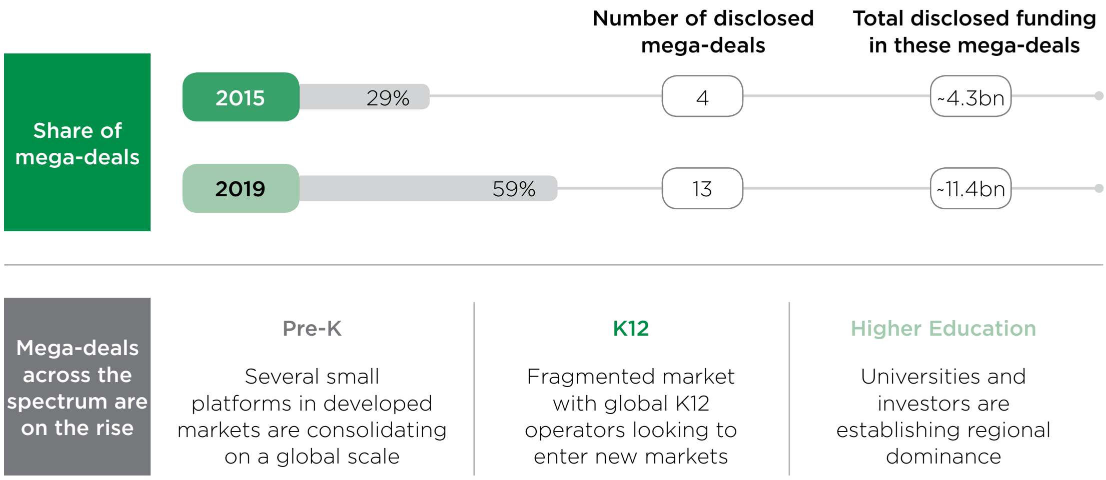
Mega-deals to tangible disruption

The global education sector is a tempting target for investors seeking growth. Deal activity in the industry has increased dramatically in the past 15 years and more mega-deals are expected. **Jitin Sethi** and **Sudeep Laad** of L.E.K. Consulting outline this year's education sector trends, highlighting where investment opportunities can be found

FIGURE 1: NUMBER OF MEGA-DEALS ($>500M), 2015-2019



Note: Only disclosed deal values have been considered for the analysis

Source: Mergermarket, L.E.K. research and analysis

Education is among the top-10 sectors in the world by gross value added. Private education is a trillion-dollar industry and the fastest-growing consumer subsector in terms of spend.

However, also dubbed a “trillion-dollar cottage industry”, education is highly fragmented in comparison to other consumer sectors, with only around 20 education companies globally generating revenues of more than $1 billion each. This represents a tremendous investment opportunity, with deal activity growing five-fold over the past 15 years. Between 2016 and 2019, more than 1,600 deals were completed and both activity levels and transaction size are expected to increase.

Mega-deals involving renowned private equity firms, large operators and conglomerates are increasing across geographies and subsegments. Investment interest stems not only from bulge-bracket and mid-market private equity firms, but also family offices, pension funds and other non-venture capital funds. This trend is supported by the high value placed on education companies with a focus on emerging markets due to their ability to reach scale. In addition, participants in emerging markets attract large investments in supplementary education due to the poor quality of public education and a growing desire for better pedagogical systems.

Last year saw a tapering off of deal activity in some regions, such as China, due to changing regulatory dynamics, but the outlook remains strong and it is expected that many more transactions will come to market in 2020. With traditional education models continuing to seek growth capital to scale up, and innovative business models attracting venture/early stage capital, investment activity is expected to be strong this year across the globe. In this article, we explore the key themes and investment trends for the education landscape in the year ahead.

2020: Another year for mega-deals

With education companies achieving unprecedented scale and looking for further growth, 2020 is primed for mega-deals. Between 2015 and 2019, the number of transactions with deal sizes exceeding $500 million more than tripled. In this period, 2018-19 was notably capital-heavy, with around $15 billion worth of large deals completed – including the acquisition of Cognita by Jacobs Holding (for about $2.6 billion); SOMOS Educação by Kroton Educacional (around $1.7 billion); Navitas by BGH Capital (about $1.4 billion); and Turnitin by Advance Publications (around $1.75 billion).

This year promises deal activity across many of the traditional sectors. In the early years/pre-K sector, there are several small platforms in developed markets acting as global consolidators. By expanding into new geographic territories, and rolling up smaller providers, they are turning into very large players. In fact, US-based childcare providers Bright Horizons and KinderCare have surpassed leading K12 providers in terms of revenue, generating upwards of about $1.5 billion in 2018.

