Sponsored Research

Curro Holdings

ANCHOR STOCKBROKERS

Reining in the spend

Date: 01 August 2022

- Since 2009 Curro has grown to the largest private school operator in SA with 179 schools, 70 408 learners. Two thirds of expansion has been developed at a significant cost, amassing a total property portfolio of R8bn. This resulted in high debt levels (net debt peaked at R4bn in FY19), which have since been managed down. The medium-term outlook sees its first period of consolidation with minimal school additions resulting in significantly lower capex, improved operating margins and regular dividends.
- Reduced expansion will see school utilisation rates rise after being largely flat at 70% for the past 6-years. Utilisation rates have been hampered by aggressive expansion as sqm of schools grew by 9.5% p.a over the past six years. We believe schools in certain geographical nodes are not achieving true potential given weaker operating fundamentals, which impede higher utilisation rates. An 85% utilisation of eventual capacity will see learners of circa 94 100, +34%.
- High schools only account for 34% of total learners given low penetration in higher grades. With Grade 8 enrolments at circa 6 800 and Grade 12 at 3 500, the roll over from Grade 8 to Grade 12 should result in an additional 7 400 students, 10.5% student growth alone over the next four years. A similar roll over from Grade 1 to 7 should see an additional 2 700 primary school learners. 10 100 students at an ave revenue per student of R53k, equates to an additional circa R540m p.a., 15% of FY21 revenue.
- Gross debtors has expanded rapidly from R44m in FY16 to R481m in FY21. As a % of revenue its risen from 2.6% to 13.6% (peaked at 14.4% in FY20). While this reflects affordability challenges it's also reflective of a slow write off policy. 52% of the book is older than 360 days with 84% provision coverage. Expediting write offs will have a marginally negative impact on the bad debt ratio. We expect a modest improvement in the bad debt ratio, but it will remain elevated in the medium term.
- EBITDA margins are anticipated to rise on positive jaws, lower bad debt costs, lower discounts offered and a recovery in ancillary income. Discounts reached a peak of 11.9% of revenue in FY20, largely due to COVID-19 affordability concerns. These declined to 9.2% but remain historically high, 6.4% in FY18. We have EBITDA margins rising from 22.3% in FY21 to 22.9% and 23.9% in FY22E and FY23E.
- We anticipate a sharp recovery in HEPS after years of disappointing growth – FY21 HEPS below that of FY17. The FY20 rights issue increased shares in issue by 45%. Our 3-year HEPS CAGR outlook is for 31%. We forecast ROE expansion from 3.5% in FY21 to 7% in FY24E.
- Curro is trading on a forward 20m P/E of 16x (11.7x to FY24E) and an EV/EBITDA of 8.3x. This in contrast to its 5-year ave P/E of 38x. In our DFCF valuation we calculate a fair value range of R11.38-R16.89, a mid-point of R13.72. Whilst already largely discounted, PSG's unbundling in Sep 2022 of its Curro stake will weigh on the share till the event.

ZAR'm (to December)	FY20	FY21	FY22E	FY23E	FY24E
Revenue	3,094	3,543	4,007	4,599	5,189
EBITDA	686	789	918	1,100	1,293
Headline earnings	179	245	302	403	551
HEPS (ZAc)	38.0	41.0	50.6	67.4	92.1
PE Ratio	25.0	26.3	21.3	16.0	11.7
Dividend (ZAc)	0.0	8.2	10.1	16.9	27.6
Dividend yield	0.0%	0.8%	0.9%	1.6%	2.6%

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Price (29/07/2022):	R10.77
Market cap	R6440mn
Shares in issue	598mn

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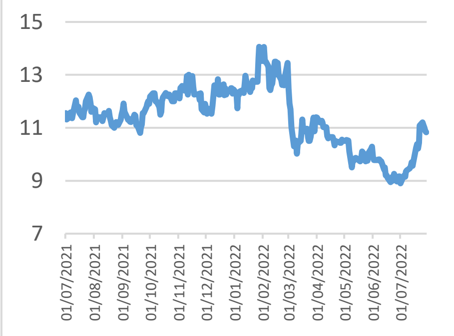
Price performance - ZAR



Source: FactSet

Figure 1 Financial summary

Year Ending	FY2017 A	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 F	FY2023 F	FY2024 F
Income Statement								
Sales	2,099	2,496	2,944	3,094	3,543	4,007	4,599	5,189
Sales growth (%)	*na*	*18.9%*	*17.9%*	*5.1%*	*14.5%*	*13.1%*	*14.8%*	*12.8%*
EBITDA	473	627	693	686	789	918	1,100	1,293
EBITDA Margin (%)	*22.5%*	*25.1%*	*23.5%*	*22.2%*	*22.3%*	*22.9%*	*23.9%*	*24.9%*
EBIT	342	473	506	455	508	620	768	942
EBIT Margin (%)	*16.3%*	*19.0%*	*17.2%*	*14.7%*	*14.3%*	*15.5%*	*16.7%*	*18.2%*
Profit before tax	273	333	188	-33	352	410	544	747
Net profit	198	242	187	-43	251	292	391	536
Net profit post minorities	209	248	202	-31	259	302	403	551
Headline Earnings	197	248	212	179	245	302	403	551
	16.6%	*25.9%*	*-14.5%*	*-15.6%*	*36.9%*	*23.4%*	*33.3%*	*36.6%*
Headline Diluted EPS, ZAc	48.0	60.0	50.5	38.0	41.0	50.6	67.4	92.1
Normalised Diluted EPS, ZAc	48.0	60.0	50.5	38.0	41.0	50.6	67.4	92.1
% Change	*9.8%*	*25.1%*	*-15.9%*	*-24.7%*	*7.8%*	*23.4%*	*33.3%*	*36.6%*
DPS, Zac	0.0	0.0	0.0	0.0	8.2	10.1	16.9	27.6
Payout ratio (%)	*0%*	*0%*	*0%*	*0%*	*20%*	*20%*	*25%*	*30%*
Balance Sheet								
Cash and Cash equivalents	571	170	114	99	90	54	70	136
Current assets (ex – cash)	237	277	415	715	488	476	507	547
Net Fixed assets	6,660	7,937	8,870	9,120	9,800	10,624	10,890	11,162
Intangible assets	566	759	829	832	849	824	799	775
Investments	50	14	248	340	325	347	361	375
Other assets	0	8	8	8	0	4	5	7
Total assets	**8,084**	**9,165**	**10,484**	**11,114**	**11,552**	**12,328**	**12,632**	**13,002**
Debt	2,382	2,980	3,883	2,986	2,875	3,236	3,088	2,989
Lease liabilities	0	0	195	323	330	343	357	371
Current liabilities	331	366	420	475	559	611	695	779
Other liabilities	375	547	571	564	688	727	767	809
Total liabilities	**3,088**	**3,893**	**5,069**	**4,348**	**4,452**	**4,918**	**4,907**	**4,948**
Shareholders' equity	5,019	5,238	5,405	6,768	7,110	7,424	7,756	8,102
Minorities	-23	34	11	-2	-10	-11	-11	-12
Total shareholders' equity	**4,996**	**5,272**	**5,416**	**6,766**	**7,100**	**7,414**	**7,745**	**8,090**
BVPS - ZAR	*12.1*	*12.8*	*13.1*	*11.3*	*11.9*	*12.4*	*13.0*	*13.5*
RoE	*7.9%*	*4.8%*	*4.0%*	*2.9%*	*3.5%*	*4.2%*	*5.3%*	*7.0%*

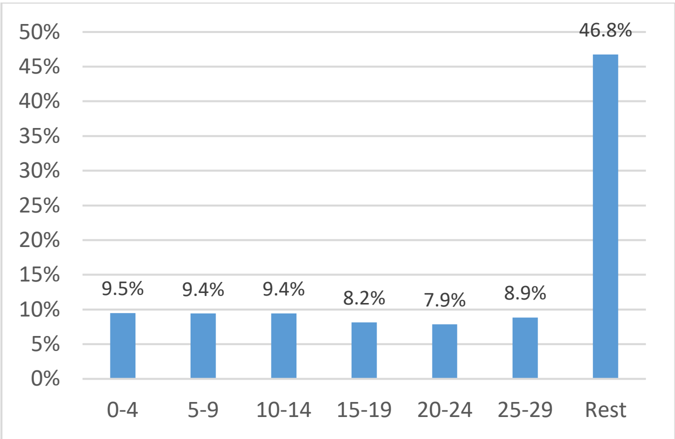
Year Ending	FY2017 A	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 F	FY2023 F	FY2024 F
Cash Flow								
Reported profit before tax	**273**	**333**	**188**	**-33**	**352**	**410**	**544**	**747**
Change in net working capital	-91	-88	-23	3	75	64	53	45
Net Interest (paid)/received	-77	-138	-204	-200	-126	-210	-224	-195
Dividends paid	0	0	0	0	0	-49	-60	-193
Depreciation	131	154	187	231	281	298	332	351
Other adjustments	77	127	326	513	186	174	71	-16
Cash flow from operations	**313**	**388**	**474**	**514**	**768**	**687**	**715**	**739**
Net Capex	-1,144	-1,089	-1,060	-584	-855	-1,122	-598	-623
Capex/sales (%)	*54.5%*	*43.6%*	*36.0%*	*18.9%*	*24.1%*	*28.0%*	*13.0%*	*12.0%*
Other investing cash flows	-48	-284	-232	-337	166	11	22	21
Cash flow from investing	**-1,192**	**-1,373**	**-1,292**	**-921**	**-689**	**-1,110**	**-576**	**-602**
Equity raised/ (bought back)	177	0	0	1,473	0	2	2	3
Net increase/(decrease) in borrowings	1,595	850	1,701	1,150	150	375	-135	-84
Other financing cash flows	-881	-344	-960	-2,132	-237	60	70	203
Cash flow from financing	**891**	**506**	**741**	**491**	**-87**	**387**	**-123**	**-71**
Net cash flow	**-135**	**-479**	**-77**	**84**	**-8**	**-36**	**16**	**66**
Free cash flow	**-770**	**-568**	**-403**	**102**	**7**	**-176**	**402**	**504**
Repayment of lease liabilities	**0**	**0**	**-3**	**-7**	**-8**	**-8**	**-9**	**-9**
Net Free cash flow	**-770**	**-568**	**-406**	**95**	**-1**	**-184**	**393**	**494**
Valuation Summary								
Valuation metrics								
Share Price- ZAc	1,770	1,538	1,084	952	1,077	1,077	1,077	1,077
P/E (Underlying) -x	36.9	25.6	21.5	25.0	26.3	21.3	16.0	11.7
P/BV -x	1.5	1.2	0.8	0.8	0.9	0.9	0.8	0.8
EV/Sales - x	4.3	3.7	3.1	2.9	2.6	2.3	2.0	1.8
EV/EBITDA -x	19.3	14.5	13.1	13.3	11.5	9.9	8.3	7.0
EV/EBIT - x	26.6	19.3	18.0	20.0	17.9	14.7	11.9	9.7
FCF Yield	-10.6%	-9.0%	-9.1%	1.7%	0.0%	-2.9%	6.1%	7.7%
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.8%	0.9%	1.6%	2.6%
Net Debt (incl lease liabilities)	1,811	2,810	3,964	3,210	3,115	3,526	3,375	3,225
Debt/Equity (incl lease liabilities)	0.36	0.53	0.73	0.47	0.44	0.48	0.44	0.40
Net Debt (excl lease liabilities)	1,811	2,810	3,769	2,887	2,785	3,183	3,018	2,853
Debt/Equity (excl lease liabilities)	0.36	0.53	0.70	0.43	0.39	0.43	0.39	0.35

