Sponsored Research

Curro Holdings

ANCHOR STOCKBROKERS

On track to deliver robust earnings growth

Date: 08 March 2023

- Curro delivered a solid set of FY22 results, with recurring HEPS of 55c (+35%), ahead of our 51c expectation. Management's strategy of reining in the spend, improving margins and cash flows and increased returns to shareholders, is delivering early signs of success. However, EBITDA margins have yet to improve, and capex remains elevated. We anticipate improvement in both instances in FY23E. The weaker than anticipated enrolment numbers for FY23E was a negative feature of the results.
- Tuition fee income (+15.8%) was broadly in line with expectations and benefitted from a 6.4% increase in average student numbers and lower discounts offered (-1.3%). This implies fee increases of circa 8%. Total revenue was ahead of our forecast given higher ancillary income (boarding fees, aftercare, bus income etc.) as activity returns to pre Covid-19 levels. The benefits of increased ancillary revenue will be felt in FY23E given the additional spend required to achieve it.
- Operating cost growth of 17.5% was marginally ahead of revenue growth. Staff costs increased 12.2%, driven by circa 5% wage inflation and 7.2% increase in number of teachers. The learner/teacher ratio declined from 18.6 to 18.4, we had forecast a gradual rising of this ratio over the coming years. Management is guiding towards a stable ratio due to the expansion of its high school grades. Applying a flat ratio to the disclosed student numbers in FY23E and 6% wage inflation equates to an estimated 10.1% increase in staff costs, 47.8% of revenue compared to 49.4% in FY22. Facility costs (12% of operating costs) will continue to experience high growth given investment in back up power generation.
- As expected, debt rose further in 2H22 as capex remained elevated at R1.1bn. We have previously modelled for debt redemption going forward given the improved operational cash flow generation. Management is, however, guiding towards stable debt levels as excess cash generation (above capex) is returned to shareholders with a consistent and growing dividend profile going forward. We are not concerned with the level of debt particularly given the strong underlying EBITDA growth over the next few years. We have the dividend payout ratio rising from 20% in FY22 to 25% and 30% in FY23E and FY24E.
- Whilst capex will decline from historically elevated levels, opportunities for acquisitive growth will continue to be explored whilst existing schools will require considerable investment to accommodate growth, particularly high schools. Maintenance capex in FY23E is estimated at R250-300m of our forecast R804m capex. Capex is guided to decline further into FY24E.
- The net February 2023 student numbers (73047) is disappointing at 3.8% growth, we expected 7.2%. The termination of long overdue accounts (which we felt were at uncomfortably high levels) is a key driver as gross enrolments were greater in 2023 vs 2022. Additional learners lost in FY22 amounts to circa 1400, approx. half due to termination with emigration accounting for around 50% of the remaining departures. Adjusting for this would have resulted in 74447 students, more in line with our original FY23E estimate of 75441 but still short. Fee increases in FY23E are likely to be at higher levels than forecast (8.5% vs 7.5%), part compensation for lower enrolments.
- Given the higher base, we revise our FY23E HEPS up from 67.4c to 68.7c, although the growth rate is reduced from 33% to 25% given lower student numbers. We still believe the company is capable of achieving 26% CAGR in HEPS over the next three years with ROE's rising from the current 4.6% to 8% in FY25E – management is targeting 10% by FY26E. On our DFCF we calculate a fair mid-range valuation of 1425c per share.

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Price (07/03/2023):	R8.13
Market cap	R4.9bn
Shares in issue	598mn