Early years companies seeking global growth are turning to emerging markets for expansion. Asia has proved to be an attractive market as economies in the region mature, bolstering demand for early education. Take Babilou Group, France’s leading network of childcare centers – the company opened a branch in Dubai in 2015 and has since expanded to India, Singapore and the United Arab Emirates. Others, such as Australia’s G8 Education and the UK’s Busy Bees, are taking advantage of the high levels of fragmentation in the market by ramping up mergers and acquisitions to attain scale. Investment activity is expected to grow as these companies put their rising revenues to use. ▶

Move up a notch to the K12 education sector, and the market proves to be ripe for mega-deals. Despite the billion-dollar revenue scale achieved by global platforms, they hold less than 20% share of the $20 billion-plus international K12 market, leaving room for further consolidation and growth. Having secured funding recently, global K12 education providers such as Cognita, GEMS, Nord Anglia and Inspired, are expected to be on the lookout for growth avenues and will inevitably expand into new markets and regions. In addition, there are several other platforms likely to seek capital as they try to join the league of consolidators.

In the higher education space, investment activity over the past decade was predominantly centered on global expansion, but investors are now moving their focus to operators chasing regional dominance. Institutions such as Galileo and INSEEC in Europe and Honoris in Africa are realising synergies at a regional level by rolling up smaller institutions in various local conurbations to achieve scale. As regional platforms like these become more dominant, they will prove themselves attractive targets for upcoming rounds of large-scale funding.

‘Move up a notch to the K12 education sector, and the market proves to be ripe for mega-deals’

Education services and upskilling – a key trend for developed markets

Developed countries like the US and UK have seen significant investment in the education services sector, which is inclusive of business-to-business models like content provision, enterprise resource planning solutions, hardware and other services to schools and colleges. This has not been reflected in emerging markets like China and India thus far, because public spend on education is substantially less. In 2020, such education service providers are likely to continue looking for consolidation and growth opportunities in light of stagnating public expenditure and should continue to be an interesting option for investors. Simultaneously, as the innovation engine churns out newer models to address the needs of institutions, students and parents, investors should leverage first-mover advantage and seek new innovative operators.

To cater to the fast-paced needs of a 21st century workplace, governments worldwide have turned their attention to new programmes that help reskill and train workers. In its 2019 report, ‘The changing nature of work’, the World Bank reported: “Technology is disrupting the demand for skills. Globally, private returns to education – about 9% a year – remain high despite the significant expansion in the supply of skilled labour. Returns to tertiary education are almost 15% a year. Individuals with more advanced skills are taking better advantage of new technologies to adapt to the changing nature of work.” This makes the ‘continuing education’ sector a sound bet for investors seeking growth. Additionally, the sector has seen government support, with countries such as the UK and France implementing systems to promote upskilling models, such as apprenticeships, with the private sector.

The sector lends itself to online and blended delivery models, allowing for scale companies and large-ticket investments. Examples include Intertek’s approximately $480 million investment in Alchemy Systems, along with Leeds Equity Partners’ investment in Vitalsmarts, a transaction that enables the latter to train more than one million corporates annually in advanced skills. As this trend begins to play out globally, more investment opportunities can be expected in the vocational and reskilling sector.

