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Curro Holdings

ANCHOR STOCKBROKERS

All eyes on student retention

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Price (11/03/2024):	R10.80
Market cap	R6.2bn
Shares in issue	577mn

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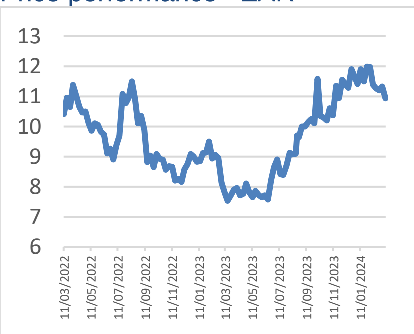
- Curro announced robust FY23 HEPS of 73.2c (+32%) ahead of our 70c estimate, primarily due to lower expected credit losses. We anticipated a higher dividend payout ratio in FY23 (30% vs 20%), however, management favoured share buy backs of R102m, equating to circa 17c per share. Buy backs continue in FY24E.
- EBITDA (adding back the credit loss charge) of R1283m was reported, vs our R1286m forecast. Relative to expectations, student numbers disappointed at the close of the year, down 1.2% on February 2023. This was offset by higher ancillary revenue (+20%) that has now normalised post Covid and should grow more in line with tuition fee revenue going forward. Revenue grew 13.5% in FY23, we anticipate 7.9% growth in FY24E driven by circa 6.2% fee increases and 1.6% student number growth (down from a previous 4.4% estimate).
- Enrolments in Feb 2024 were disappointing, achieving 1.1% growth on Feb 23. Growth was 2.1% on 4Q23. High school enrolments are performing better with early Primary school grades faring the worst. A further clean-up of the arrears book contributed to lower student numbers in FY23, albeit to a lesser extent than FY22 – we see further slippage in FY24E. This together with affordability leavers contributed to the utilisation rate declining from 72.3% to 71.8%.
- As expected, facility cost growth was high (+12%), including R23m of diesel for generators. Facility cost growth should be considerably lower in FY24E due to lower anticipated load shedding. FY24E staff increases were agreed at circa 5%, down from 6% in FY23. These two costs account for 76% of total costs, which we have rising 6.7% in FY24E. A stable learner/teacher ratio combined with weaker student growth in FY24E, facilitates lower staff cost growth.
- The credit loss charge dropped from 3.5% to 2.7% of revenue due to reduced provisions in both the active and inactive book (total provision coverage of 32%). Active provisions reflect better ageing and quality according to management. Looking at it from an age analysis perspective, there are sufficient provisions to cover all debtors >360 days, with an 8% provision on the remaining book. We see some risk in this regard, placing reliance on managements assertion that collections have improved and gaining comfort that the provision methodology has not changed. By comparison, ADvTECH schools division had a 1.9% credit loss ratio and 52% provision coverage in 1H23.
- Debt levels have risen further in FY23, and we don't anticipate a drop in FY24E with surplus cash channeled towards share buy backs. Capex was in line with expectations and the outlook remains for managed expansion – we forecast R662m of total capex of which maintenance comprises R356m. We see management favouring buy backs over a higher dividend payout in FY24E, whilst the stock trades at a 13% discount to its NAV.
- We make minimal changes to our HEPS outlook, revising FY24E from 87.9c to 88.4c (benefiting from further buy-backs) and FY25E from 109.8c to 107.2c. The ROE rose from 4.6% to 5.9% in FY23, and we see this positive trajectory continuing with 8.9% forecast in FY26E (management targets 10%). On our DFCF we calculate a fair mid-range valuation of circa 1300c, largely unchanged.
- Management is delivering on its strategy of improving profitability. Its revenue challenge remains with student numbers as its ability to price well ahead of inflation is limited – fee hikes were more measured than expected in 2024. Improved affordability will be a catalyst, until then a focus on enhancing the student proposition (to retain students) is key, including lower fee increases in primary schools. Operational gearing is high given low utilisation rates, however, an improved economic outlook with lower interest rates remains key.

