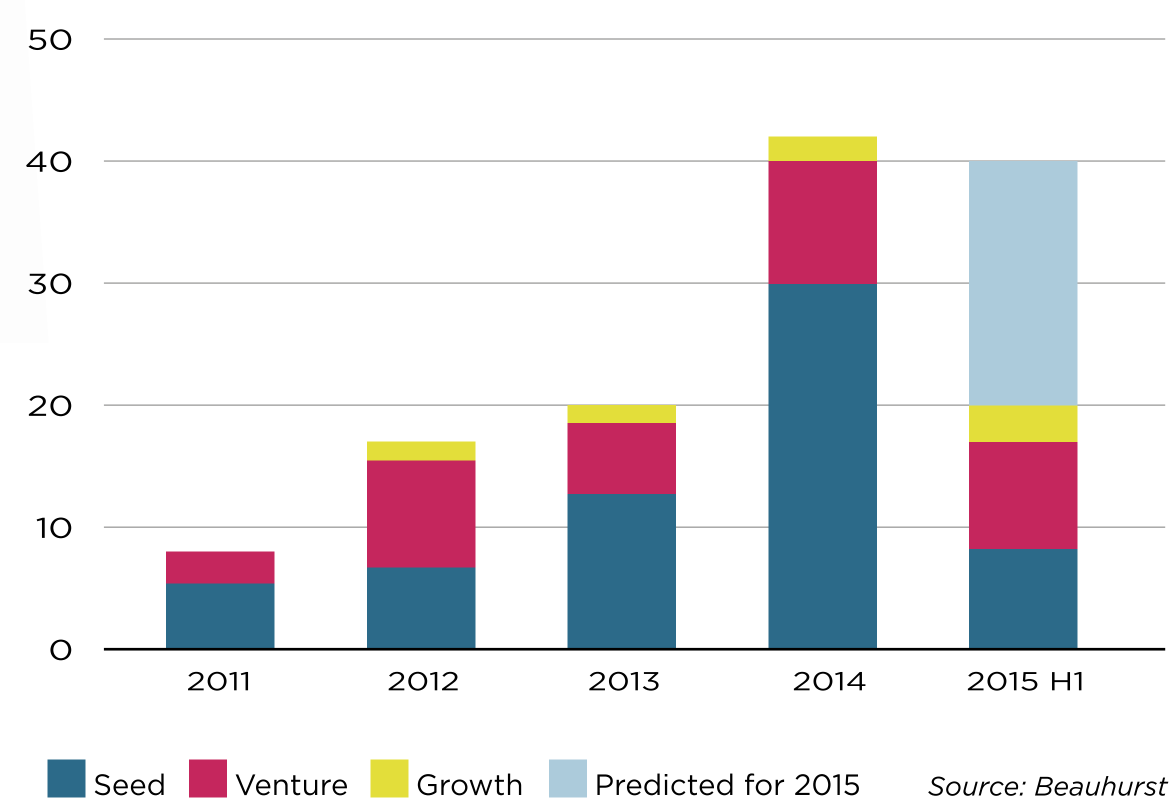
Mattern, who observes the start-up ecosystem at its grass roots, says that Europe's talent pool is varied and deep and investors are sure firms will start to scale more significantly soon. We're also seeing start-ups finding alternative forms of financing: take revision app Gojimo, which raised £750,000 on the crowdfunding platform CrowdBnk this year, or Hubbub, a fundraising platform for universities, which raised £405,700 on CrowdCube last year.

But others feel the deficit of investment capital in Europe, as compared with the US is still a big issue. Although "the gap is narrowing, it is not as fast as we would like", says Bhavneet Singh, founder of Sandbox & Co, an ed tech investment firm based in London. There's also a real possibility that talent will start crossing the Atlantic to find backing in future.

Europe is also geographically far more fragmented than the US as a market, and scaling across it can be tough. Regional start-ups would do well to factor emerging markets such as India and China into their business plans, then.

But despite the challenges, Singh says European ed tech still has huge potential. "A lot of successful companies have come out of Europe such as Spotify and Zoopla," he says. "I think with ed tech it's just a matter of time before some bigger players start to emerge." ■

EQUITY DEALS FOR UK ED TECH COMPANIES 2011 TO 2015 H1



Source: Beauhurst