Source: Company data, FactSet, ASB estimates

SA Schools Environment

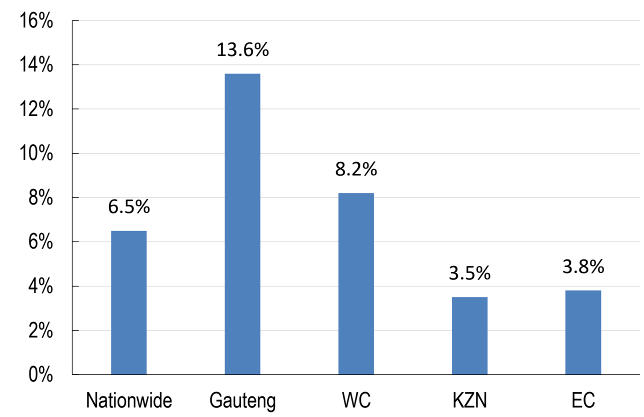
SA has a very young population (53% below the age of 30) and therefore the demand for schooling and tertiary education is very high. According to Stats SA, 37% of the population is below the age of 20, Curro's target market. Unfortunately, the government is struggling to adequately fulfil this demand with overcrowding of schools and poor pass rates highlighting the challenges. There has been a significant development of private schools over the past 10 years, primarily by Curro and ADvTECH. Yet private schools account for approximately 6.5% of SA scholars, according to government estimates. The demand for private schooling is therefore significant, the key determinant to their success is affordability.

Figure 2 SA population by age, 2018



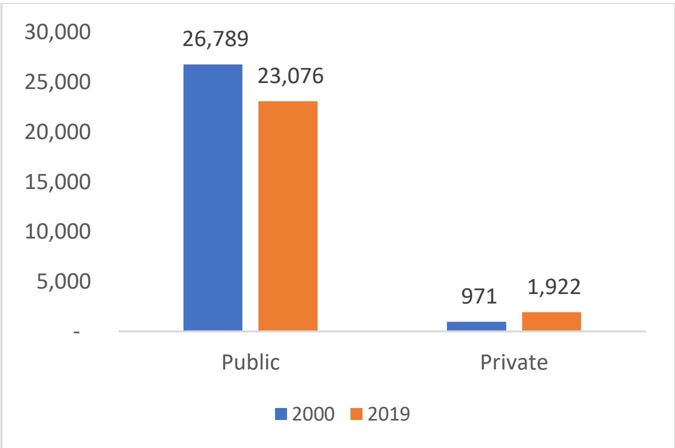
Source: Stats SA, ASB Research

Figure 3 Private school learners in SA - 2019



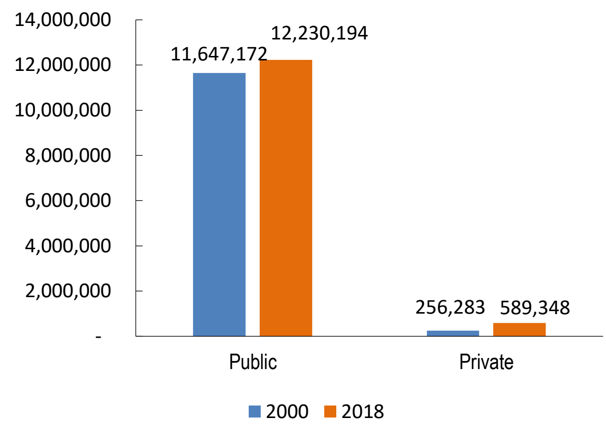
Source: Stats SA, ASB Research

Figure 4 Number of schools in SA - 2019



Source: Company data, ASB Research

Figure 5 Private school learners in SA - 2018



Source: Company data, ASB Research

Since 2000 the number of public schools in SA has declined by an estimated 14%, yet the number of scholars in these schools has risen by 5% (to 2018), increasing the burden placed on teachers in these schools and jeopardising the quality of education. In recent years the state has struggled to allocate pupils to schools at the start of each academic year due to overcrowding and urbanisation.

The pass rate in private schools is significantly better than state schools. The 2021 IEB (Independent Examinations Board) matric pass rate was 98.4% compared to the state school matric pass rate of 76.4%.

IEB achieved university pass rates of circa 90% compared to NSC (National Senior Certificate) of 36.4%. 897 163 candidates wrote the NSC matric exams in 2021 compared to 13 825 IEB, the latter representing 1.5% of the total scholars writing matric. This highlights the potential for growth as the IEB is insignificant in numbers but superior in results. It must be noted that many private schools also write the NSC exams, a reason the 1.5% is far short of the 6.5% estimate of private school learners. For example, Curro's 2021 Grade 12 class had 1 774 IEB learners vs. 1 196 NSC.

Curro's Background

Established in 1998, Curro has grown significantly from one small independent school to 179 on 77 campuses. In 2005 it was part of the Naspers group when Educor, a subsidiary of Naspers, acquired a 25% stake in Curro. In 2006 Naspers exited Educor when Curro had 3 schools. The founders together with the current CEO, Andries Greyling (see biography in Appendix 1), acquired the 25% stake. In 2009 PSG Group Ltd acquired 50% through its subsidiary Paladin, increasing it to 75% shortly thereafter.

In 2011 the company listed on the JSE and raised R318m in a rights offer. A further rights offer and private placement of R476m followed in 2012. The funds were required to meet the company's listing target of 45 000 learners by 2020 via 40 campuses, numbers that were well surpassed.

In 2012, Curro together with the PIC and Old Mutual joined forces to raise R440m to develop a group of Meridian schools to accommodate 20 000 learners. Meridian would be the group's most affordable school offering. Meridian has had its challenges resulting in it falling short of its target – 9 727 learners at February 2022. One key aspect has been the failure of government subsidy support of the initiative resulting in high debt levels constraining growth prospects.

A further rights offer and private placement of R606m occurred in 2013 to expand existing schools, acquire and develop new ones. Curro and Old Mutual injected a further R188m into Meridian. Curro successfully raised R150m in 5-year bonds through a JSE listed domestic medium term note programme. 2013 ended with 21 027 learners.

In 2014, R600m was raised through a right issue and a further R125m in 5-year bonds. 2014 ended with 28 737 scholars after adding 10 campuses in the year (8 constructed, 2 acquired).

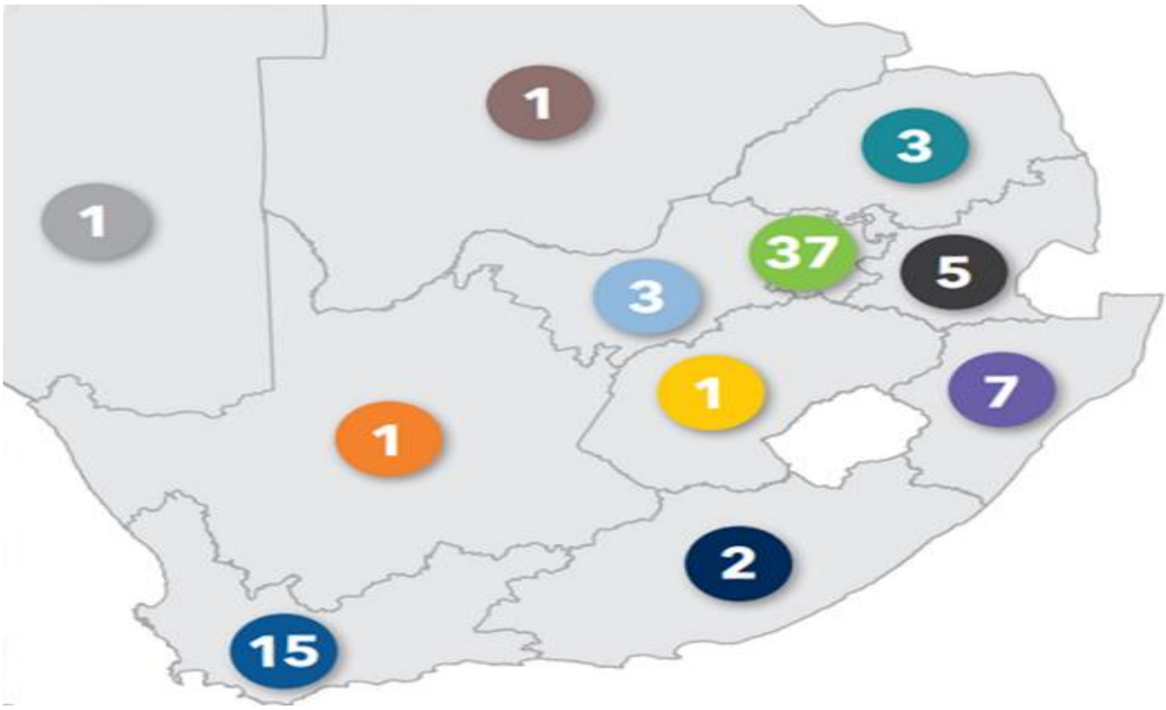
2015 saw a further rights offer of R740m to part fund R1bn in growth and expansion projects in that year. Continued aggressive expansion occurred and scholars reached 43 183 by 31 December 2016. In October 2017 the group decided to unbundle its tertiary education business, Stadio. Expansion continued unabated requiring a R1.5bn rights offer in 2020 following the impact of lockdown restrictions due to COVID-19. These proceeds also allowed the group to redeem circa R1.1bn of its growing and significant debt pile – net debt of R3.8bn in FY19 reduced to R2.8bn in FY21.

COVID-19 challenged the financial performance of the group and prompted a full review of the operations. It was decided to re-strategise the nursery schools and to exit one school. Nursery schools would limit exposure to 0–3-year-old children, a strategy that was the primary driver of a decline in nursery school learners of approximately 2 000 in FY20. Curro Online was launched as a consequence of lockdown and has become a standalone and profitable offering with over 600 learners. In February 2022 total learner numbers had reached 70 408.