Price performance - ZAR



Source: FactSet

Figure 1 Financial summary – R'mn

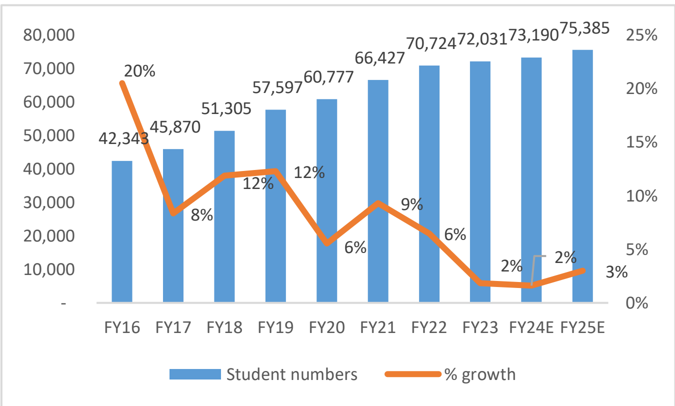
Year Ending	FY2021 A	FY2022 A	FY2023 A	FY2024 F	FY2025 F	FY2026 F
Income Statement						
Tuition fees	3,277	3,794	4,283	4,621	5,045	5,509
Growth (%)	*15.0%*	*15.8%*	*12.9%*	*7.9%*	*9.2%*	*9.2%*
Ancillary revenue	266	362	436	470	515	566
Growth (%)	*8.6%*	*36.1%*	*20.4%*	*7.8%*	*9.5%*	*10.0%*
Total revenue	3,543	4,156	4,719	5,091	5,560	6,075
Growth (%)	*14.5%*	*17.3%*	*13.5%*	*7.9%*	*9.2%*	*9.3%*
Other income	0	0	45	24	26	27
Operating costs	2,623	3,083	3,481	3,714	4,038	4,404
Growth (%)	*16.0%*	*17.5%*	*12.9%*	*6.7%*	*8.7%*	*9.1%*
Expected credit losses	131	147	128	132	150	164
% of revenue	*3.7%*	*3.5%*	*2.7%*	*2.6%*	*2.7%*	*2.7%*
EBITDA	789	926	1,155	1,269	1,397	1,534
EBITDA Margin (%)	*22.3%*	*22.3%*	*24.5%*	*24.9%*	*25.1%*	*25.2%*
EBIT	508	645	847	963	1,082	1,211
EBIT Margin (%)	*14.3%*	*15.5%*	*17.9%*	*18.9%*	*19.5%*	*19.9%*
Profit before tax	352	289	98	682	829	979
Net profit	251	235	32	491	597	707
Net profit post minorities	259	239	41	501	608	720
Headline Earnings	245	330	426	501	608	720
	36.9%	*34.7%*	*29.1%*	*17.6%*	*21.3%*	*18.4%*
Headline Diluted EPS, ZAc	41.0	61.0	73.2	88.4	107.2	127.0
Normalised Diluted EPS, ZAc	41.0	55.2	73.2	88.4	107.2	127.0
% Change	*7.8%*	*34.7%*	*32.6%*	*20.7%*	*21.3%*	*18.4%*
DPS, Zac	8.2	11.1	14.6	17.7	32.2	38.1
Payout ratio (%)	*20%*	*20%*	*20%*	*20%*	*30%*	*30%*
Balance Sheet						
Cash and Cash equivalents	90	63	64	70	79	91
Current assets (ex – cash)	488	472	489	526	370	401
Net Fixed assets	9,800	10,487	10,543	10,899	11,223	11,598
Intangible assets	849	902	797	773	750	727
Investments	325	340	417	429	454	468
Other assets	0	0	0	0	0	0
Total assets	**11,552**	**12,264**	**12,310**	**12,697**	**12,876**	**13,286**
Debt ex lease liabilities	2,840	3,247	3,317	3,465	3,040	2,700
Lease liabilities	365	380	424	441	459	477
Current liabilities	559	604	675	713	775	843
Other liabilities	688	777	766	802	845	885
Total liabilities	**4,452**	**5,008**	**5,182**	**5,422**	**5,119**	**4,906**
Shareholders' equity	7,110	7,270	7,151	7,337	7,836	8,364
Minorities	-10	-14	-23	-24	-25	-27

