As Recession Worries Grow, Smart Education Investments Can Provide Growth and Resilience

Alex Hicks , Benzinga Contributor
November 06, 2019 4:56pm

Investors are stepping up their interest in the education sector recognizing it as a relatively safe harbor in any coming economic downturn that will continue to provide strong returns.

Not all types of education businesses are created equal, though. It's important for investors to differentiate between which market niches and which types of businesses will be more resilient in a recession.

Although not totally immune from a recession, the $830 billion K-12 market in the U.S. will probably prove the most robust part of the education sector thanks to its reliance on public funding. However bad the downturn is, kids will still go to school and education districts will still demand services related to classroom learning and administration services.

Providers that focus on meeting school districts' targeted outcomes for students and those that have a strong technology component should prove to be the most attractive.

Spending on content and curriculum in the K-12 sector is getting a prolonged updraft from the spread of digital technology that is becoming increasingly indispensable to teachers and students. More and more, schools are investing in digital tools that allow teachers to assess their students' work better and faster and to tackle learning problems at an earlier stage.

The technology is allowing schools to adapt to different pathways for learning that are shaking up traditional classroom methods. Flipped learning, which reverses the traditional learning method by delivering content, usually online, outside the classroom, is one example. It's expected to be a $2.4 billion business globally by next year, up from less than $500 million in 2015.

Not all K-12 providers are going to be successful, though. Investors need to be cautious not just about the area of education but about the ability of companies to adjust to ongoing changes in state regulatory frameworks as they affect K-12.

For example, in California and Texas, two of the nation's most important and influential curriculum markets, state policymakers have in recent years ceded a lot of decision-making power on academic resources to local school districts. K-12 businesses that can adapt nimbly to such changes and to the shift toward digital learning resources will be the most attractive.

After K-12, higher education is probably next in the hierarchy of recession-resistant education sectors, helped by the growing popularity of alternative learning methods in fields such as computer coding that make post-high-school education more accessible.

Edtech firm 2U's $750 million acquisition this year of Trilogy Education, a workforce accelerator that provides training for adults to pursue digital careers, is one sign of the growing interest and opportunity in this sphere. Corporate training budgets are vulnerable to being one of the first things on the chopping block when companies experience a downturn, but again it is important to differentiate between the various types of providers and their niches.

Companies providing training that encompasses safety and security or areas that have a regulatory or compliance aspect to them should be on safer ground as these programs are often viewed as close to essential. The most attractive corporate training providers will probably be those which work closely with HR departments to produce tailored content. This makes them more attractive and relevant to companies compared to providers who sell off-the-shelf programs.

The value that investors see in well-positioned edtech companies has been underlined by two recent blockbuster deals. Tech investment firm Silver Lake bought the main edtech assets of Weld North Education, which develops digital curricula and tools for K-12, for a reported $925-950 million, valuing it at a lofty 17-18 times EBITDA.
In 2017, private equity firm Thoma Bravo acquired K-12 school administrative provider Frontline Education in a deal reportedly valued at more than 20 times EBITDA. Ten acquisitions over the previous three years had boosted Frontline's valuation to over $1 billion.

Businesses that have size and scalability like this will continue to be highly coveted and command double-digit EBITDA valuations. Smaller, mid-market providers may attract valuations of up to 10 times EBITDA, while upstart subscription-based companies with no EBITDA to speak of can still sell at 3-5 times revenue, or higher for the stellar performers.

Even in this high-valuation environment the education sector continues to represent an appealing opportunity for investors. The price you pay may be high but if the investment can deliver growth over its lifetime and meet return models, that's not such a bad outcome in the face of growing economic and market risks.

Alex Hicks is a Director and Co-Head of MHT Partners' Education practice