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A decade of profitable investment

Imad Ghandour, managing director of private equity investor CedarBridge Partners shares some of his insights after 10 years of investment in education in the Middle East and North Africa

In 2006, early in my private equity career, I was among the few in the Middle East and North Africa (MENA) region to realise the attractiveness of education as an investment theme. At that time education was regarded by most to be exclusively a non-profit activity aimed at social development. Governments, religious institutions, philanthropists, and ambitious educators dominated the sector, and they were all driven by their development agendas rather than profits.

The increased attention – or may I call it intrusion – by financial investors like myself over the past decade was new to the traditional participants in the sector. Local educators – like educators elsewhere – pride themselves as being driven by many things, except for profit, and working with internal rate of return-driven private equity managers was not an easy marriage.

The MENA region presents a unique opportunity in education. It is home to a substantial number of families with high disposable incomes, yet the region's governments have failed to provide basic services to their citizens – including education services. Therefore, demand is high, and supply for quality education is scarce. Families battle to get their kids in the few good local schools and universities.

Hence, the education sector in this region offers a unique proposition for investors: sticky and growing demand fuelled by the highest population growth rates in the world, stable cash flow from increasing private payers, positive cash cycle paid for upfront, and healthy margins and returns. These characteristics became more relevant after the financial crisis as investors flocked to defensive sectors with stability and predictability. Fund managers, particular private equity ones, realised the potential of investing in education.

The sector was very fragmented save for a dozen emerging local chains like GEMS in the United Arab Emirates (GEMS was very UAE-centric back in 2006), SABIS in Lebanon, Maarif in Saudi Arabia, Future Schools in Egypt, and so on. These local chains realised early on the size of the opportunity, and started to expand locally, regionally, and a few went all-out internationally.

Until the financial crisis, most of these chains were owned by their founders, and private equity invested elsewhere, as the returns realised from real estate, construction and public equities dwarfed any return available from education. Investors were realising 100% returns in real estate and initial public offerings, and few believed in the long-term prospects of the education sector and its favourable risk-return profile.

Two noticeable investments were completed pre-crisis – in 2007 to be more specific. Abraaj Capital invested in GEMS, then operating around 60 schools mainly in the UAE, and Gulf Capital, where I led the education practice, invested in Maarif Education, then the largest chain of schools in Saudi Arabia. Yet in 2008, these were only two out of a portfolio of 300 active private equity investments.

In September 2008, the financial crisis hit the world, including MENA. It was my second year into the Maarif investment, and registration for the new year started in October 2008. I was very anxious to see how many students would register, but by the end of that week SAR110 million (£12.4 million) in tuitions were deposited in our bank accounts. Demand for K12 education proved super inelastic, even more so than demand for oil.

Post-financial crisis, private equity investors tried to invest in education. However, the education sector remained elusive to such investors. Only a few transactions were completed and fund managers complained that there were few deals available, and those available were overpriced. Moreover, those that invested in the sector faced the inevitable scrutiny attached to social services, limiting their manoeuvrability in terms of tuition increases, new licences, new services, and even exit possibilities. The media and the regulators became increasingly repelled by private equity intrusion and its profit-maximising intentions.

Yet, family groups continue to reap significant dividends from the education sectors. As I have examined hundreds of investment opportunities in the sector, I have invariably noticed how lucratively the initial investors have been rewarded and how significant the business margins were. Hence, the problem may not be with the sector, but with the standard private equity investment template, in particular:

- Think long term – the traditional time frame of a private equity investment of three-to-five years seems unfit for education, particularly K12, because you can only effect change (for example, by increasing tuition fees or opening a new branch) once a year.
- Focus on capacity building before margin improvement – private capital is most welcomed when it initially seeks to build new capacity. Focusing in the early stages on tuition increases and margin improvement brings unwanted friction with parents and regulators.
- Enter early – entering at the early stages of the business life cycle allows you to be rewarded by the growth in enrolment, which remains the highest contributor to profit growth. This will also increase the investible number of opportunities.
- Talk education before finance – drop the financier's hat and talk about educating the kids. Also, private equity firms are keen to publicise their achievements and their investments, but this is a sector where less talk will improve returns.
- Look at other subsectors – K12 may be the biggest subsector, but other subsectors such as nurseries, e-learning, higher education, and so on, may be more lucrative and attractive.

Our investment in Kids First Group, currently the largest chain of nurseries in MENA, is a good investment template. We invested in a greenfield holding company that aimed to roll-up small stand-alone nurseries. Our initial investment was $1.2 million (£873,000), but we eventually invested a total of $7 million. Earnings before interest, taxes, depreciation and amortisation grew from $200,000 to $4.5 million in seven years, as we grew the number of branches and capacity. We're currently into our seventh year of the investment and I believe we can grow it for a couple of more years before exiting, bringing the investment horizon closer to 10 years – longer than that which most private equity funds aim for.

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