Float tests the market

Investors who fancy the education sector have a new prospect, writes Roger Montgomery

SEEK AND EDUCATION AUSTRALIA, a company owned by 38 local universities, jointly own IDP Education. IDP will list on the ASX under the stock code, IEL, possibly in December.

Education Australia has agreed to hold its 50% shareholding in escrow until the release of the 2015-16 results in August. At the time of writing, Seek was yet to determine how much of its 50% stake it intended to sell in the initial public offering (IPO). However, it seems likely it will exit the business if the offer price is set near the top of the $2.40 to $2.65 a share range.

IDP has four business units. The English language testing and student placement divisions account for more than 90% of the company's revenue and gross profit. The English language teaching and event management divisions account for the balance.

IDP co-owns the international English language testing system (IELTS), a high-stakes English language test, with its developer, Cambridge Assessment, and the British Council, a public corporation. High-stakes English language tests are used as a prerequisite for foreign applicants and are set by tertiary institutions as well as by companies and immigration departments in English-speaking countries. A test score of six to seven (out of 10) is required to apply to the various institutions, for visas and for jobs.

IDP operates and contracts 400 test sites in more than 50 countries, mostly in Asia and the Middle East. IELTS is the dominant high-stakes English language test, with around 60% market share. Of the 2.7 million IELTS tests in 2014-15, IDP administered 826,000 (31%). Over the past 12 years, the number of IELTS tests taken each year has grown at an average 17%pa. Average revenue is about $250 a test, which is expected to deliver revenue of $241 million in the year to June 2016.

Operating costs are largely variable, including Cambridge Assessment's royalty – about £30 ($65) a test – and direct fees paid to the test sites, many of which are operated by third parties.

The student placement division markets tertiary education courses at more than 600 institutions based in Australia, the US, the UK, Canada and New Zealand, to overseas students and provides counselling and visa application services. IDP sources students through 89 offices in 30 countries.

In 2012, Asia accounted for 52% of the 4.5 million foreign student enrolments globally and, because of the strong growth of Asia's middle class, the International Education Advisory Council estimates numbers will grow at an average 5%pa over the next five years.

International student enrolment numbers peaked in Australia in 2009 at nearly 600,000. The tightening of visa regulations, the change to student working entitlements and the high Australian dollar meant foreign enrolments fell to 480,000 by 2012. Government reforms that streamlined student visa processing, increased post-study work entitlements for some graduates and the fall in $A have caused enrolments to recover to near their 2009 peak. Government has focused on building the international student market, now an $18 billion export industry.

IDP generally receives a fee determined as a percentage of the first year's tuition, while operating costs are largely denominated in the local currency of the source market. Operating costs are expected to be higher than in the past in 2015-16 as IDP acquired Beijing Promising Education in May 2015, which included 11 new offices in China. IDP has also recently opened a number of offices in India to support future growth.

IDP is forecast to achieve $50 million worth of earnings before interest and tax in the year to June 2016, and looks to have a relatively capital-light business model – management believes sustainable maintenance capital expenditure is about $6 million a year.

Potential investors should be aware of two points. The first is that the company hedged its British sterling cost base for 2015-16 at £0.545, using 12- to 18-month forward contracts, and this compares with the current rate of £0.468, a 16% increase. This provides a one-off benefit to the 2015-16 earnings forecast in the prospectus and will drop out in 2016-17.

The second is the very gentle hurdle rate of the long-term incentive plan for the company's executive team and the degree to which the strike price of the options is well "in the money".

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