Overview of operations

Nature of Schools

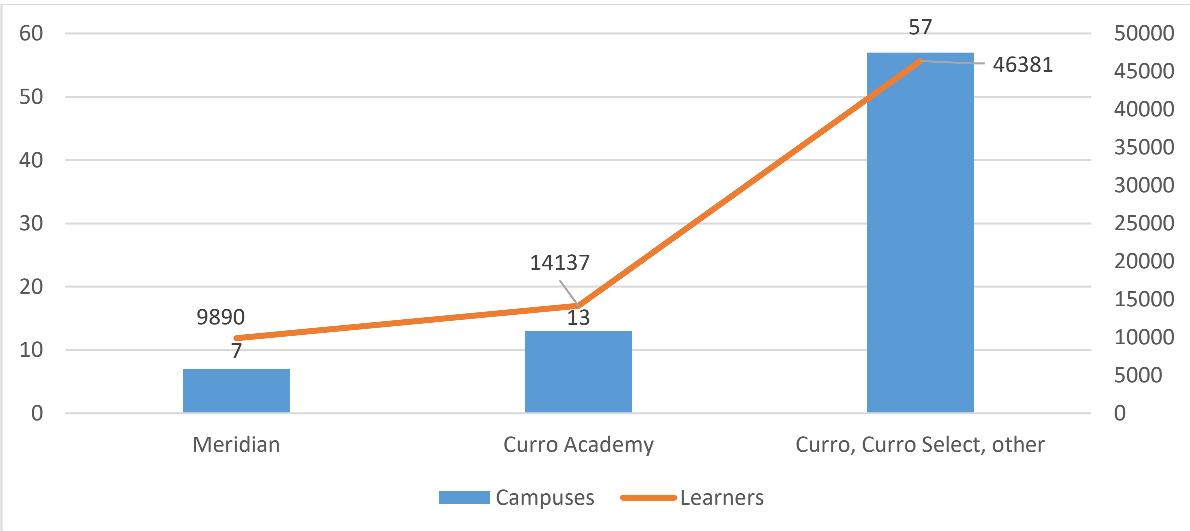
Figure 6 National footprint – schools in each province/neighbouring country



Source: Company data, ASB Research

Curro has a nationwide presence of 179 schools (including the recent acquisition of HeronBridge College). Schools range from Grade R to Grade 12 as well as pre-primary schools accommodating pre–Grade R through Curro Castle.

Figure 7 Number of campuses (LHS) and learners per school category



Source: Company data, ASB Research

There are three primary categories of schools within the portfolio:

Meridian – the joint venture with PIC and Old Mutual. This is the most affordable offering (fees from R2472 to R3 384 pm) within the stable providing quality education with focused subjects, targeted sports and cultural activities. It can accommodate learners from Grade R to 12 with many having nursery school facilities. Learner numbers are typically limited to 35 per classroom. NSC examinations are written in Matric.

Curro Academy – a very similar model to Meridian but branded Curro. Average monthly fees R2 837 to R4 452 with max class sizes of 35.

Curro, Curro Select & other – this includes the following:

- Curro schools – smaller class sizes, a variety of sports and activities and IEB examinations in Grade 12. Covers Grade R to 12 with Castle Nursery schools in some. Average monthly fees R5397 with max class sizes of 25.
- Curro Select – similar offering to Curro schools, however, these are schools that have been acquired and retain their well-established identities and ethos with support from the group. IEB and Cambridge Assessment International Education examinations are offered. These schools have state of the art facilities. Average monthly fees R3 448 to R7 140 with max class sizes of 25.
- Curro Castle Nursery schools – from 4 years until the child goes to Grade R. Meals are included as well as extended operating hours. Average monthly fees R5 896.
- Assisted learning schools – includes on-site therapists, NSC examinations, small class sizes, adapted classrooms and teaching.
- Curro DigiEd schools – a cost effective, innovative, technologically advanced option for learners from Grade 8. Teaching uses innovative methods such as videos and e-learning in class with teachers providing one-on one assistance. Future focused subjects and a technology driven programme to ensure readiness for the fourth industrial revolution. Average monthly fees R2 067 to R2 733.
- Curro online – learn from home (from Grade 4) through online learning with live teacher guided online lessons. IEB examinations are written. All teaching is done with teachers and therefore parents don't need to get involved. Students learn at their own pace. It has more than 600 learners with average monthly fees of R4201.
- Curro Private College – there are 5 schools at present. Instead of Grade 10,11 and 12, learners complete NCV (National Certificate Vocational) levels 2,3 and 4. NCV is a skills focused accreditation that runs parallel to NSC. It's a career-focused, Matric qualification with average monthly fees of R5 655.

Note: Average fees are based on all learners across all grades in each brand of schools for the 2021 year. Curro's fees increase with each grade and is highest in the high school and specifically from Grade 10 to 12.

Student and School numbers

Figure 8 Learner numbers, capacity, utilisation and capex

	2015	2016	2017	2018	2019	2020	2021	CAGR
Ave Learners	35148	42343	45870	51305	57597	60777	66447	11.2%
% change		20%	8%	12%	12%	6%	9%	
Schools	100	114	127	138	166	177	178	10.1%
% change		14.0%	11.4%	8.7%	20.3%	6.6%	0.6%	
Sqm - '000	449	559	598	656	701	713	772	9.5%
% change		24.4%	7.1%	9.7%	6.8%	1.7%	8.3%	
Utilisation -% of build capacity	N/A	69%	70%	69%	70%	69%	70%	
Utilisation - % of eventual capacity	50%	52%	53%	53%	52%	51%	60%	
Cumulative Capex - Rm	4864	6350	7486	8979	10265	10915	11844	16.0%
% change		31%	18%	20%	14%	6%	9%	
Learners at 85% utilisation of eventual capacity							94133	
% change							42%	

N/A – Not disclosed

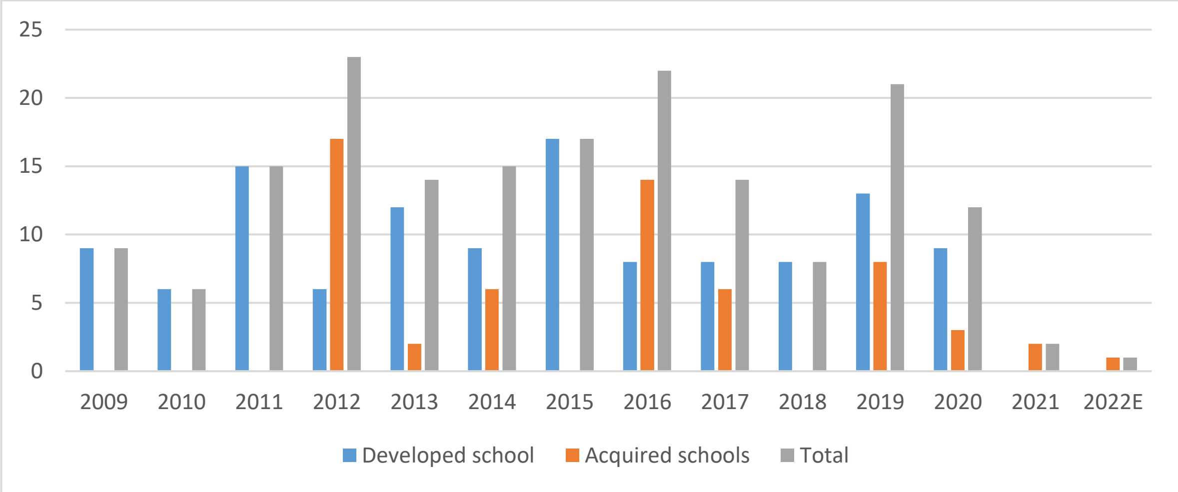
Source: Company data, ASB Research

As is evident from the table above, there has been significant expansion in the group over the past six years with 9.5% CAGR growth in square meterage. Cumulative Capex has risen from R4.9bn in FY15 to R11.2bn in FY21, a CAGR of 16%. Average annual learner numbers have grown by 11.2% p.a over the past 6 years, broadly in line with 10.1% growth in the number of schools, hence little change in utilisation rates. Student numbers at Feb 22 are 70 408, up 6% on the average learner numbers in 2021.

Because of the ongoing expansion, utilisation rates (% of build capacity) has remained relatively stable over the period – increasing marginally from 69% in FY16 to 70% in FY21. Eventual capacity utilised has also remained relatively stable but improved considerably from 51% to 60% in FY21. This improvement is partly due to the change in utilisation of buildings – for example the closure of nursery schools' capacity (0–3-year-olds), and to represent the medium-term growth potential for schools more accurately as expansion capex is reined in until returns on capital improves sufficiently.

An 85% utilisation of eventual capacity will see learners of circa 94 100, +34% on the Feb 2022 student numbers.

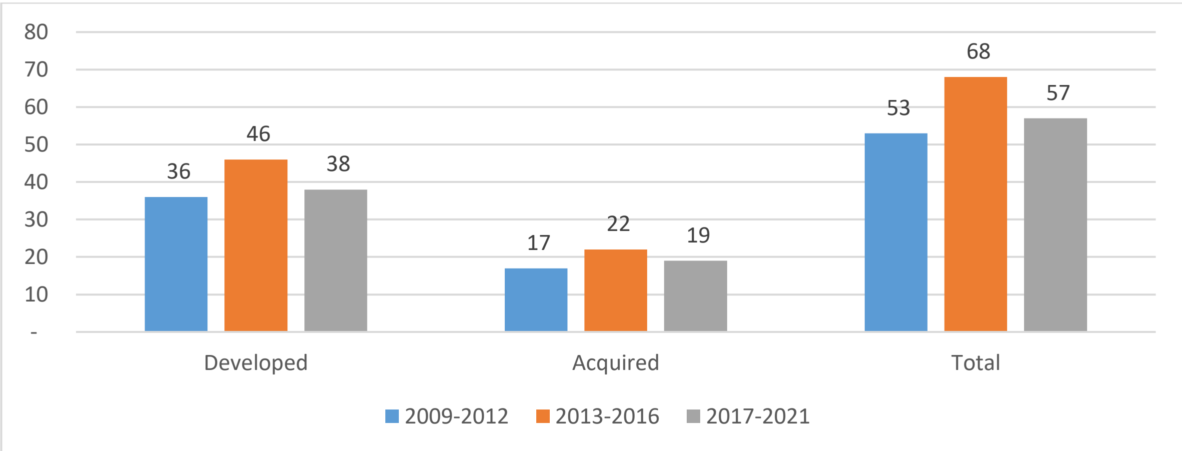
Figure 9 Developed, acquired and total number of schools per annum



Source: Company data, ASB Research

As per Figure 9 above, aggressive expansion occurred from 2011. The average net number of schools added p.a. is 13 and this was exceeded from 2011 to 2017 and again in 2019. Expansion has slowed significantly since 2020 with 2 schools added in 2021 (one was also closed) and one school added in FY22E with one anticipated to be closed. On a net basis FY22E is likely to end with 178 schools, in line with 2021.

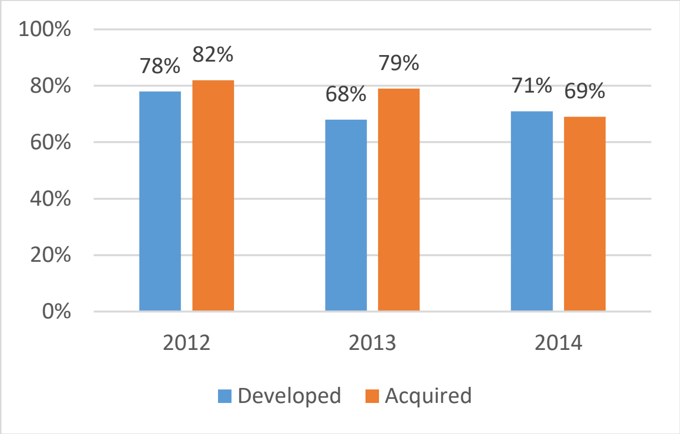
Figure 10 Number of schools acquired and developed



Source: Company data, ASB Research

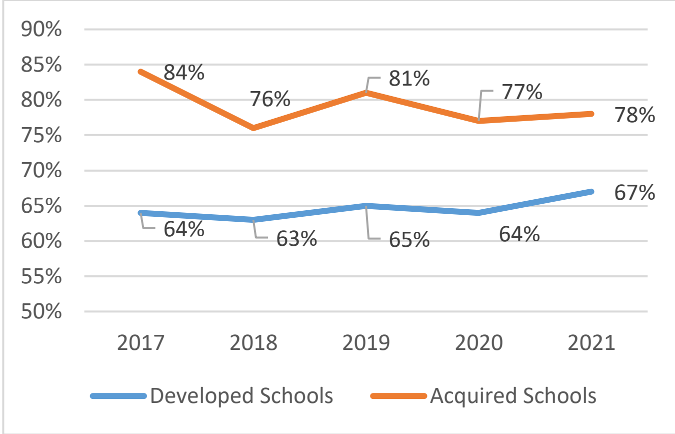
In its disclosure of utilisation rates the company differentiates between developed and acquired schools. From Figure 10 above it is evident that more schools have been developed than acquired – almost 2 developed for every one acquired. This is true for all periods of its history. The most aggressive expansion occurred in the period 2013 to 2016 – this is also the period in which a rights issue was done in each year.