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Price performance - ZAR

Source: FactSet

Year Ending	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023 F	FY2024 F	FY2025 F
Income Statement								
Sales	2,496	2,944	3,094	3,543	4,156	4,732	5,357	6,018
Sales growth (%)	*18.9%*	*17.9%*	*5.1%*	*14.5%*	*17.3%*	*13.9%*	*13.2%*	*12.3%*
EBITDA	627	693	686	789	926	1,127	1,281	1,451
EBITDA Margin (%)	*25.1%*	*23.5%*	*22.2%*	*22.3%*	*22.3%*	*23.8%*	*23.9%*	*24.1%*
EBIT	473	506	455	508	645	831	961	1,121
EBIT Margin (%)	*19.0%*	*17.2%*	*14.7%*	*14.3%*	*15.5%*	*17.6%*	*17.9%*	*18.6%*
Profit before tax	333	188	-33	352	289	556	705	896
Net profit	242	187	-43	251	235	406	515	654
Net profit post minorities	248	202	-31	259	239	411	520	660
Headline Earnings	248	212	179	245	330	411	520	660
	25.9%	*-14.5%*	*-15.6%*	*36.9%*	*34.7%*	*24.5%*	*26.6%*	*27.0%*
Headline Diluted EPS, ZAc	60.0	50.5	38.0	41.0	61.0	68.7	87.0	110.4
Normalised Diluted EPS, ZAc	60.0	50.5	38.0	41.0	55.2	68.7	87.0	110.4
% Change	*25.1%*	*-15.9%*	*-24.7%*	*7.8%*	*34.7%*	*24.5%*	*26.6%*	*27.0%*
DPS, Zac	0.0	0.0	0.0	8.2	11.1	17.3	26.3	38.9
Payout ratio (%)	*0%*	*0%*	*0%*	*20%*	*20%*	*25%*	*30%*	*35%*
Balance Sheet								
Cash and Cash equivalents	170	114	99	90	63	123	8	119
Current assets (ex – cash)	277	415	715	488	472	379	421	464
Net Fixed assets	7,937	8,870	9,120	9,800	10,487	10,995	11,371	11,703
Intangible assets	759	829	832	849	902	875	849	823
Investments	14	248	340	325	340	363	376	388
Other assets	8	8	8	0	0	0	0	0
Total assets	**9,165**	**10,484**	**11,114**	**11,552**	**12,264**	**12,735**	**13,024**	**13,498**
Debt ex lease liabilities	2,980	3,863	2,953	2,840	3,247	3,260	3,010	2,960
Lease liabilities	0	215	356	365	380	395	411	427
Current liabilities	366	420	475	559	604	684	775	870
Other liabilities	547	571	564	688	777	821	866	912
Total liabilities	**3,893**	**5,069**	**4,348**	**4,452**	**5,008**	**5,161**	**5,062**	**5,170**
Shareholders' equity	5,238	5,405	6,768	7,110	7,270	7,611	8,024	8,414
Minorities	34	11	-2	-10	-14	-15	-15	-16
Total shareholders' equity	**5,272**	**5,416**	**6,766**	**7,100**	**7,256**	**7,596**	**8,008**	**8,398**
BVPS - ZAR	*12.8*	*13.1*	*11.3*	*11.9*	*12.3*	*12.9*	*13.6*	*14.3*
RoE	*4.8%*	*4.0%*	*2.9%*	*3.5%*	*4.6%*	*5.5%*	*6.7%*	*8.0%*