Year Ending	FY2021 A	FY2022 A	FY2023 A	FY2024 F	FY2025 F	FY2026 F
Total shareholders' equity	**7,100**	**7,256**	**7,128**	**7,313**	**7,810**	**8,337**
BVPS - ZAR	*11.9*	*12.1*	*12.4*	*13.1*	*14.0*	*15.0*
RoE	*3.5%*	*4.6%*	*5.9%*	*6.9%*	*8.0%*	*8.9%*
Cash Flow						
Reported profit before tax	**352**	**289**	**98**	**682**	**829**	**979**
Change in net working capital	75	0	-19	1	218	37
Net Interest (paid)/received	-126	-152	-222	-282	-253	-232
Dividends paid	0	-49	-65	-84	-98	-179
Depreciation	281	281	308	306	315	323
Other adjustments	186	380	710	91	21	-39
Cash flow from operations	**768**	**749**	**810**	**714**	**1,031**	**888**
Net Capex	-855	-1,111	-694	-662	-639	-699
Capex/sales (%)	*26.1%*	*29.3%*	*16.2%*	*14.3%*	*12.7%*	*12.7%*
Other investing cash flows	166	37	16	24	11	22
Cash flow from investing	**-689**	**-1,074**	**-678**	**-638**	**-628**	**-676**
Equity raised/(bought back)	0	-97	-126	-220	0	0
Net increase/(decrease) in borrowings	150	410	9	150	-400	-200
Other financing cash flows	-237	39	51	85	104	179
Cash flow from financing	**-87**	**303**	**-131**	**-70**	**-395**	**-200**
Net cash flow	**-8**	**-22**	**1**	**6**	**8**	**12**
Free cash flow	**7**	**-219**	**360**	**418**	**744**	**-165**
Repayment of lease liabilities	**-8**	**-10**	**-14**	**-15**	**-15**	**-16**
Net Free cash flow	**-1**	**-229**	**346**	**403**	**728**	**-181**
Valuation Summary						
Valuation metrics						
Share Price- ZAc	1,245	900	1,080	1,080	1,080	1,080
P/E (Underlying) -x	30.4	16.3	14.8	12.2	10.1	8.5
P/BV -x	1.0	0.7	0.9	0.8	0.8	0.7
EV/Sales - x	2.9	2.5	2.2	2.0	1.9	1.7
EV/EBITDA -x	12.0	10.2	8.2	7.5	6.8	6.2
EV/EBIT - x	18.6	14.7	11.2	9.8	8.7	7.8
FCF Yield	0.0%	-4.3%	5.6%	6.7%	12.1%	-3.0%
Dividend Yield	0.7%	1.2%	1.4%	1.6%	3.0%	3.5%
Net Debt (incl lease liabilities)	3,115	3,564	3,677	3,836	3,420	3,086
Debt/Equity (incl lease liabilities)	0.44	0.49	0.52	0.52	0.44	0.37
Net Debt (excl lease liabilities)	2,785	3,222	3,299	3,443	3,011	2,661
Net Debt/Equity (excl lease liabilities)	0.39	0.44	0.46	0.47	0.39	0.32

Source: Company data, ASB research

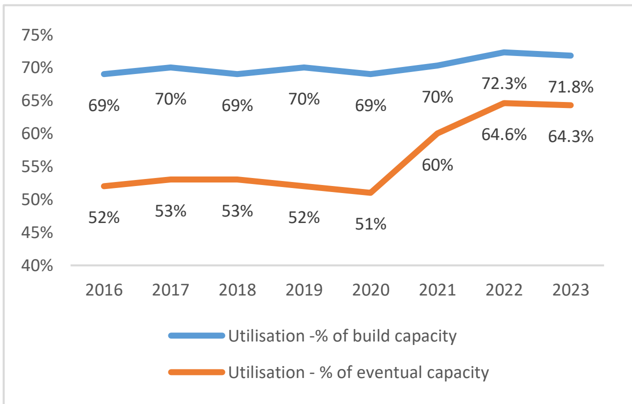
- Tuition fee revenue broadly reflects 1.6% growth in student numbers (largely flat on Feb 2024) and 6.2% growth in the average fee per student. The latter is negatively impacted by a change in mix favouring higher student growth in the cheaper high schools.
- Ancillary revenue is expected to grow more in line with tuition fee revenue after having recovered sharply post Covid.
- We calculate staff cost growth of 6.8% based on our outlook for student numbers, a flat learner teacher ratio and the agreed 5% salary increase in FY24E.
- Overall operating cost growth is estimated at 6.7% in FY24E compared to 7.9% growth in revenue, resulting in EBITDA margins rising from 24.5% to 24.9%.
- We expect a slight improvement in the credit loss ratio in FY24E given managements indication that collections have improved as well as the overall credit quality of the book. We don't see scope for much improvement thereafter given low provision coverage ratios, particularly relative to historic levels.
- Net capex is expected to be relatively stable over the next three years and broadly in line with FY23. School numbers have grown from 182 in 2023 to 189 in Feb 24, largely due to 5 additional schools in Namibia. These are joint ventures with Namibian institutions that fund and provide the land and buildings with Curro providing equipment and operating the schools. Its therefore a capital light strategy. There was a further school opened in WC and Gauteng, the latter being a DigiEd school in Barlow Park.
- Gross debt increased from R3627m to R3741m in FY23. We expect it to rise 4% to R3906m in FY24E as surplus cash is channelled into share buy backs.
- The company bought back 11.5m shares in FY23 for a total consideration of R102m, an average price of R8.87, a 19% discount to the prevailing share price.
- Based on its recent SENS announcement the company has acquired a further 9.7m shares in 2024. We anticipate a total of 20m shares bought and cancelled in FY24E. We don't forecast for any buy backs in FY25E at this stage.