Figure 11 2021 utilisation rates for schools developed in 2012/3/4



Source: Company data, ASB Research

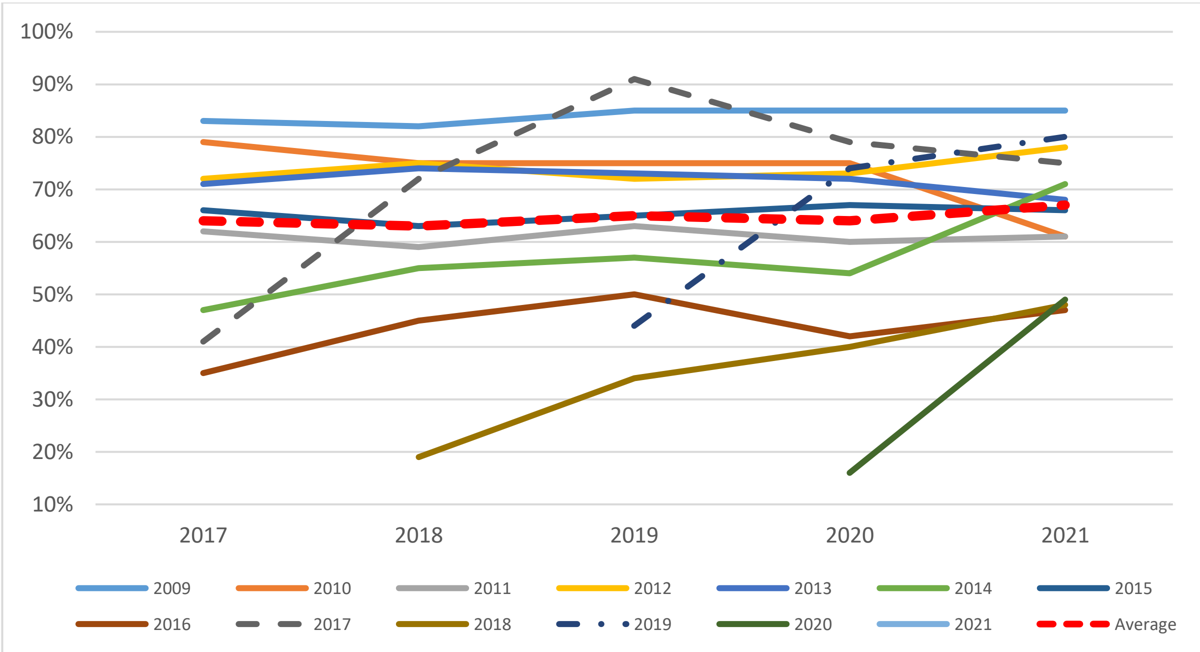
Figure 12 Utilisation rates – developed vs acquired



Source: Company data, ASB Research

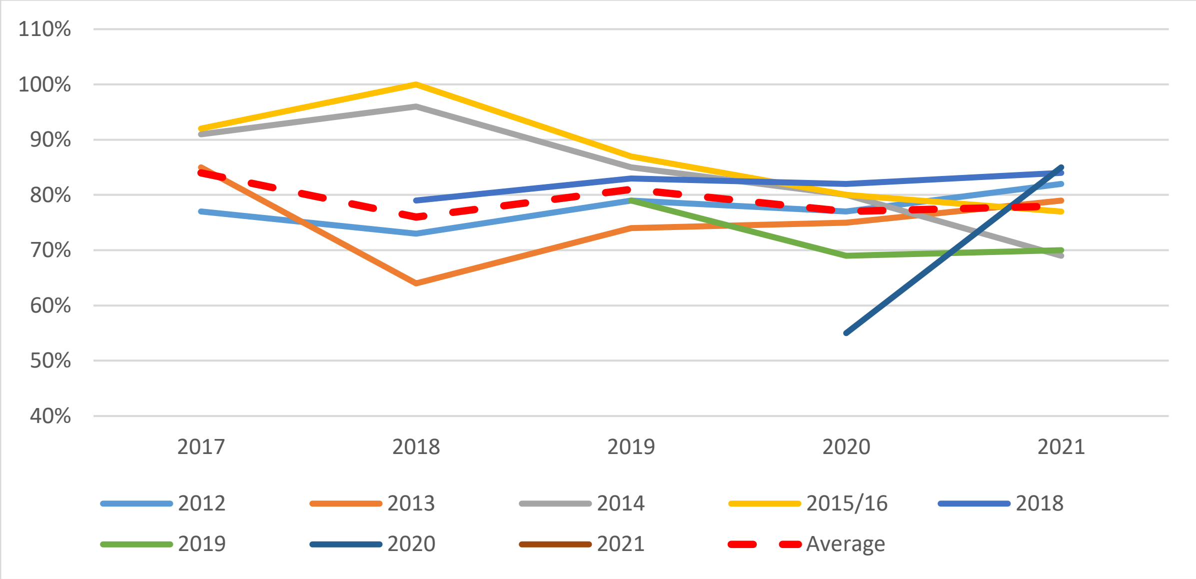
Before analysing the utilisation rates in more detail, we look at the rates per category. One could assume that acquired schools have higher utilisation rates given they are established schools. This is indeed the case, and it has been consistent over the past five years (Figure 12). In the absence of further aggressive development (which is the current strategy), the two should ultimately converge **suggesting significant upside for learners in existing developed schools.** We illustrate this by looking at the 2021 utilisation rates of developed and acquired schools in 2012/3/4. Developed schools have largely obtained the utilisation rates of acquired schools, with 2013 being an exception (there was an above average 13 schools developed in 2013 and clearly not all of them have been optimally located).

Figure 13 Utilisation rate vintages – developed schools



Source: Company data, ASB Research

Figure 14 Utilisation rate vintages – acquired schools



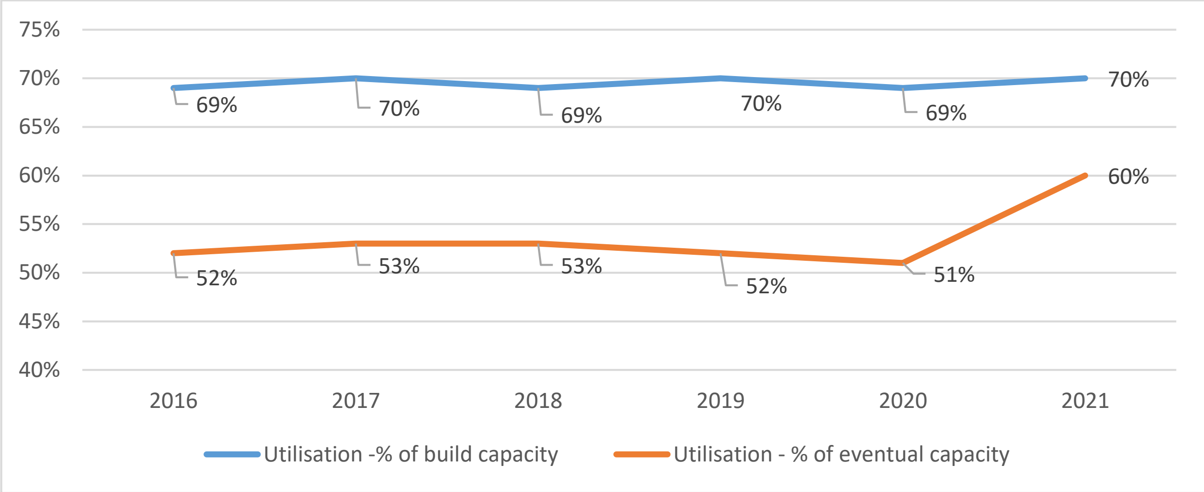
Source: Company data, ASB Research

In the charts above we analyse the build capacity utilisation rates for developed and acquired schools going back to the company's inception. Our observations are as follows:

- Acquired schools have higher utilisation rates as expected
- Acquired schools on average have fairly stable utilisation rates.
- On balance, developed school utilisation rates have been rising for each year of development. However, the average rate has been declining since 2019 given the additional capacity added at considerably lower utilisation rates – for example 2018 & 2020
- Older schools (apart from 2009 and before) have not achieved peak utilisation rates (85%-90%). This is particularly true for schools developed in 2010 and 2011, some of which are in more rural locations.
- Schools developed in 2015 & 2016 have struggled to gain traction.
- It seems that an 85% utilisation rate is the ceiling for developed schools.
- Mature acquired schools have not shown an increase in utilisation rates. These are generally premium schools and would suffer the most from emigration and higher fee hurdles.
- As an overall portfolio the utilisation rates have remained flat over five years. This is not the outcome that would be expected.

Build capacity utilisation is impacted by the rate of capacity expansion. Eventual capacity utilisation fell from 2017 to 2020 suggesting that a lot of capacity was added as learner numbers were rising at a good pace. As per Figure 8, the 6-year CAGR of Sqm expansion was 9.5% vs. learner growth at 11.2%.