FIGURE 2: GLOBAL MOBILITY CONTINUES TO BE IN DEMAND THEREBY GIVING RISE TO MULTIPLE OPPORTUNITIES

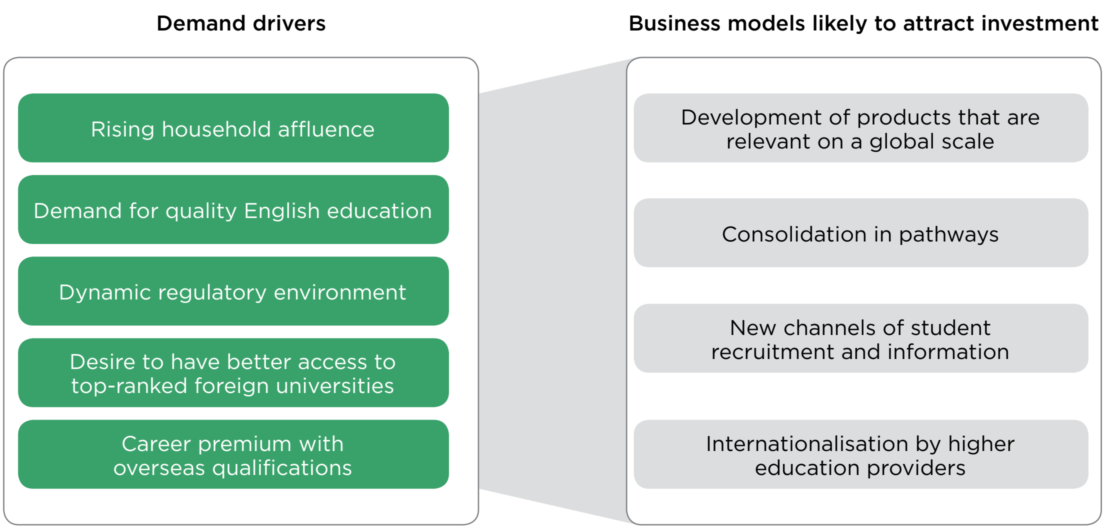
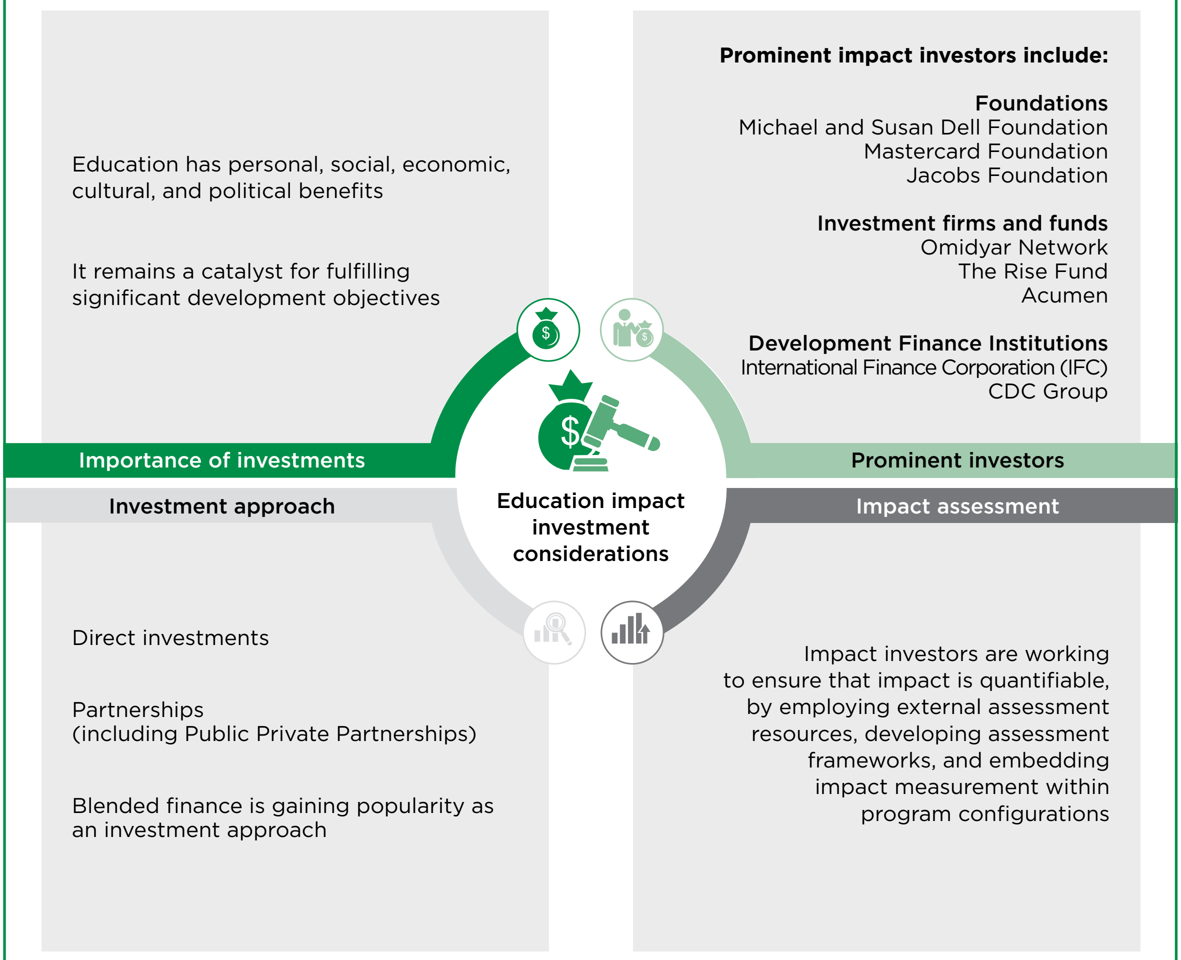


FIGURE 3: THINGS YOU NEED TO KNOW ABOUT IMPACT INVESTMENTS



Global mobility

In the 10-year period leading up to 2018, the number of international students enrolled globally more than doubled to around six million, reflecting an annual demand growth of 6% during this period. This surge in demand has been sustained by four main drivers: the rise in the number of households that can afford an international education; poor-quality and insufficient English education in the students' countries of origin; higher compensation for students with internationally recognised degrees when they enter the workforce; and students with higher education aspirations entering the system early in their desired destination countries (see *figure 2*).

