

## **SIIA 2008 Ed Tech Business Forum – December 1-2, 2008**

### **Morning Panel: Financial and Industry Analyst Views**

In this session, industry analysts in the ed tech space provided their views on the state of the K-12 and postsecondary education technology market. Moderated by Jeffrey Fromm, Partner at Dorsey and Whitney, LLP, the following panelists discussed the industry at large and the factors they consider when evaluating prospective education technology investments:

Michael Marchesano, Managing Director, The Jordan Edmiston Group

Vivek C. Kamath, Director, Berkery, Noyes & Co., LLC

Robin Warner, Managing Director, The van Tulleken Company

*Summary by Jim Rosso, Director, External Relations, Project Tomorrow. (Supplemented with notes by Annie Galvin Teich, The Teich Group, Inc.)*

#### **Robin Warner: K-12**

Robin Warner started with a look at European schools, especially English schools which are generally 12-18 months ahead of the US market. --all UK Vendors must provide Professional Development in order to be on the approved vendor list. Budgets are increasing for 2009-2010, but K-12 budgets are in decline by about 5%. Everyone is buying White Boards. League Tables – Benchmarks are proving controversial as some people find that they represent a new kind of racism.

In the United States, big transactions in the education market were done in 2008 by companies that were not around five years ago. A great deal of change is occurring, and companies are being bought, merged, etc. Never underestimate the strategies! 600,000 White boards were installed in 2008. A lot of content is being produced that can easily be used on White Boards. However, a few words of caution – many white boards are being used as projectors only and not for their interactivity. There is a theory that as younger teachers move into the classroom, this will change.

#### **Vivek Kamath: Postsecondary Education**

Overall the profit margins have been healthy in postsecondary. When there are economic downturns, PSE does quite well. Investors have traditionally viewed education as a safe haven in challenging environments. PSE has out earned Major Market Indexes. The number of students taking programs entirely online has increased. In 2002 it was 0.5 million, and in 2008 it was 2.1 million.

Mike Marchesano

M&A in a turbulent market – despite the challenging market, quality assets will find buyers. Companies need to focus on their core business. With regard to strategic sponsors versus financial sponsors – one is more risk averse than the other. Technology is absolutely driving higher valuation than more traditional publishing companies. Data weighted to the first 6 months of 2008. Budget gaps range from \$10M in HI to \$2B in Arizona (20% of general fund budget). Expect to see continued weaknesses in ability to buy, which will lead to more market consolidation which will, in turn, drive more M&A activity.

#### Audience Q & A

For Robin Warner: Do you expect to see more foreign buyers, and what type of companies will they be looking for?

Response: Yes, but with more caution. China is still a big market.

For Mike Marchesano: What is the outlook for IPOs?

Response: 2009 is a year of caution. Grand Canyon IPO. M&A activity from strategies.

For Robin Warber: Can you say more about Web 2.0?

Response: Five months ago there was too much pushback, but now “stealth learning” is widely accepted. It is very important that the content look like fun. Gaming used for learning.

General Question: What about M&A activity in 2009? Will there be more international buyers?

Response: There will always be M&A . The United States is too big to ignore; everything will be more cautioned.

General Question: What is the landscape for early stage companies?

Response: It will be a more challenging time.

###

*Summary by Richard Carey, Managing Director, RC/A Digital Media*

Jeff Fromm

“I’ve seen situations where people decided not to raise more capital than they thought the needed. However as cash becomes tighter the opportunities have become thinner, and the valuation can plummet pretty precipitously.”

Robin Warner

“The UK market is trending 12-18 months ahead of the US. It’s almost as if what happens in the UK is played out in the US a year or year and a half later.” BECTA is an adoptions agency - approved software and vendors -- and requires all vendors to include professional development or they won’t make list. Therefore, Moogole cannot be used because there is no professional development, however, HTG credits can be used for hardware or software/programming. Budgets are increasing overall in ‘09-10 but declining 3.5% in primary schools and 5.5% in secondary schools for systems and software.

Whiteboards are extremely prevalent.

“Web 2.0 virtual learning environments, comprised of servers that sit in schools, present huge integration challenges. SCORM is working but the software is not fully compatible so this is a big issue.”

With regard to League Tables, there is wide testing but a lot of push back from various communities.

The predominant companies are busy integrating very large acquisitions but “never underestimate the power of the strategics” (Pearson, McGraw, Cengage, Houghton Mifflin et al) to participate and/or alter a deal. The average valuation multiple is 1.6x to 1.7x. There were 13 transactions in the past 12 months in the UK market for about 15.5M in total in K-12. 1.6-1.7M is the mean deal size with multiples ranging from 0.6x low to 4x high.

Deals are becoming more creative. Active product categories include blended learning, mobile computing, testing and assessment, Web 2.0, 24x7 learning, global social networks, virtual learning, and professional development.

Buyers are willing to pay for technology that \*looks\* easy, but not for products that look complex or difficult. Opportunity areas and factors include good, easy to use content for whiteboards; and the higher education market.

#### Vivek Kamath

Overall the for-profit post-secondary market has been quite resilient. There is continual growth in the number of students. Enrollment grew 9% in 2008 and is expected to grow to 13.6% by 2013. Generally, it is counter-cyclical to the general educational market environment.

Growth in for-profit post-secondary businesses is also driven by the economic downturn, as the down economy sees the channeling of more resources toward retraining workers for new jobs. With relatively high barriers to entry, investors see educational technology as a safe haven. This is a huge disparity compared with the rest of the Dow and NASDAQ. Another growth area is taking products entirely online.

#### Mike Marchesano

“Quality assets will find buyers even in this challenging market, as long as entrepreneurs focus on their core business.” Financial sponsors are more risk averse and we’re seeing lower valuations, while strategic sponsors are looking to augment growth by finding synergies with existing businesses which results in higher valuations.

With regard to the political landscape, last June 31 state BOEs were projecting budget gaps; there are more now and they're beginning to target cuts in K-12. Market consolidation will likely occur through 2010.

Mid-size companies are working with (and may acquire) channel partners. 2009 is looking like a year of caution with more activity in 2010. VC having a hard time exiting their current portfolios so they're investing in them, not in new deals. M&A is looking for efficient companies, proper revenue, must have product, tie-in with funding sources to be of interest.

###