Year Ending	FY2018 A	FY2019 A	FY2020 A	FY2021 A	FY2022 A	FY2023 F	FY2024 F	FY2025 F
Cash Flow								
Reported profit before tax	**333**	**188**	**-33**	**352**	**289**	**556**	**705**	**896**
Change in net working capital	-88	-23	3	75	0	173	48	53
Net Interest (paid)/received	-138	-204	-200	-126	-152	-275	-256	-225
Dividends paid	0	0	0	0	-49	-65	-102	-267
Depreciation	154	187	231	281	281	296	320	330
Other adjustments	127	326	513	186	380	124	65	-17
Cash flow from operations	**388**	**474**	**514**	**768**	**749**	**810**	**782**	**770**
Net Capex	-1,089	-1,060	-584	-855	-1,111	-804	-696	-662
Capex/sales (%)	*43.6%*	*36.0%*	*18.9%*	*24.1%*	*26.7%*	*17.0%*	*13.0%*	*11.0%*
Other investing cash flows	-284	-232	-337	166	37	16	25	25
Cash flow from investing	**-1,373**	**-1,292**	**-921**	**-689**	**-1,074**	**-788**	**-671**	**-637**
Equity raised/(bought back)	0	0	1,473	0	-97	0	0	3
Net increase/(decrease) in borrowings	850	1,701	1,150	150	410	28	-234	-34
Other financing cash flows	-344	-960	-2,132	-237	39	75	110	275
Cash flow from financing	**506**	**741**	**491**	**-87**	**303**	**38**	**-226**	**-22**
Net cash flow	**-479**	**-77**	**84**	**-8**	**-22**	**60**	**-115**	**111**
Free cash flow	**-568**	**-403**	**102**	**7**	**-219**	**345**	**443**	**600**
Repayment of lease liabilities	**0**	**-3**	**-7**	**-8**	**-10**	**-11**	**-11**	**-12**
Net Free cash flow	**-568**	**-406**	**95**	**-1**	**-229**	**335**	**432**	**588**
Valuation Summary								
Valuation metrics								
Share Price- ZAc	1,538	1,084	952	1245	813	813	813	813
P/E (Underlying) -x	25.6	21.5	25.0	30.4	14.7	11.8	9.3	7.4
P/BV -x	1.2	0.8	0.8	1.0	0.7	0.6	0.6	0.6
EV/Sales - x	3.2	2.7	2.6	2.3	1.9	1.7	1.5	1.3
EV/EBITDA -x	12.8	11.5	11.7	10.1	8.6	7.1	6.2	5.5
EV/EBIT - x	16.9	15.8	17.6	15.7	12.4	9.6	8.3	7.1
FCF Yield	-9.0%	-9.1%	1.7%	0.0%	-4.8%	7.0%	9.0%	12.3%
Dividend Yield	0.0%	0.0%	0.0%	0.7%	1.4%	2.1%	3.2%	4.8%
Net Debt (incl lease liabilities)	2,810	3,964	3,210	3,115	3,564	3,532	3,413	3,268
Debt/Equity (incl lease liabilities)	0.53	0.73	0.47	0.44	0.49	0.47	0.43	0.39
Net Debt (excl lease liabilities)	2,810	3,769	2,887	2,785	3,222	3,177	3,044	2,884
Debt/Equity (excl lease liabilities)	0.53	0.70	0.43	0.39	0.44	0.42	0.38	0.34

Student numbers and tuition revenue

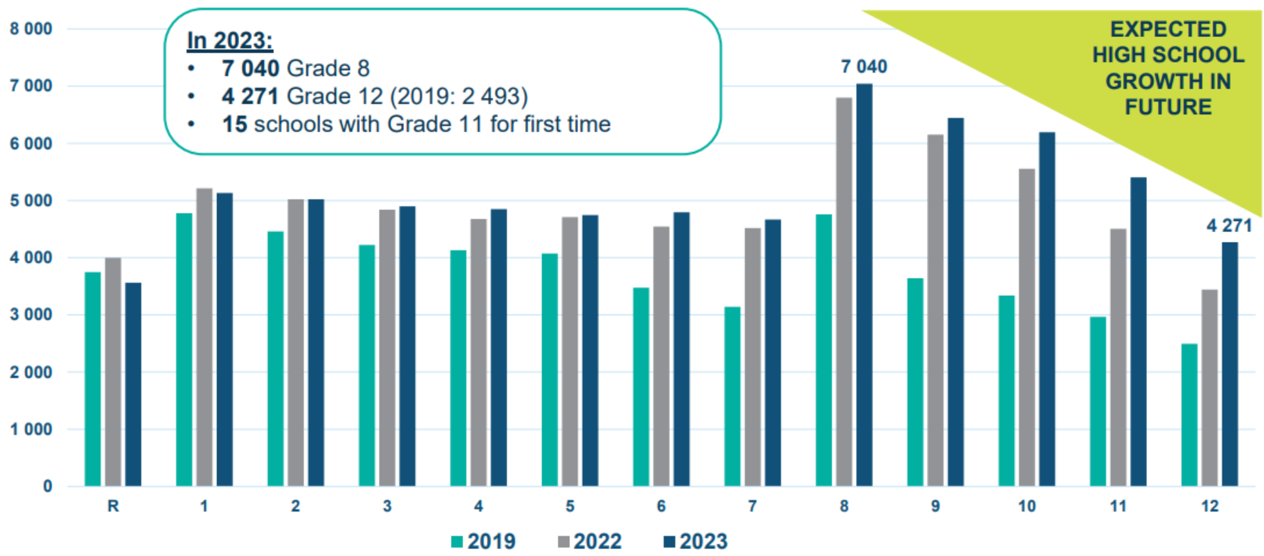
Figure 1 Learner numbers, capacity, utilisation and capex