Figure 15 Utilisation rates – build vs eventual capacity



Source: Company data, ASB Research

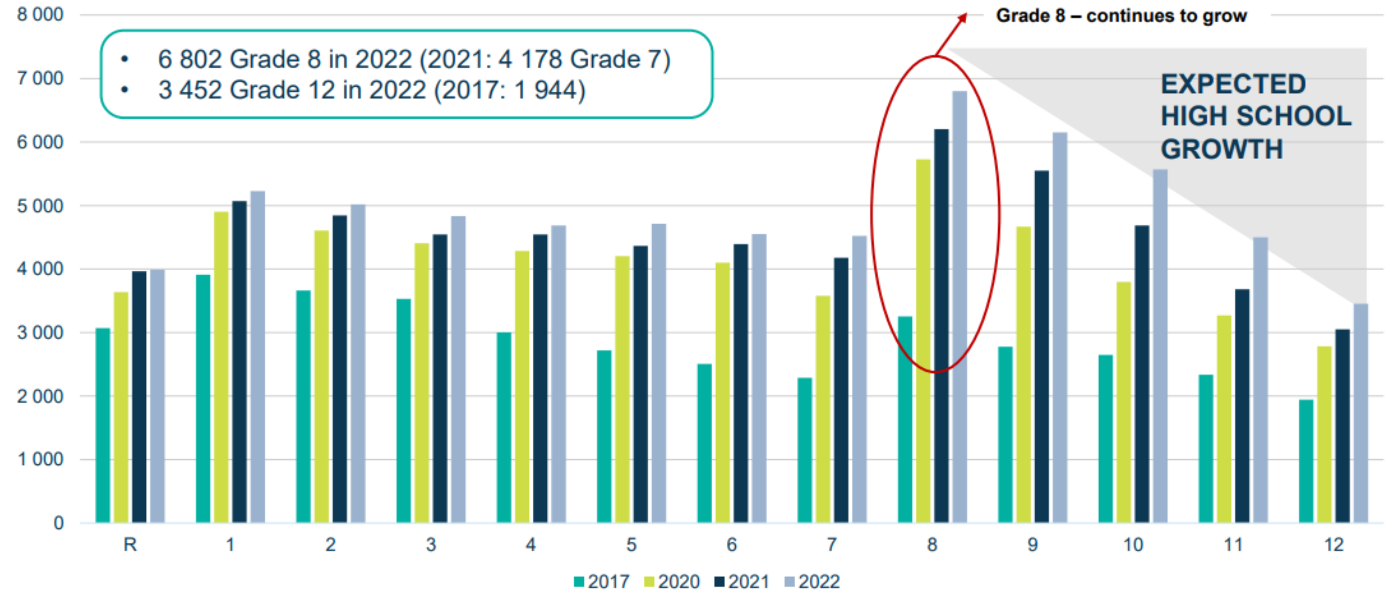
Utilisation rate summary:

The above charts depict a disappointing overall trend in utilisation rates, suggesting the aggressive expansion strategy has not delivered as optimally anticipated. The SA economy has stalled since the more aggressive years of expansion, having a major negative impact on affordability. Low economic growth has impacted certain cities and regions more than others with urbanisation an ongoing trend. This is impacting Curro which has a more nationwide presence (certainly compared to ADvTECH) with schools in underperforming provinces like Limpopo, Mpumalanga, North West and Northern Cape. COVID-19 further impacted affordability and resulted in lifestyle changes - these had a major impact on nursery school numbers. Perhaps a more measured expansion strategy would have delivered better results. With the backing of its parent (PSG) and shareholders, the aggressive expansion strategy was, however, endorsed to establish a meaningful national network of schools which cater to different price points and markets.

It's how management intends managing the situation going forward. It has openly admitted that mistakes have been made and therefore a review of its operations has been performed (for impairment or sale) and cost efficiencies sought to optimise margins. One school was closed in FY21 and a further one envisaged in FY22E. Net school numbers will likely remain flat for two years and potentially longer, a major departure from its aggressive historic strategy. The focus is now on filling its capacity and cutting back significantly on capex. Developed school capacity is at 67% utilisation, below the group average of 70%, and this is where there is considerable potential as existing grades are filled, particularly in high schools.

Outlook for student numbers

Figure 16 Expansion potential in high school with roll over from Grade 8 to 12



Source: Company data, ASB Research

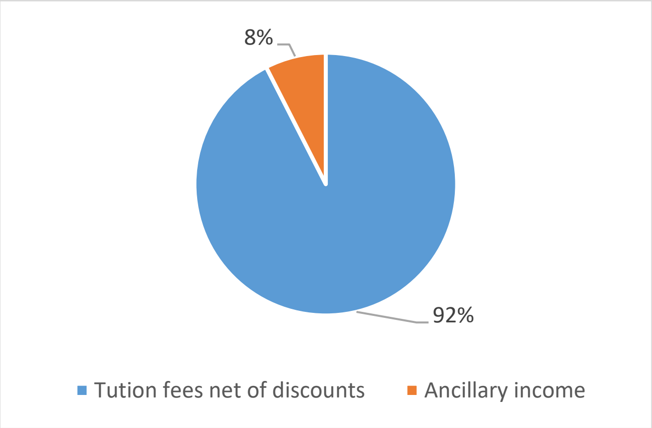
We acknowledge for reasons already given that the portfolio utilisation rate may not get to 85%, but there is certainly scope to improve from the current 70% level. We believe that built utilisation rates will gradually rise, driven primarily by developed schools, given the following:

- Expansion has slowed significantly – no schools were developed in 2021 (compared to an average of 10 in prior years) and the medium-term outlook is very measured.
- High school grades are underutilised and currently only account for 34% of learners and about 25% of eventual capacity. As developed schools mature it's the higher grades that take the longest to be occupied. A new school would cater to Grade 8 and possibly Grade 9 but the later grades are only developed thereafter. These are also the grades attracting the highest fees. It's evident from the chart above that Grade 8 and Grade 1 are the formation years for most developed schools and slowly learners progress onwards. Assuming the maturity of schools, with the numbers provided in Figure 16, if all subsequent grades from Grade 1 had the same number of students (circa 5200), it would imply approximately 2700 more primary school learners. Applying the same logic to Grade 8, the additional learners to come from Grades 9-12 would be approximately 7400. In total this is 10 100 additional learners, 14% growth from current levels – 80 500 approximate learners. This ignores the fact that there is scope to increase class sizes in each Grade from these current levels.
- Certain geographic nodes, outside of the major metropolitan areas, are seeing a revival given migration out of Gauteng. Curro schools in coastal areas like George (a primary and pre-school), Hermanus (a primary, high and pre-school), Langebaan (a primary, high and pre-school), Mossel Bay (a primary, high and pre-school), Somerset West (a primary, high and pre-school), Port Shepstone (a primary, high and pre-school) and Salt Rock (a primary, high and pre-school) are great examples benefiting from the "semigration" trend.
- Improved commodity prices is supporting a revival in mining towns such as Secunda, Nelspruit, Rustenburg, Kathu, Klerksdorp and Emalahleni where Curro has schools.
- Closure of poor performing schools – one was closed in 2021 and a further one is envisaged in 2022.

Financials

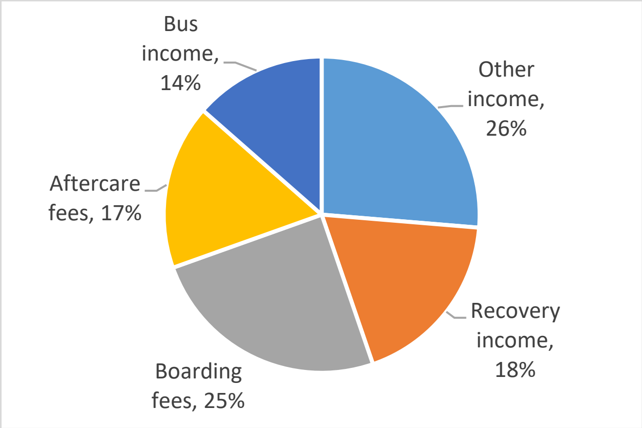
Revenue

Figure 17 Revenue split – FY21



Source: Company data, ASB Research

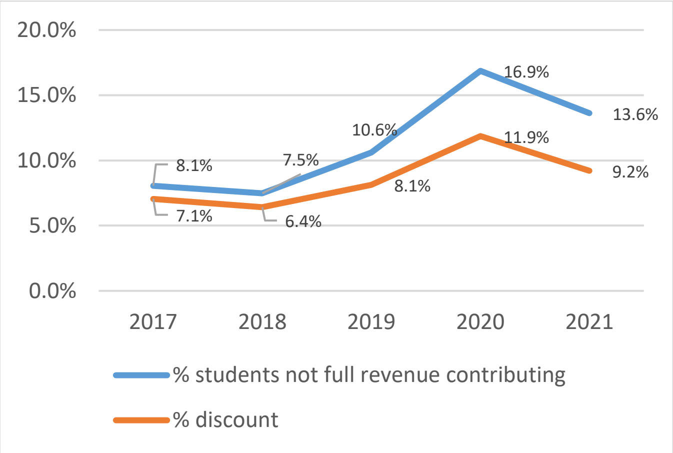
Figure 18 Ancillary revenue split – FY21



Source: Company data, ASB Research

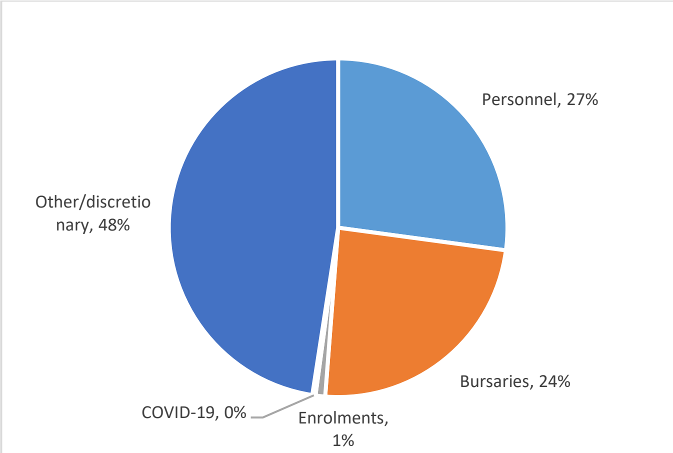
Revenue is derived primarily from school fees, approx. 92%, with the balance from ancillary income. School fees are a function of the number of learners, the fees charged, and the discounts offered. Discounts is a common industry practice and largely involves discounts to teachers' children, school bursaries/scholarships and other discretionary discounts particularly to those experiencing affordability issues. Ancillary income is primarily boarding income (25%), after care fess (17%), and bus income (14%). Recovery income is a recovery of an expense incurred by Curro on behalf of a learner, e.g., a school tour.

Figure 19 Discounts by value and student numbers



Source: Company data, ASB Research

Figure 20 Source of discounts



Source: Company data, ASB Research

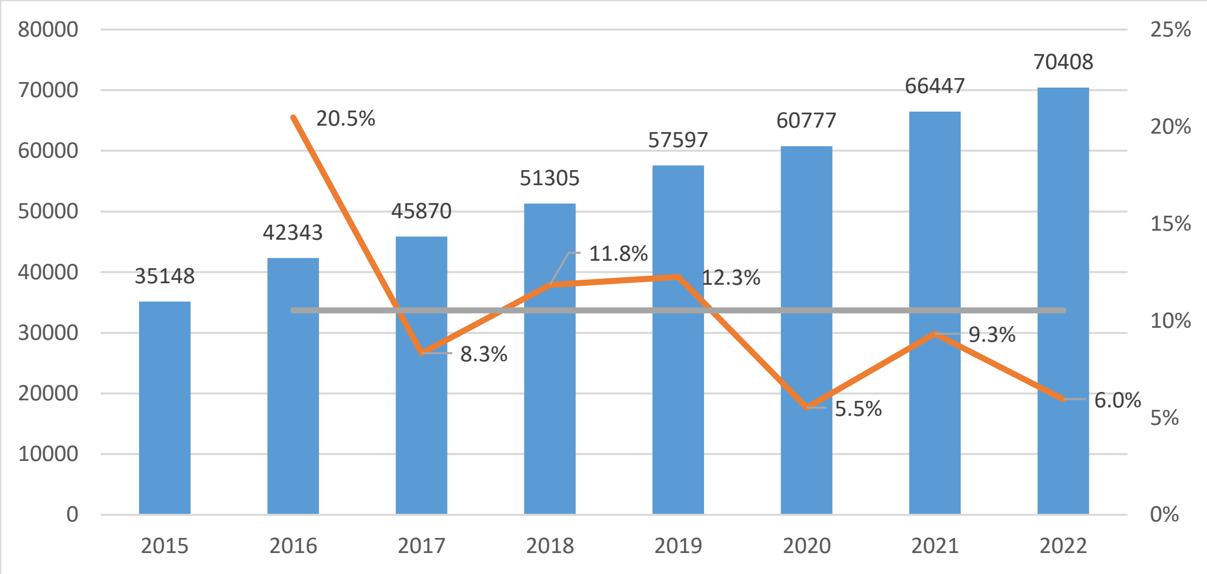
13.6% of learners receive some form of discount on their tuition fees, resulting in a 9.2% discount in school fee revenue. This is down from the FY20 peak but above historical levels. FY20 was impacted by COVID-19 discretionary discounts that were offered to assist with affordability. These discounts were no longer offered in FY21. Discounts tend to be higher for premium schools where scholarships for sports, culture and academic excellence play a key role. Discounts at lower end schools are predominantly to assist with affordability and are kept at lower levels than premium schools as the bad debt experience is higher.