Figure 2 Student numbers – growth momentum slowed



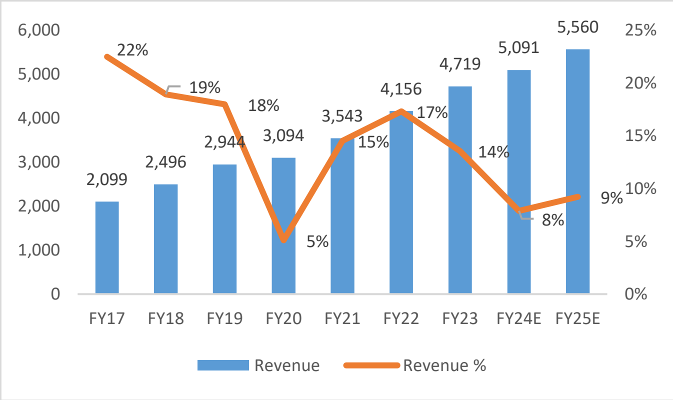
Source: Company data, ASB Research

Figure 3 Utilisation rates – under pressure



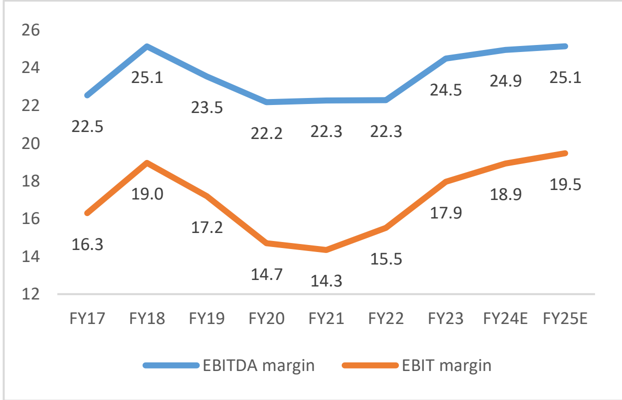
Source: Company data, ASB Research

Figure 4 Total revenue – R'm (growth in %)