	2016	2017	2018	2019	2020	2021	2022	CAGR
Ave Learners	42343	45870	51305	57597	60777	66447	70724	7.8%
% change	20%	8%	12%	12%	6%	9%	6%	
Schools	114	127	138	166	177	178	181	7.7%
% change	14.0%	11.4%	8.7%	20.3%	6.6%	0.6%	1.7%	
Sqm - '000	559	598	656	701	713	772	789	5.5%
% change	24.4%	7.1%	9.7%	6.8%	1.7%	8.3%	2.2%	
Utilisation -% of build capacity	69%	70%	69%	70%	69%	70%	72.3%	
Utilisation - % of eventual capacity	52%	53%	53%	52%	51%	60%	64.6%	
Cumulative Capex - Rm	6350	7486	8979	10265	10915	11844	12959	10.9%
% change	31%	18%	20%	14%	6%	9%	9%	
Learners at 85% of eventual utilisation capacity							93058	
% change							27%	

Source: Company data, ASB estimates

From the figure above, the significant slowdown in school expansion and added square meterage is evident in FY22, a trend that will continue in the short to medium term driving down capex. This is in line with the theme of our initiation report, Reining in the spend . Instead, the focus is on increasing the capacity utilisation of existing schools, with the results beginning to reflect – utilisation rates are now at a seven year high of 72.3% with significant scope for improvement. Achieving a 85% utilisation rate will result in 93058 students, a rise of 27% from current levels.

Figure 2 Expansion potential in high school with roll over from Grade 8 to 12

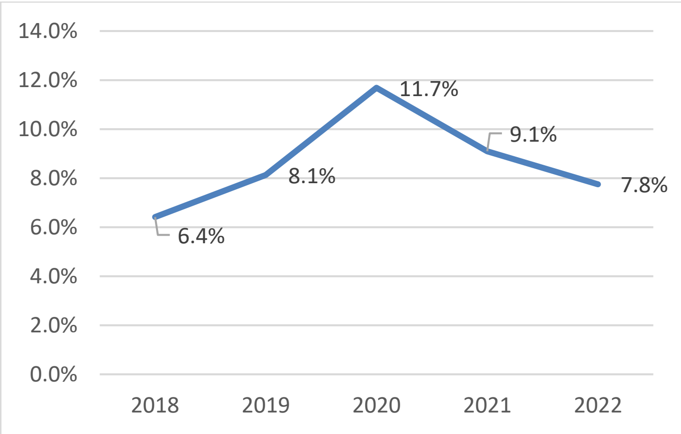


Source: Company data

High schools are not operating at capacity given the higher grades have considerably lower pupils than the earlier ones as highlighted in the chart above. Assuming all grades had 7040 students (as is currently in Grade 8), it would equate to an estimated 6000 additional students. This was closer to 7400 on FY21 data highlighting that the rollover of students from Grade 8 to 12 is happening as anticipated. It's also worth noting that 15 schools have a grade 11 class for the first time. This is negatively impacting learner/teacher ratios in the short term.

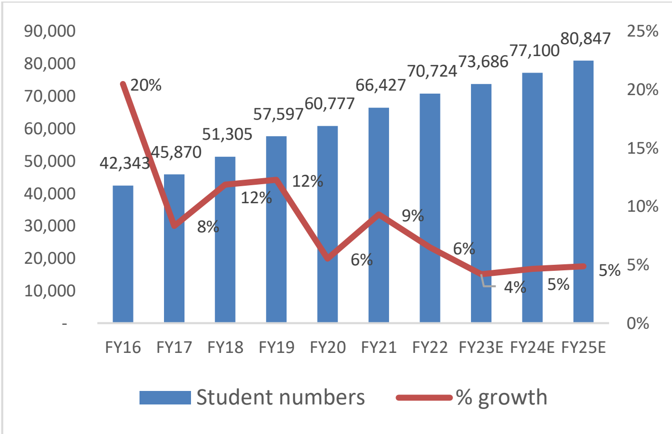
Tuition income will benefit from lower discounts offered. By value discounts are declining as anticipated (see Figure 3 below), a positive for margins going forward. This would, however, negatively impact student numbers as discounts are also offered where affordability constraints exist – other/discretionary discounts dropped from R156m to R138m.