Management noted a similar aggregate bad debt and discount level across the portfolio with a different mix at each brand level.

With 48% of discounts being discretionary, there is scope to reduce discounts, especially once utilisation rates rise. All being equal, a 1% reduction in the discount rate to 8.2%, which is broadly in line with FY19, adds 0.7% to EBITDA margins.

Revenue outlook

Figure 21 - Ave student numbers, growth rates and ave growth rate of 10.5% (2022 is Feb data)



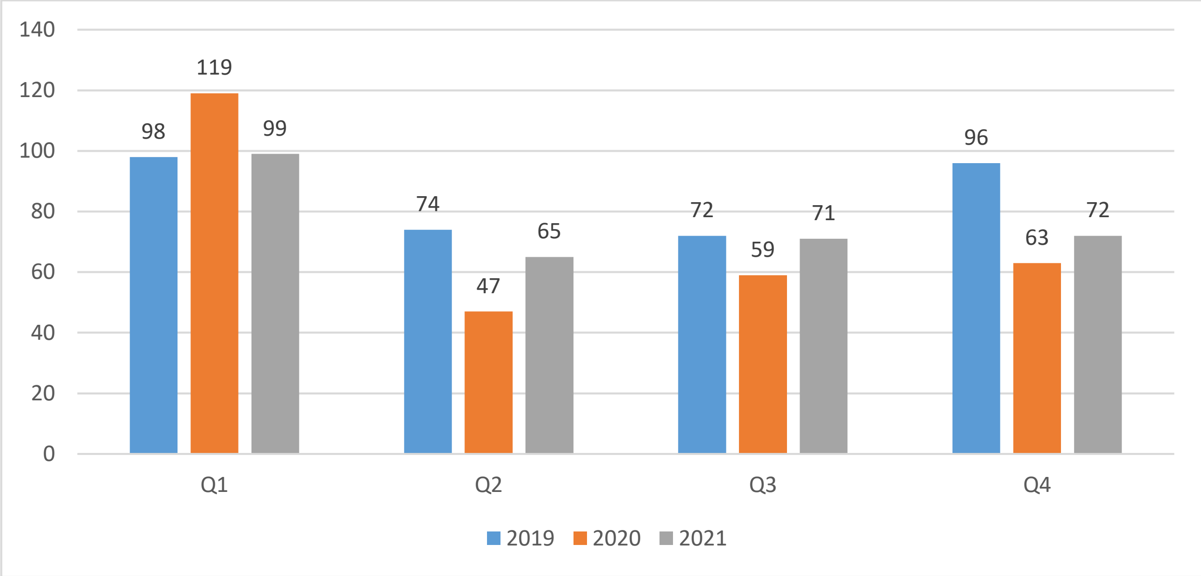
Source: Company data, ASB Research

The key driver is learner numbers. This is a function of greenfield expansion, acquisitions, expansion of existing facilities and ultimately higher utilisation rates. Given that 1 in 3 schools are acquired, it's fair to assume that the bulk of learners have been organically acquired. From the chart above, growth in student numbers has averaged 10.5% p.a. over the past seven years. More recent growth rates have slowed due to COVID-19, termination of learners due to outstanding accounts (circa 3 200 in Jan 21), slower expansion but also the market repositioning of certain nursery schools which saw approximately 2 000 learners leave in 2020 due to the COVID-19 lockdown. Record enrolments occurred in Feb/Mar 2021. The Feb 2022 intake delivered 6% net student growth which is likely to rise during the year as was the case in 2021 – we envisage 7.8% full year growth underpinned by the addition of approximately 1 100 students from the HeronBridge College acquisition. We envisage 6% to be the medium-term growth rate in students given less expansion.

School fees tend to be inflation benchmarked, however, the formula stems more from teacher wage inflation which generally runs ahead of headline inflation. Fee increases in 2022 averaged 5.8% (3.4% in FY21 and 5.4% in FY20). This is in contrast with government primary and secondary school fee increases of 2.5% and 4.3% respectively in 2021 and 7.3% and 7.6% in 2020. The improved academic results from Meridian is allowing more pricing flexibility. We forecast 7.5% fee increase in FY23E given heightened inflation and 6.5% in FY24E.

In total we have 14% and 15% tuition fee growth forecast for FY22E and FY23E.

Figure 22 Quarterly ancillary revenue – 2019-22



Source: Company data, ASB Research

Ancillary income is coming off a low base given the disruptions from COVID-19. As per the chart above, 2020 (from Q2) saw a sharp drop in ancillary revenue from COVID-19 with a modest recovery in 2021. As an example, after care income from nursery schools would have dropped significantly. Ancillary revenue should rise with growth in student numbers and therefore there is scope for a recovery in FY22E given no growth in the past two years. We forecast ancillary income to grow by 6% and 8% in FY22E and FY23E. In subsequent years growth should track student number growth plus inflation.

Overall, we estimate revenue growth to be approximately 13.1% in FY22E and 14.8% in FY23E.

Debtors Costs

Figure 23 Gross debtors and provision coverage

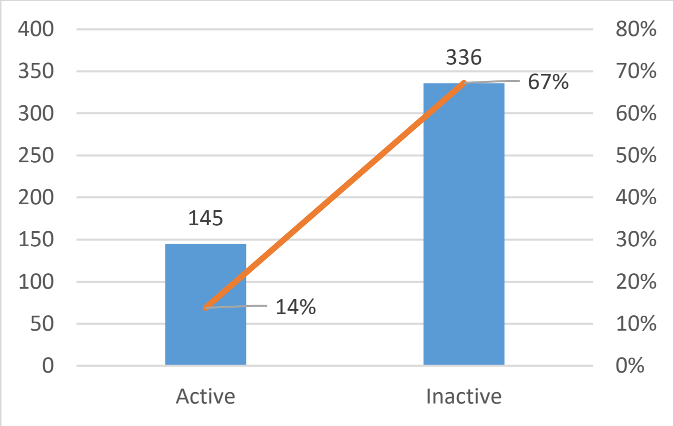
R'm	2016	2017	2018	2019	2020	2021
Gross debtors	44	75	121	249	447	481
Revenue (net of discounts)	1715	2099	2496	2944	3094	3543
% in debtors	2.6%	3.6%	4.8%	8.5%	14.4%	13.6%
Provisions	11	16	32	69	215	246
Provision coverage ratio	25.0%	21.3%	26.4%	27.7%	48.1%	51.1%
Net debtors	33	59	89	180	232	235

Source: Company data, ASB Research

Gross debtors have escalated considerably over the past five years – going from 2.6% of revenue (post discounts) in FY16 to 13.6% in FY21. We ascribe the following reasons:

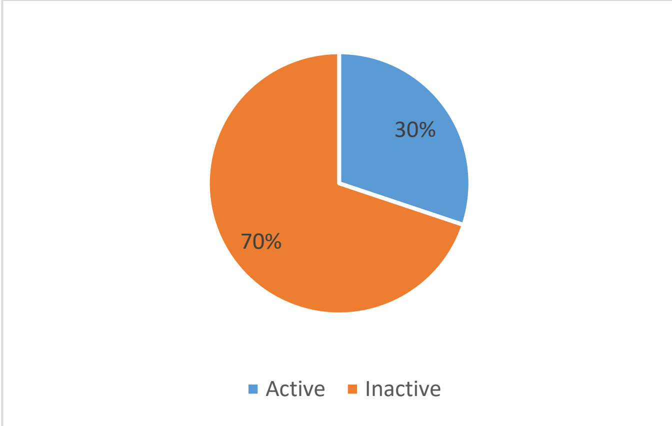
- The operating environment including the impact of COVID-19. The ratio climbed from 8.5% in FY19 to 14.4% in FY20.
- A very slow bad debt write off policy. Writes off totalled R2m in the three years from FY18 to FY20. Management acknowledges not being aggressive enough in clearing out the arrears book. R100m was written of in FY21, and we anticipate a more aggressive stance in FY22E.

Figure 24 Active vs inactive debtors – value (R'm) and provision coverage



Source: Company data, ASB Research

Figure 25 Split between active & inactive debtors



Source: Company data, ASB Research

Debtors are classified as active and inactive - depending on whether the learner is still at a Curro school or not. Active debtors account for 30% of gross debtors and as expected attract a lower provision coverage as there is still some leverage held over the enrolled learner. Interest is accrued on overdue accounts at a rate of 15% p.a and reflected in interest income. Interest accrual is suspended once an account is fully provided for.

Figure 26 Debtors age analysis – FY21

	<90 days	90-180	101-360	361-540	>540	Total
Debtors	92	52	85	65	187	481
Provisions	3	5	27	38	173	246
% coverage	3.3%	9.6%	31.8%	58.5%	92.5%	51.1%

Source: Company data, ASB Research

A new provision policy in FY20 saw the debtors book being segmented into age buckets based on the oldest portion of the debt which should see higher provision coverage of longer overdue accounts and ultimately higher write offs. As per the table above, provisions are slow to be raised, with 92.5% provisions only raised on the debtors book older than 1.5 years. We would expect it fully provided or written off at this stage. We also feel the 6% provision coverage on debt between 90-180 days is light. An IFRS9 provision methodology is in place and therefore it's both backward and forward looking with management indicating that it is adequately provided on its arrears based on past collection experience.

Arrears are initially chased up by the respective schools as relationships exist with parents and learners. Should this not succeed (after 30 days) it is taken up by the centralised call centre (circa 20 agents). Post 90 days the schools would look to evict the learner and the account is handed over for external collection. The recent trend has been to terminate learnership earlier than in the past, with several reviews during the year.

Figure 27 Bad debt charge

R'm	2016	2017	2018	2019	2020	2021
Opening B/S Provisions			16	32	69	215
Closing B/S Provisions			32	69	215	246
Provisions charged to I/S			16	37	146	31
Net bad debts written off	18	31.2	0	1	1	100
Income statement charge	18	31.2	16	38	147	131
Revenue (net of discounts)	1715	2099	2496	2944	3094	3543
Bad debt ratio	1%	1.5%	0.6%	1.3%	4.8%	3.7%

Source: Company data, ASB Research

The bad debt ratio (income statement charge as a % of revenue) was 3.7% in FY21, down from 4.8%. It was, however, considerably lower at 1.3% in FY19. Pre IFRS9 (2017 and prior) it appears that problematic accounts were not provided for, rather written off. This did result in higher recoveries – these are now negligible given the later write off policy.

