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Why private equity investors are betting on digital education

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Digital streaming services such as Spotify and Netflix have forever changed the business of music and movies. Now, that same approach is slowly transforming education publishing. Those hefty textbooks weighing down kids' book bags all over the U.S. could become a thing of the past.

The U.S. spends more than $7 billion every year on K-12 textbooks, the FCC says. And prices have skyrocketed. For example, prices of university textbooks have risen 812% since 1978, according to the American Enterprise Institute.

But textbooks are almost out of date upon publication, so it's little wonder that a new breed of education-technology companies is targeting this market using software on tablets to break huge volumes into bite-sized digital portions.

The digitization of education content and curriculum has made personalized learning, or 1:1 learning, trendy. That 1:1 refers to one device for one student — a concept that took hold around 2011 with the advent of tablets and has been booming ever since.

Venture capital flowing to edtech companies is plentiful. Though still a long way from 2015's highs, edtech investments in 2017 were close to beating 2016's numbers in terms of value, with more than $1.9 billion invested as of last November.

From an M&A perspective, 2017 transaction volume of $10 billion-plus should substantially outpace 2016's results.

Private equity investors are putting their money into smart edtech firms that have developed great content, or software to be used on tablets — from math to English-language learning to remedial classes and teacher training.

So where are the compelling opportunities for investors on the M&A front?

Companies that offer related services, such as distribution and management of learning devices, or platforms that make it easy for students to use new content, are generating major investor interest.

A case in point is Troxell Communications, which distributes technology to schools — everything from devices themselves to asset management. The firm was acquired in 2008 by AEA Investors because of its large market share and proprietary software that makes it easier for schools to manage devices.

Firms selling digital solutions for testing and assessing students — something once done on bubble cards with a pencil, but now increasingly digitized — are also attracting investor interest. One of the leading independent providers is Illuminate, a portfolio investment of Insight Venture Partners.

Altogether, the market for content, curriculum, assessment and device management could top $30 billion annually in the U.S., including K-12 and higher education. Investors are looking for the next-generation education publisher or platform that could do to that business what Amazon did to consumer-book retailing.

For investors the most attractive firms are those with strong customer relationships and contracts with larger school districts that have robust budgets for innovations.

Investors are looking for companies that have at least $10 million in annual revenue. A firm of that size would typically have contracts with public and private schools in suburban and rural settings. Investors are particularly interested in firms with more than $20 million of annual revenue — companies that typically have contracts with at least one large school district, if not several.

That makes companies with strong sales organizations and recurring revenue particularly attractive. And customer-retention rates are a critical measure in identifying the most attractive firms.

Investors also favor companies that have a strong, proprietary technology offering, such as Glynlyon., a portfolio investment of Linsalata Capital that can be grown by adding other firms on that platform.

For some firms' private equity investors are paying double-digit valuations based on trailing Ebitda. Frontline Education bought a series of smaller firms, becoming a dominant software provider for teacher development and special education programs.

Frontline, backed by Insight Venture Partners, had bought 10 firms since 2014. Then, in August 2017, Frontline was sold to a larger PE firm, Thoma Bravo, in a deal that valued the company at more than $1 billion, Frontline Chief Executive Tim Clifford told *EdSurge*.

EdSurge also noted that PowerSchool, owned by Vista Equity Partners, had spent about $1 billion on eight acquisitions since 2015, and that BV Investment Partners gave $150 million to Hero K12 in June to acquire smaller edtech firms.

As more and more PE investors learn about edtech, the number of deals is sure to rise, especially in states like California, Texas and Florida that have large school districts and bountiful opportunities.

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