Figure 3 Discounts as a % of gross tuition fees



Source: Company data, ASB Research

Figure 4 Ave student numbers and growth rate



Source: Company data, ASB Research

We forecast 4.2% student growth in FY23E (+3.8% at February 2022) as a consequence of additional joiners during the year. We forecast 4.6% in FY24E, down from our initial estimates of 6%. We believe this is conservative as the structural removal of long overdue accounts has already occurred and gross enrolments were higher in 2023 vs. 2022. The risk remains with emigration and affordability creating leakage during the year. There is also a trend of parents delaying the admission of children to private schools, to the later grades (facilitated by low utilisation rates at schools) – this could cause greater churn in the lower grades. Due to higher fee increases and a higher FY22 base, our revised tuition fee forecast of R4304m in FY23E is in line with our original estimate of R4295m.

Ancillary Income

This income was well ahead of our expectations , R362m vs forecast of R282m. However, the earnings impact has not been as significant given high levels of spend to resume normalised levels of additional services like boarding facilities, extra mural activities, events etc. As a % of total revenue it has improved from 8.1% in FY21 to 9.5% in FY22. It was 11.1% in FY19 and therefore there is still scope for greater rates of growth than tuition fees – we forecast growth of 18% in FY23E with lower commensurate spend, positively impacting margins.

Debtors

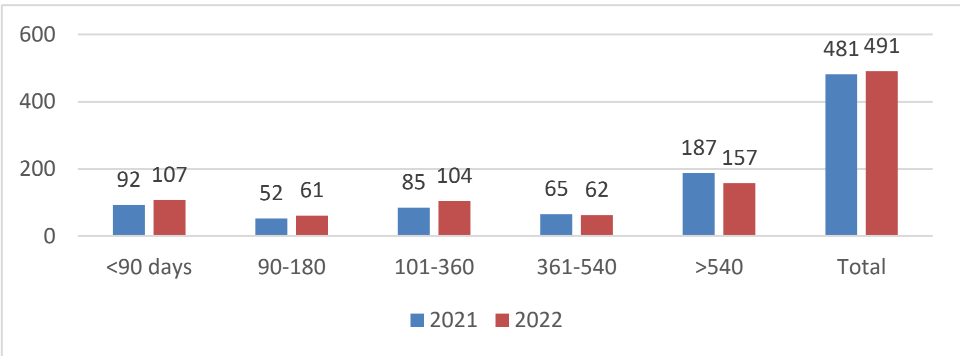
Figure 5 Debtors – coverage ratio and income statement charge - R'm

	2017	2018	2019	2020	2021	2022
Gross debtors	75	121	249	447	481	491
Revenue (net of discounts)	2099	2496	2944	3094	3543	4156
% in debtors	3.6%	4.8%	8.5%	14.4%	13.6%	11.8%
Provisions	-16	-32	-69	-215	-246	-242
Provision coverage ratio	21.3%	26.4%	27.7%	48.1%	51.1%	49.3%
Net debtors	59	89	180	232	235	249
	2017	**2018**	**2019**	**2020**	**2021**	**2022**
Opening B/S Provisions		16	32	69	215	246
Closing B/S Provisions		32	69	215	246	242
Provisions charged to I/S		16	37	146	31	-4
Net bad debts written off	31.2	0	1	1	100	151
Income statement charge	31.2	16	38	147	131	147
Revenue (net of discounts)	2099	2496	2944	3094	3543	4156
Bad debt ratio (excl collection costs)	1.5%	0.6%	1.3%	4.8%	3.7%	3.5%

Source: Company data, ASB estimates

As hoped for, a more aggressive stance was taken towards the arrears in the debtors book in FY22 – debtors as a % of revenue rose to 13.6% in FY21 and has now dropped to 11.8% due to the sale of mainly inactive debtors to third party collection agents. Historically it remains high and therefore the risk of further elevated student terminations remains. This negatively impacted provision coverage ratios as the debtors sold would have attracted higher provision coverage. Provision policies were unchanged in the year. The income statement charge reflects a drop of R4m in provisions and net write offs of R151m.

Figure 6 Age analysis of the debtors book R'm



Source: Company data, ASB estimates

The arrears profile of the book reflects the write off of longer dated inactive accounts with arrears greater than 360 days declining. Arrears >90 days as a % of revenue has declined from 11% to 9.2%. Arrears <90 days has grown slightly below revenue growth suggesting no deterioration in credit quality, confirmed by management. Management has guided to further margin improvement from a declining bad debt ratio in FY23E (particularly as tolerance for overdue accounts has declined) - we forecast the ratio to decline from 3.5% to 3.4% in FY23E.