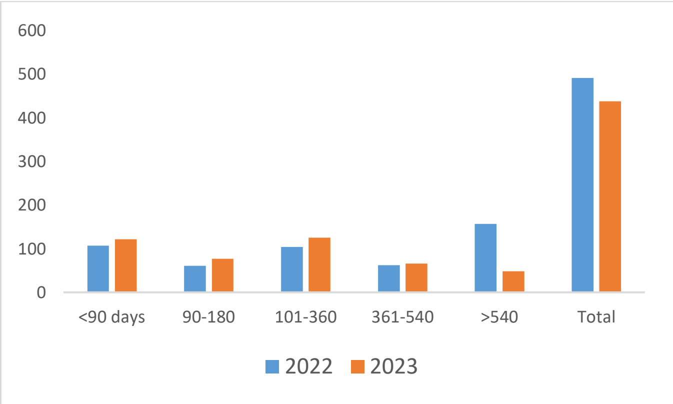
Source: Company data, ASB Research

Figure 5 Margins – strong recovery



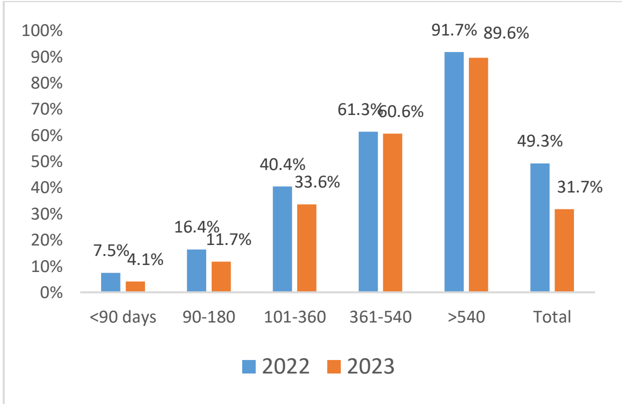
Source: Company data, ASB Research

Figure 6 Debtors ageing – sale of long dated debt



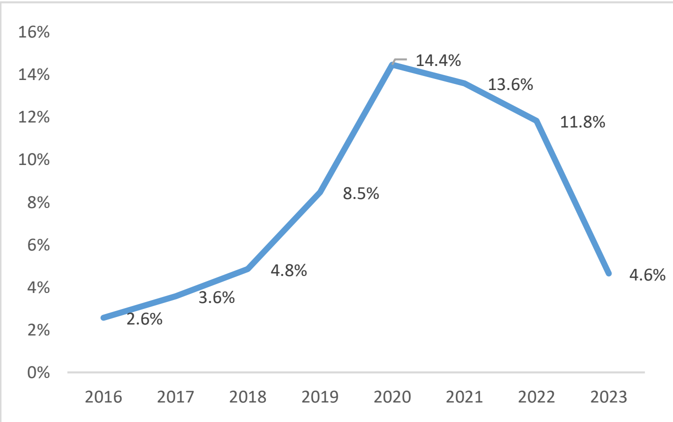
Source: Company data, ASB Research

Fig 7 Provision coverage alludes to better quality



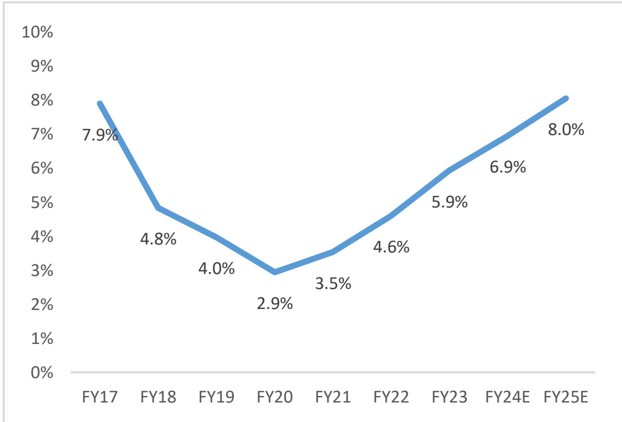
Source: Company data, ASB Research

Figure 8 Debtors as a % of revenue – book sales have had a big impact



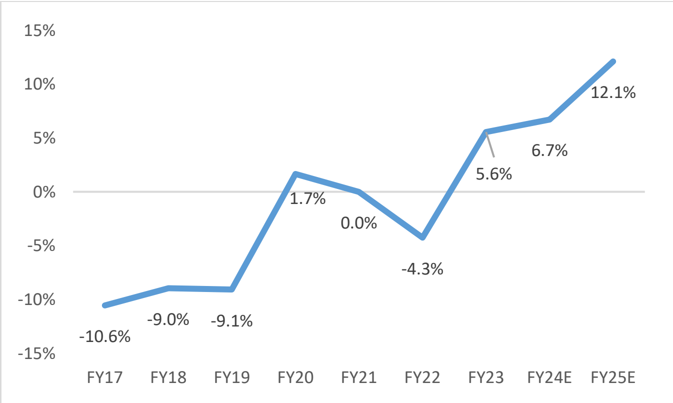
Source: Company data, ASB Research

Figure 9 ROE – management targets 10% in FY26E, ahead of our estimates



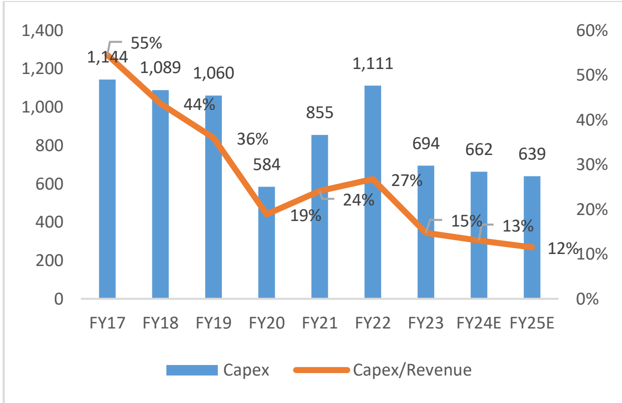
Source: Company data, ASB Research

Figure 10 FCF yield - strong cash generation



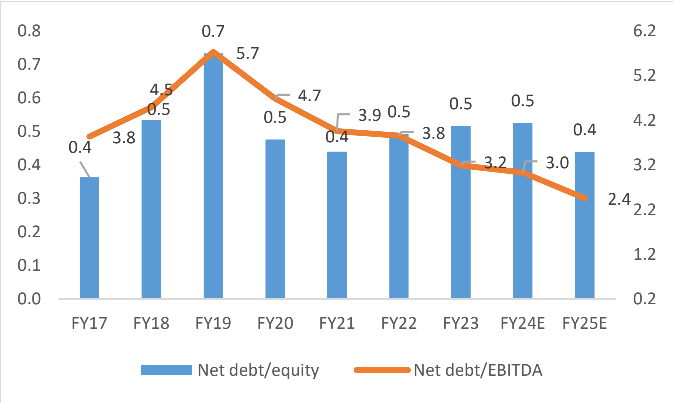
Source: Company data, ASB Research

Figure 11 Capex – R'm – ongoing tight management



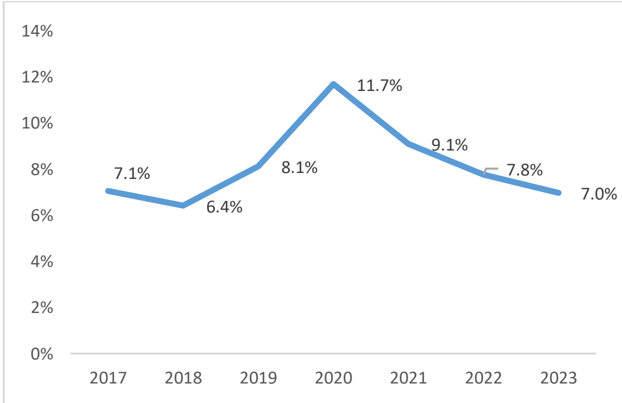
Source: Company data, ASB Research

Figure 12 Gearing – to remain stable



Source: Company data, ASB Research

Figure 13 Discounts – sharp post Covid recovery



Source: Company data, ASB Research

Updated Valuation

Figure 14 DFCF valuation assumptions

WACC Assumptions	
Risk free rate	11.4%
Beta	0.65
Market risk premium	6.5%
Marginal tax rate	27.0%
Pre-tax cost of debt	8.7%
Cost of equity	15.6%
Target debt/value ratio	35%
Target equity/value ratio	65%
WACC	12.4%
Growth Rate assumption	
Sustainable long term growth rate	4.5%

Source: ASB estimates

Figure 15 DFCF sensitivity to WACC and growth rate