Whilst some relief can be expected in the bad debt ratio (given COVID-19 in the base), we don't see it reaching FY19 levels, especially if write offs are accelerated as provisions in 360-540 days are only at 59% and 93% for >540days. Whilst the IFRS9 provision policy is based on past experience we feel it could be more prudent to increase the provision for arrears and write off debt earlier. Perhaps the opportunity will be taken now that the quality of the book improves. We see the bad debt ratio remaining elevated and declining slightly to 3.5% in FY22E, 3.3% in FY23E and 3.1% in FY24E.

EBITDA

Each school is a cost centre plus the head office. Certain head office costs are allocated to each division; however, the bulk are allocated to Curro (4% to Meridian). Within Curro these costs have been managed between 6-7% of its revenue for the past five years. Certain costs have been centralized whilst other remain at a school level. Schools manage their own HR requirements, but head office mandates the salary increases. Data networks are centralised as well as approximately 80% of marketing costs.

Figure 28 Calculating staff costs which account for circa 70% of costs

	2018	2019	2020	2021	2022E	2023E	2024E	2025E	Avg 2015-2021
Learners	51305	57597	60777	66447	70408	75778	80221	84547	
% growth	12%	12%	6%	9%	6.0%	7.6%	5.9%	5.4%	12.9%
Learner/teacher ratio	17.4	17.8	17.7	18.6	18.6	18.6	18.8	19.0	
Number of teachers	2945	3230	3425	3579	3785	4074	4267	4450	
% growth	6%	9.7%	6.0%	4.5%	5.8%	7.6%	4.7%	4.3%	9.5%
Wage inflation (base on prior year CPI +1.5%) or actual	6.0%	6.0%	5.5%	0.8%	4.5%	6.0%	5.5%	5.5%	5.6%
Teacher salaries (volume and inflation adj) - R'm (A)	851	1022	1097	1300	1437	1639	1811	1993	
% increase		20%	7.3%	18.5%	10.5%	14.1%	10.5%	10.0%	
Ave Teacher salary - R'000	289	316	320	363	380	402	424	448	
% change		9%	1%	13%	4.5%	6.0%	5.5%	5.5%	
Other employees - R'm (B)	347	431	328	365	389	423	453	485	
Volume increases (33% of teacher increase)					1.9%	2.5%	1.6%	1.4%	
Inflation increase					4.5%	6.0%	5.5%	5.5%	
Total % increase		24.2%	-23.9%	11.3%	6.5%	8.7%	7.2%	7.0%	
Head office – R'm (C)	92	116	142	165	185	207	228	250	
% increase	18%	26%	22%	16%	12.0%	12.0%	10.0%	10.0%	
Staff costs – R'm (A) + (B) + (C)	1290	1569	1567	1830	2010	2269	2492	2728	
% increase		21.6%	-0.1%	16.8%	9.9%	12.9%	9.8%	9.5%	
% of revenue	51.7%	53.3%	50.6%	51.7%	50.2%	49.3%	48.0%	46.9%	

Source: Company data, ASB Research

Staff costs account for circa 70% of operating costs. In forecasting staff costs we need to consider both wage inflation and teacher number increases. The latter is best derived from the learner/teacher ratio. The learner/teacher ratio has been rising as schools are filled and later grades are occupied – gone from 15.3 in FY15 to 18.6 in FY21. As utilisation rates rise so will the ratio. We have it on a path towards 19 by FY25E driven by high school expansion. Therefore, teacher numbers need to grow by circa 5.6% p.a over the next four years. This considered with wage inflation (4.5% agreed in FY22), results in teacher salary costs increasing by 10.5% and 14.1% in FY22E and FY23E.

Other employee numbers are also correlated to learner numbers but to a lesser extent. We assume 1/3 of the impact on teacher numbers. We apply the same wage increases as these staff are in the schools. We estimate other employee costs to increase by 6.5% and 8.7% in FY22E and FY23E.

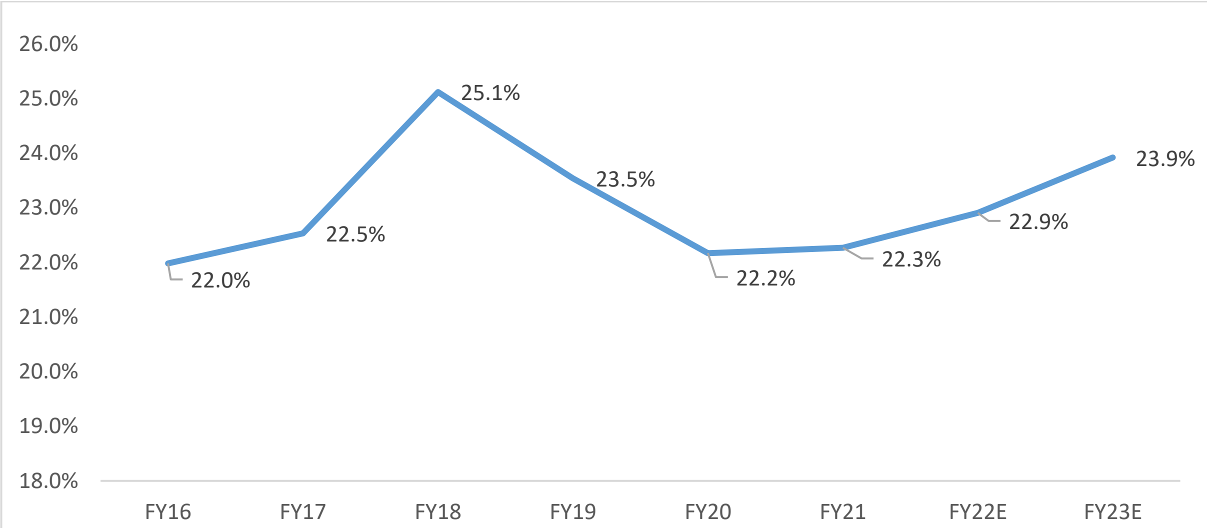
Lastly, we calculate head office salary costs. These have seen considerably higher increases, in part due to incentivisation schemes but also greater staff numbers. We apply a 12% increase in FY22E and FY23E.

Our result is staff costs growing at 9.9% in FY22E and 12.9% in FY23E.

Facility costs is a further 12% of costs. Facility costs have increased significantly from 2019 (+46%) due to high municipal rate increases – above inflation hikes are likely to persist in the medium term. We forecast low double-digit growth.

We forecast total expenditure to grow by 12.4% and 13.5% in FY 22E and FY23E

Figure 29 Group EBITDA margins



Source: Company data, ASB Research

EBITDA margins have averaged 22.9% over the past six years, peaking at 25.1% in FY18. We anticipate a recovery in EBITDA margins for the following reasons:

- Declining discount rates
- Declining bad debt ratio
- Positive jaws – revenue growth exceeds cost growth
- Rising utilisation rates

Debt and capex

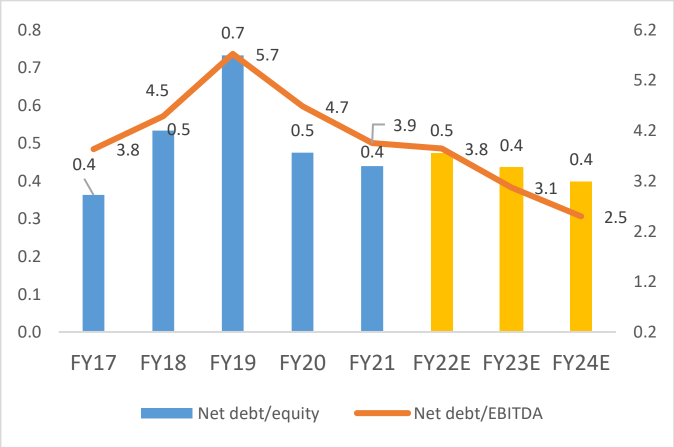
High capex spend has resulted in high debt levels despite circa R4.2bn of equity raised. Net debt peaked at R4bn in FY19, a net debt/equity ratio of 0.73 (incl lease liabilities). Following its R1.5bn rights issue in FY20, net debt has declined to R3.1bn. This resulted in finance costs declining from R223m in FY20 to R170m in FY21. We estimate the average cost of debt at approximately 7.4%, with around 50% of the debt at a fixed rate because of swaps being implemented.

With a capex budget of R1.1bn in FY22E and operating cash flow of circa R690m, additional debt will be raised. This as a return to regular dividends is also envisaged. We anticipated net debt of R3.5bn (R3.2bn excl. leases) in FY22E – a 0.48 debt/equity ratio. This will decline gradually going forward. We see these debt levels as manageable.

Excluding the HeronBridge College and other building acquisitions (R230m) in FY22E, capex would be circa R870m, lower than the gross R929m capex in FY21. Maintenance capex of R400-500m is required p.a. In addition, approximately R1bn needs to be spent on expanding the building capacity for grade growth in existing high schools. This will occur through to FY25E. Barring no major acquisitions or development, capex will be on a declining trajectory over the next few years. We anticipate capex to decline from R1.1bn in FY22E to R598m in FY23E and R623m in FY24E as per Figure 31 below.

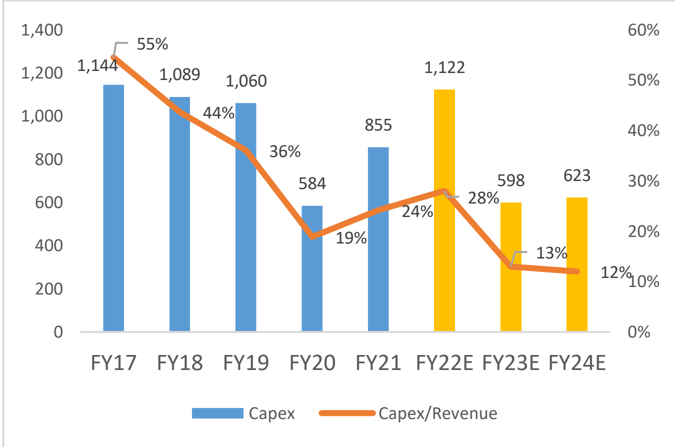
Debt will decline modestly from FY23E as a more progressive dividend policy is implemented – we anticipate a 20% pay-out ratio in FY22E rising to 30% in FY24E.

Figure 30 Net debt (incl. lease liabilities)



Source: Company data, ASB Research

Figure 31 Net capex



Source: Company data, ASB Research

Tax

With approximately 95% of schools owned, the company enjoys a sizeable property portfolio, carried at R8bn. The temporary differences from the depreciation of buildings gives rise to considerable deferred tax liabilities – currently amounting to R664m.

The effective tax rate is broadly in line with the SA corporate tax rate, a trend that's unlikely to change. There are recurring assessed losses (R292m) that will be utilised and will ensure a lower cash tax payable in FY22E – R36m vs a normal income tax charge of R118m.

Headline earnings

FY19 was a challenging year for Curro as it saw rising debt, heightened emigration issues, a doubling of the bad debt ratio and a sharp rise in staff costs due to significant high school growth. Unfortunately, FY20 didn't fare much better with the impact that COVID-19 had on the economy and affordability – the bad debt ratio increased significantly, discounts offered also soared and ancillary income came under pressure. FY21 saw 8% HEPS growth off this low base, impacted by the R1.5bn rights offer dilution.