Costs

Staff costs account for 67% of operating costs with teacher salaries a large component thereof. In the table below we calculate an estimated staff cost based on a learner/teacher ratio and student numbers. We maintain the learner/teacher ratio at 18.4 in FY23E and FY24E. We apply a 6% wage increase for teachers in FY23E and FY24E. We further assume that other employees rise in numbers by one third of teacher numbers with the same wage growth. We have head office staff costs rising by 12%. We calculate a 10.1% increase in FY23E staff costs, a considerable driver of the margin expansion envisaged (staff costs as a % of revenue declines from 49.4% in FY22 to 47.8% in FY23E).

Figure 7 Calculating staff costs

	2019	2020	2021	2022	2023E	2024E	2025E
Learners	57597	60777	66447	70724	73686	77100	80847
% growth	12%	6%	9%	6.4%	4.2%	4.6%	4.9%
Learner/teacher ratio	17.8	17.7	18.6	18.4	18.4	18.4	18.5
Number of teachers	3230	3425	3579	3835	4005	4190	4370
% growth	9.7%	6.0%	4.5%	7.2%	4.4%	4.6%	4.3%
Wage inflation (base on prior year CPI +1.5%) or actual	6.0%	5.5%	0.8%	5.0%	6.0%	6.0%	5.5%
Teacher salaries (volume and inflation adj) - R'm (A)	1022	1097	1300	1475	1632	1810	1992
% increase	20%	7.3%	18.5%	13.4%	10.7%	10.9%	10.0%
Ave Teacher salary - R'000	316	320	363	385	408	432	456
% change	9%	1%	13%	5.9%	6.0%	6.0%	5.5%
Other employees - R'm (B)	431	328	365	392	422	454	486
Volume increases (33% of teacher increase)				2.4%	1.5%	1.5%	1.4%
Inflation increase				5.0%	6.0%	6.0%	5.5%
Total % increase	24.2%	-23.9%	11.3%	7.5%	7.6%	7.6%	7.0%
Head office - R'm (C)	116	142	165	185	207	232	255
% increase	26%	22%	16%	12.0%	12.0%	12.0%	10.0%
Staff costs - R'm (A) + (B) + (C)	1569	1567	1830	2054	2261	2496	2733
% increase	21.6%	-0.1%	16.8%	12.2%	10.1%	10.4%	9.5%
% of revenue	53.3%	50.6%	51.7%	49.4%	47.8%	46.6%	45.4%

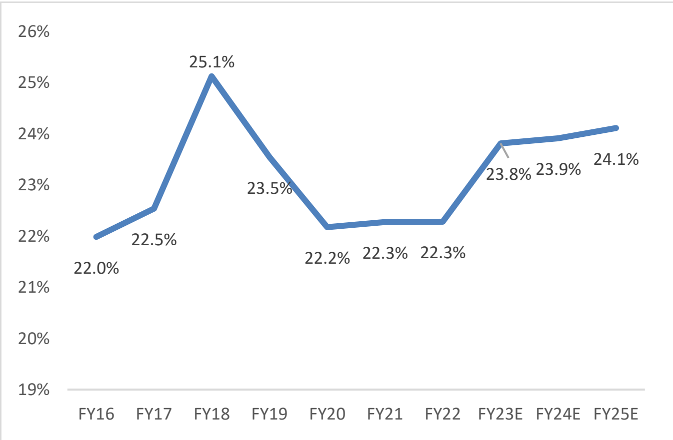
Source: Company data, ASB estimates

Impairments

Net impairments of R127m (post tax) occurred in FY22, against 12 schools, an additional 8 in the year. These are schools falling short of the required WACC (which rose in FY22) and do not necessarily require closure. A 1% higher discount rate would require an additional R127m impairment. Declining interest rates should see some reversals in the coming years.