Strong demand has been met with favourable regulatory dynamics. While the climate in the US was challenging due to the geopolitical factors, other countries such as the UK, Canada and Australia made several positive changes to their legislative frameworks, thereby supporting inbound mobility. The UK, for instance, took significant steps to recruit more international students by deploying a favourable visa and post-study work regime. Canada has also taken a pro-skilled immigration stance over the past decade, which is indicated by its policy to allow students to gain citizenship more quickly. Unconventional 'study abroad' markets, such as Germany and France, are also slowly gaining investor attention, however typical Anglophone destinations, like the US, UK and Canada, still attract about 40% of all international students and provide compelling opportunities.

With robust demand drivers, several investment themes in the sector are poised to emerge in 2020:

- Existing channels into higher education for overseas students, such as foundation courses and sixth-form colleges, are likely to seek investment to derive synergies from scale and hence lower their risk profile by diversifying their revenue streams
- Digitally native companies will continue to innovate, finding new channels for student recruitment and the delivery of educational services. For example, companies such as ApplyBoard and Adventus are developing online channels to connect students to universities
- Universities in markets such as Australia and the UK are looking to establish their presence in emerging markets, providing potential partnership propositions to private players in these countries. ▶

Ed tech – a collective favourite

The number of ed tech deals in the Americas, Asia, Australia and Europe increased by more than 20% between 2015 and 2018, while the value of these transactions rose by 56%. Investment in the sector peaked in 2018 at over $7 billion, and there has been a continuous rise in the number of deals with smaller ticket sizes, reflecting a growing share of venture capital and early stage investments. In the wave of ed tech companies that emerged and achieved unicorn status over 2017 and 2018 are the likes of Byju's, VIPKid, Yuanfudao, iTutorGroup, all of which received significant investments.

The next wave of unicorns is now in the making, evidenced by the continued growth of venture capital interest in the sector. The ed tech models to watch out for are those that focus on peer networks, reskilling and machine learning. There is also the potential for consolidation in traditionally fragmented subsectors such as tutoring, test prep and enrichment, besides vocational, corporate and adult training. While ed tech companies have started seeing investments from traditional private equity funds, profitability remains challenged due to the high costs associated with customer acquisition. After continued rounds of investments, the unicorns are expected to start charting out their roads to profitability.

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Increasing returns through impact investment

Education is not only the fastest-growing consumer segment, it's also now achieving the highest growth within the broader impact investing world. Organisations are increasingly placing importance on mobilising resources to realise one of United Nations' sustainable development goals, aimed at ensuring inclusive and equitable quality education and promoting lifelong learning opportunities for all. Entities such as Michael & Susan Dell Foundation, Mastercard Foundation and Jacobs Foundation, among others, have demonstrated their commitment to this goal through their investments in the education sector (*see figure 3*).

Given the need to scale and innovate in this sector, private education and ed tech have witnessed a spike in interest from impact investors. For example, Andela trains and helps developers in Africa to work remotely for American corporations. The company has attracted investments from the Chan Zuckerberg Initiative and Omidyar Network. While investors deploy capital through various means such as partnerships, grants, and direct investments, they also increasingly look to use blended finance, which introduces concessionary capital from public or philanthropic funders to reduce risk for investors. As impact investing becomes more relevant, practices such as 'impact washing', where traditional investments are falsely labelled as impact investments, are unfortunately becoming more common, hence necessitating a systematic framework for measuring impact.

Conclusion

Be it large-scale mega-deals, ed tech unicorns, adult retraining or foundational programmes for international students seeking globally valued degrees, the education industry is expected to provide an opportunity to both large and small investors in 2020. The sector is on the cusp of a renaissance due to the emergence of innovative business models, but it is still supporting the traditional mechanisms that have shaped the landscape as we know it. Due to these simultaneous realities in the market, mega companies with more than $1 billion valuations continue to emerge and flourish.

With both funding and deal activity bourgeoning, investors should look to capitalise on the trends fostering growth in the year ahead. Given the multiple avenues available for rapid expansion in the sector, it can be a challenge to navigate the nuances of the industry successfully. Approaching the market with a one-size-fits-all investment strategy has its pitfalls, and investors should therefore be vigilant in carving out their thesis before embarking, and clearly defining the drivers that create value. ■

Jitin Sethi and Sudeep Laad are partners in L.E.K. Consulting's global education practice. Akansha Baradiya, marketing coordinator, edited this piece. Contributors to the research include Abhishek Bansal and Jaisal Kapoor.

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and rigorous analysis to help business leaders achieve practical results with real impact. The L.E.K. global education practice is a specialist international team of 60-plus consultants and seven partners who have completed more than 700 education sector engagements across more than 90 countries, serving CxOs and boards of some of the world's largest education organisations. Our experts bring insights on education businesses, investment opportunities, market dynamics and impact across segments from K12 to ed tech.

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