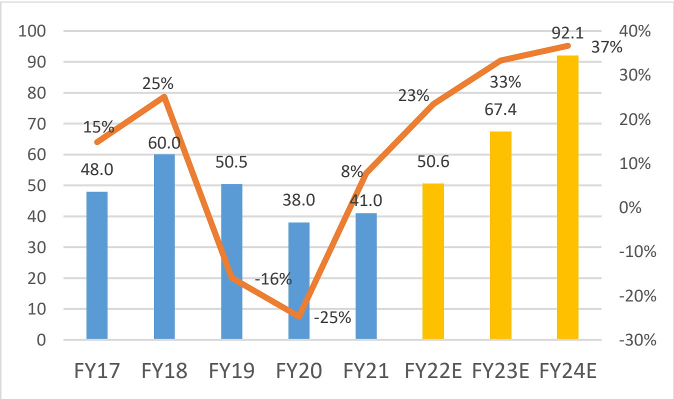
As indicated above, we see most trends improving in FY22E as many of the COVID-19 effects are reversed. Capex remains high though, particularly due to the acquisition of a building in Cape Town and HeronBridge College (circa R230m in aggregate) and investment in high school capacity expansion. This will require additional debt, particularly as management has indicated a return to a regular dividend declaration policy. We forecast a recovery in HEPS to 50.6c (+23%), a level similar to FY19 which was a challenging year.

The prospects into FY23E and beyond look far more promising. Debt will begin to decline as capex is slashed considerably – down 47%. A freeze on new schools will see rising utilisation rates, particularly in high schools (higher fees per grade). Revenue growth will surpass expenses growth and margins will benefit further from a lower bad debt charge and lower discounts. FY23E will see HEPS rise (+33%) to a new high for the group, but still only 12% above FY18. We see ongoing robust HEPS growth of 37% in FY24E.

In a trading statement dated 26 July 2022 the company indicated that recurring HEPS will rise between 22.2% and 39.7% (23.7c to 27.1c). The annualised mid-range of this guidance equates to 50.8c in line with our estimate of 50.6c for FY22E. The reference to recurring HEPS is due to a government subsidy received for Meridian, an event which is long overdue, being treated as non-recurring.

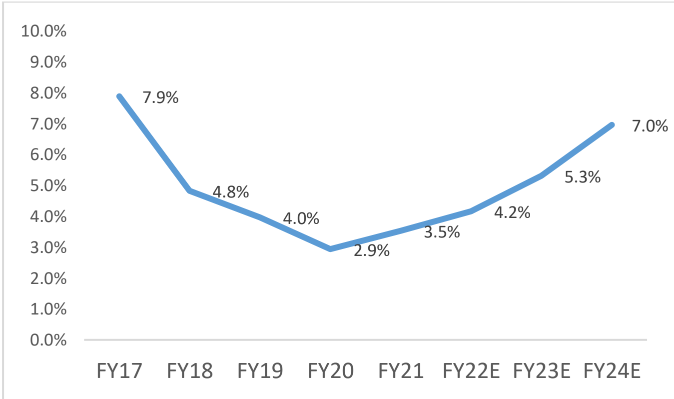
The groups ROE declined to a low of 2.9% in FY20, driven by the large equity raise in the year. Whilst we have it improving considerably over the next few years it's still not optimal. Increased capacity utilisation and a more progressive dividend policy should see ongoing improvements in the ROE beyond FY24E.

Figure 32 HEPS – reported and growth



Source: Company data, ASB Research

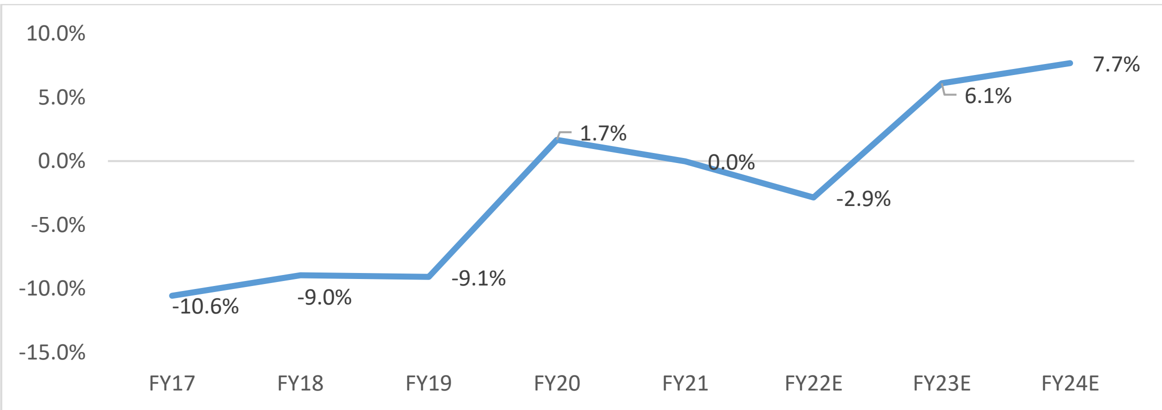
Figure 33 ROE - %



Source: Company data, ASB Research

Valuation

Figure 34 Free Cash Flow Yield



Source: Company data, ASB Research

After three years of negative free cash flow in FY17-FY19 (due to high capex), FY20 produced a positive result with breakeven achieved in FY21. The escalation in capex in FY22E will again produce a negative outcome but we have this reversing sharply from FY23E and accelerating as capex declines significantly and profitability improves.

Figure 35 DFCF valuation assumptions

WACC Assumptions	
Risk free rate	10%
Beta	0.65
Market risk premium	6.5%
Marginal tax rate	28.0%
Pre-tax cost of debt	7.4%
Cost of equity	14.2%
Target debt/value ratio	35%
Target equity/value ratio	65%
WACC	11.1%
Growth Rate assumption	
Sustainable long term growth rate	4.5%

Source: ASB estimates

Figure 36 DFCF sensitivity to WACC and growth rate

		WACC				
		-1%	-0.50%	0%	0.5%	1.0%
Terminal Growth	3.0%	1514	1344	1197	1069	957
	3.5%	1632	1442	1279	1138	1015
	4%	1772	1555	1372	1216	1081
	4.5%	1938	1689	1481	1306	1156
	5%	2141	1849	1610	1410	1242

Source: ASB estimates

We apply a risk-free rate of 10%, long term growth rate of 4.5% (due to low utilisation rates unwinding), Beta of 0.65 (in line with ADvTECH) and a debt/equity of 35:65 including the right of use assets. This results in a revised WACC of 11.1%. Our valuation range equates to R11.38-R16.89/share, a mid-point valuation of R13.72. By contrast our forecast NAV per share in FY22E is R12.40.

Based on our HEPS forecasts, the stock trades on a 20m forward P/E of 16x, an 8.3x EV/EBITDA. The stock has traded on an average 5-year P/E of 38x and therefore there is considerable scope for a rerating. We expect the rerating to be driven by its significant HEPS growth outlook and rising ROE's. The stock trades on a 20m forward 1.6% dividend yield.

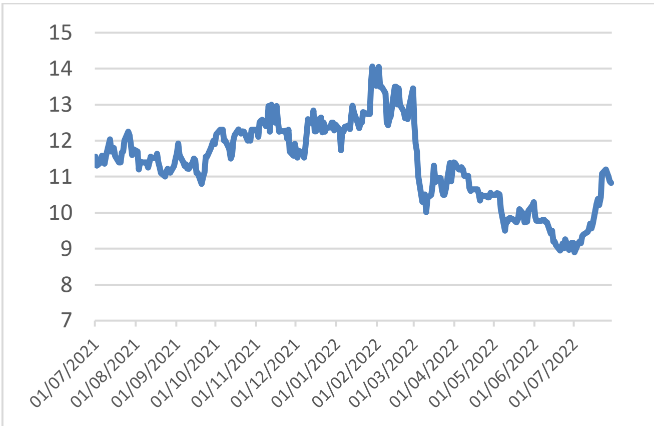
Unbundling of Curro stake by PSG Group

On the 1st of March 2022, PSG announced its intention to unbundle its 63.6% holding in Curro as part of its strategy to unlock value and delist. The PSG unbundling record date is 9 September 2022 with unbundled shares reflecting in shareholders accounts on 12 September 2022. The Curro share price subsequently underperformed considerably, down 25% relative to the ALSI (Figure 38), before rebounding more recently. This leads us to believe that the event has largely been discounted in the price.

Figure 37 Curro share price – 5yrs

Source: FactSet, ASB Research

Figure 38 Share price rel to ALSI – since 28 Feb 22



Source: FactSet, ASB Research

According to FactSet, PSG's top 10 institutional shareholders account for 6.74% of its stock. Of these shareholders, four have a stake in Curro amounting to an immaterial 3.14%. Allan Gray is the only shareholder (apart from PSG) that owns >5% of Curro and its not reflected on the PSG institutional shareholder list. This is positive as its unlikely that any one shareholder will be overly concentrated to Curro upon the unbundling.

We believe shareholders are likely to retain their Curro shares based on the positive fundamentals of the stock and its significant price underperformance. However, there will be shareholders looking to sell for reasons outside of the stocks fundamentals and this will likely put pressure on the stock immediately post the unbundling. It could turn out to be a great liquidity event for those institutions that have been unable to build a meaningful stake in the company given its weak free float.

Risks

- Affordability pressure on consumers from rising inflation, rising interest rates and an economy that is struggling to improve.
- The political environment – this will affect the rate of emigration, which has an impact on student leavers, particularly at premium schools.
- On the positive side, ongoing student enrolment issues at public schools could lead to better enrolments at private schools
- Regulatory changes – while none are envisaged in the short term, any additional requirements enforced on private educators could be harmful.
- Teacher availability – while Curro does not pay salaries that differ significantly from those paid to public school teachers, teachers benefit from subsidised tuition fees, which is a significant appeal for them.
- Any significant deterioration in academic results would be negative. We see little risk of this occurring.
- A further COVID-19 induced lockdown

Appendix 1: Executive Management team

CEO - JF (Andries) Greyling CA(SA)

Andries has been Curro's CEO since 1 July 2017. He started his career as audit manager at KPMG Inc. and subsequently held financial positions at several companies. In 2000, he joined the International Colleges Group of Media24 Ltd, which included brands such as INTEC and Damelin, as financial director, and was subsequently promoted to financial director of Educor (Pty) Ltd (Educor). In 2006, Educor bought a 26% stake in Curro. Andries, together with Curro founder Dr Chris van der Merwe, created the business plan upon which Curro's current growth strategy is based. In 2007, when Naspers Ltd disposed of Educor, including its interest in Curro, Andries acquired a shareholding in Curro and joined the company as financial director. In 2011, when Bernardt van der Linde was appointed as the financial director of Curro, Andries's role changed to that of chief operating officer.

CFO - JP (Cobus) Loubser CA(SA)

Cobus was appointed as an executive director and the CFO of Curro on 1 January 2021. He started his career at KMPG Inc., served as the financial manager of Virgin Active SA for 4 years, and held the CFO position for 11 years at Holdsport Limited until it was acquired by Long4Life in 2017. He left his position as CEO of Long4Life's Sport and Recreation division at the end of 2020 to join Curro.

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The date for above share price (close price) and market capitalisation is the close price on 29 July 2022. The close price is the final price at which the security is traded in the relevant exchange on the date indicated.

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