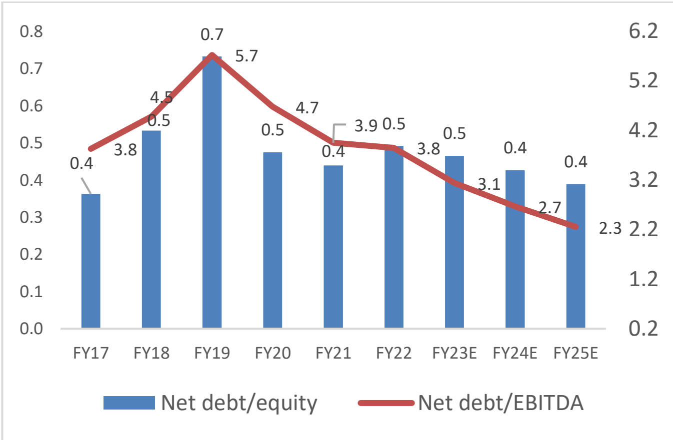
Outlook

Figure 8 EBITDA margins



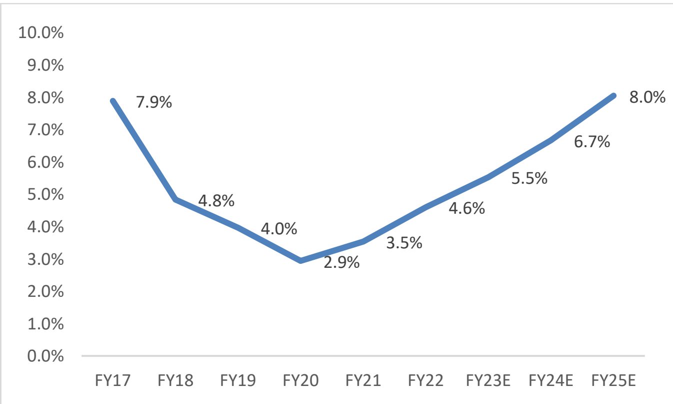
Source: Company data, ASB Research

Figure 9 Net debt



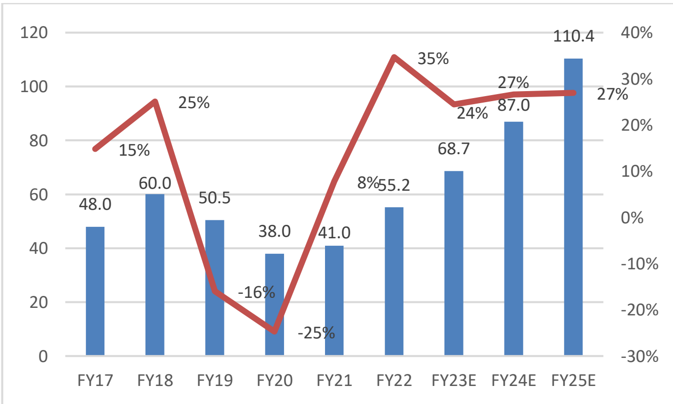
Source: Company data, ASB Research

Figure 10 ROE



Source: Company data, ASB Research

Figure 11 HEPS - per share and growth rate



Source: Company data, ASB Research

We make changes to our FY23E and FY24E HEPS forecast based on a slower growth trajectory in student numbers. We revise FY23E from 67.4c to 68.7c given the higher base in FY22 and we revise FY24E from 92.1c to 87c.

Figure 12 DFCF valuation assumptions

WACC Assumptions	
Risk free rate	10.5%
Beta	0.65
Market risk premium	6.5%
Marginal tax rate	27.0%
Pre-tax cost of debt	9%
Cost of equity	14.7%
Target debt/value ratio	35%
Target equity/value ratio	65%
WACC	11.9%
Growth Rate assumption	
Sustainable long term growth rate	4.5%

Source: ASB estimates

Figure 13 DFCF sensitivity to WACC and growth rate

		WACC				
		-1%	-0.50%	0%	0.5%	1.0%
Terminal Growth	3.0%	1569	1407	1264	1138	1027
	3.5%	1676	1496	1339	1203	1082
	4%	1799	1598	1425	1275	1144
	4.5%	1943	1716	1523	1357	1213
	5%	2113	1854	1636	1451	1292

Source: ASB estimates

We apply a risk-free rate of 10.5%, 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 11.8%. Our valuation range equates to R12.03-R17.16/share, a mid-point valuation of R14.25. By contrast our forecast NAV per share in FY22E is R12.90.

Based on our HEPS forecasts, the stock trades on a 12m forward P/E of 11.8x, a 7.1x EV/EBITDA. We expect the stock to rerate given its strong HEPS growth outlook, rising ROE's and improving dividend yield. The stock trades on a 12m and 24m forward 2.1% and 3.2% dividend yield.

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