		WACC				
		-1%	-0.5%	0%	0.5%	1.0%
Terminal Growth	3.5%	1417	1275	1150	1039	940
	4%	1506	1350	1214	1094	987
	4.5%	1607	1435	1286	1155	1040
	5%	1724	1532	1367	1224	1098
	5.5%	1861	1644	1461	1302	1165

Source: ASB estimates

Our WACC remains largely unchanged at 12.4%. Our valuation range equates to R10.94-R15.32/share, a mid-point valuation of R12.86, 19% upside from current price levels.

Based on our HEPS forecasts, the stock trades on a 12M forward P/E of 12.2x, an EV/EBITDA of 7.5x. By comparison, on our estimates ADvTECH trades on a 13x P/E 12m forward.

We see the following as key risks to our outlook:

- Interest rates remaining elevated for longer. This will continue to place affordability pressure on parents with Primary School student numbers most at risk. This has been a trend for the past 18 months and we envisage some improvement.
- Further declines in utilisation rates. This is directly related to affordability but will also be impacted by schools in towns that are economically challenged, e.g. highly exposed to a weak commodity cycle. This could also see further impairments.
- The lower provision levels proving to be inadequate with a return to higher coverage levels as seen in the past few years and more in line with ADvTECH.
- Loadshedding has become less of a risk with backup power now across all its schools. However, a deterioration in electricity supply would be negative for facility costs as these are envisaged to reflect an improving energy supply.

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